BANKING / INVESTMENTS \ ADVISORY

ABLV

Fortitude

2016 Annual Report

ABLV

Table of Contents

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Validating Fortitude

Romans Surnačovs
ABLV Bank Chief Operating Officer
2016 Annual Report Editor

There is a saying that a friend in need is a friend indeed. Overcoming obstacles is not only a test for a team's professionalism, but also for team members' ability to cooperate and stay loyal to their company during hard times. This is also a test for managers in regard to their ability to set clear tasks and motivate subordinates. Together, all these factors reflect the fortitude of the company and predetermine its long-term development.

Last year we lived under the sign of compliance, and, for almost all of us, this meant a lot of hard work on top of our daily duties. In the process, we strengthened and restructured our internal control functions and carefully reviewed our client base.

Meanwhile, despite the huge amount of extra work and associated costs, we were continually developing all of ABLV's business lines. Our success in this regard is reflected in the facts that in 2016 the bank's profits reached an all-time high, while return on equity peaked at 27.2%, a result that has hardly been characteristic of the industry in recent years. In addition, we paid EUR 22 million in taxes into Latvia's state budget. Clients' assets under management and investments exceeded EUR 1.54 billion. As for profits per employee, we are among the most productive organisations in the country — it is safe to say that we have recruited the most competent specialists. Once again, we earned public recognition as one of the country's best employers, while an independent poll revealed that the loyalty of our employees exceeds average European figures many times over.

We continue to offer clients new products, some of which are unique on the local market. We put a lot of effort into arranging the issue of clients' debt securities: we were instrumental in the issue of EUR 44 million of corporate bonds. In addition, we serviced complex CTF transactions (commodity trade financing) and issued new commercial loans worth a total of EUR 153 million. With future generations in mind, we launched some products for our clients' children.

Among ABLV Group companies, it is the Pillar Group that is about to face the greatest challenges in relation to the recent launch of building infrastructure under its large-scale New Hanza project. Meanwhile, our subsidiary bank in Luxembourg is actively developing its operations. Having attracted sufficient clients to break even, it is continually expanding the range and quality of its services.

As always, we have been active supporters of social projects aimed at helping to make the world a fairer, friendlier and kinder place. It goes without saying that the biggest private bank in the country should take responsibility for the development of Latvia's business environment and the welfare of our clients, which is what we are doing. The bank's management is a proactive participant in various professional organisations and in the development of legislative initiatives, presenting the industry's case clearly and articulately to legislators and society. In close collaboration with our long-term philanthropic partner, ABLV Charitable Foundation, we organised a special charity campaign to celebrate the 10th anniversary of the foundation, and raised over EUR 1 million for the benefit of various charitable causes.

The bank's management and major shareholders have always said that the key to the company's fortitude and visible achievements is its team. Our team harnesses the combined power of over 800 people. That is why the cover of this year's annual report features little bronze bulls: the commemorative awards we give to our employees who have worked for the group for 10 and 20 years respectively. By the end of 2016, 329 employees had received the figurines with a deeply symbolic message "Labor Omnia Vincit" meaning "Work conquers all".

We Only Rely on Ourselves

They say there is no place like home. A respectable mansion built at the beginning of the last century on Elizabetes Street, where the headquarters of ABLV Bank is located, adjoins the house where the father of Ernests Bernis, Chief Executive Officer at ABLV Bank, was born. For him as a hereditary resident of Riga, it is important to be on home ground. He says that it ensures alertness, and true grit. So our conversation begins with a question about fortitude.

Personally, how do you define fortitude?
For me, this quality is a lot to do with endurance, continuity of intentions, and strategic goals. To show fortitude is not to jump from project to project, but to consistently move towards the main goal. Of course, there are both ups and downs along the road.

Fortitude, as a rule, is the ability to endure under adverse circumstances. What did the bank endure in 2016?
First and foremost, it endured itself.

That is quite surprising…
Usually everybody thinks that fortitude must be directed outwards, but the strength of a character primarily lies within. Yes, the working conditions have changed; in particular, compliance requirements have become stricter. To comply with them, it's necessary to restructure internally. Many organisations fail to do so; they start changing leadership, key employees… However, we did it — we carefully assessed the internal situation, understood and accepted the need for change. If one looks at how many processes we had to transform, how many clients we refused to cooperate with, the changes could be called quite radical.

That is why fortitude also means quality, which helps one to adhere to good aspects and to change potentially problematic things in the course of adapting to new conditions.

Is this the first time the bank has had to deal with such requirements?
In terms of regulation related to the compliance system, yes. Throughout our history, we've undergone quite serious internal changes several times. Oddly enough, we always have handled them on our own. That sums up the fortitude of our organisation perfectly. The most recent example was the crisis of 2008–2010, when we drastically adjusted our operations: improved risk management, dealt with lending problems, and tweaked our strategy.

Do you have to take similar steps now?
To some extent. For a long time, we specialised in servicing foreign clients, financing Latvian projects and trading securities. Now we see the need for deeper specialization in servicing certain types of foreign clients. That will be the basis of our strategy for the coming years.

How did you manage to set a historical profit record in these difficult circumstances last year?
In many regards, profits are a reflection of what was done a couple of years before. In any case, our business model has shown its efficacy. We were able to terminate our collaboration with about one fifth of our clients, significantly reducing our risks. We regret every severed relationship, but it was necessary in the present climate.

We have excellent financial condition that we didn't squander even in the so-called "fat years".

Is this pressure due to non-resident servicing?
It's due to all clients, but mostly the foreign ones. The level of requirements has risen; the government's rules have changed. Given such expectations, we were forced to raise the bar as far as requirements for clients were concerned. This is where everyone gets a choice: some aren't ready; some have easier ways, and some make promises, but can't fulfil them, and so on. However, most clients still manage to handle the situation and treat the increasingly exacting requirements understandingly.

Won't these requirements transform financial institutions into some kind of investigative bodies?
If this conversation had happened ten years ago, I would have said yes. But now all we can do is follow the regulations. Now banks have numerous additional functions. We are obliged to fulfil them, whether we like it or not.

What bank reserves are you using at this stage?
Firstly, finance. We are in excellent financial condition, a status that we didn't squander even during the so-called "fat years". Therefore, we have all the necessary capital and liquidity reserves, and are in a position to cover the expenses we need.

Secondly, staff. At the moment, more than 15% of our staff are specialists in compliance. In many leading world banks, the numbers are similar: 10–18%. I'll reiterate again and again that we have one of the best qualified staff in Latvia. The most important thing is that our employees are familiar with the values of our organisation and the corporate culture in general. For the last five years, we have created at least 50 new vacancies every year and filled them with applicants in whom we see the potential and desire to develop, learn and gain experience, regardless of age.

You have mentioned your excellent financial condition, which is confirmed by the record high return on equity ratio. Your rate for the past year has exceeded 27%, whereas in the reports of Western European banks the ratio sits around 5%. How do you plan to sustain this profitability in future?
We have a very sober approach to everything we do. If we choose an activity, we want to become one of the leaders in this field. In all business areas of the ABLV Group, we achieve impressive results. However, we don't just grasp for everything and anything.

For example, we gladly finance the construction of commercial properties, but not housing. Why? Because the lending cycle of a commercial property goes up to 20 years after commissioning. By taking a risk today, we get the opportunity to receive income for many years after the launch of the project. The situation is more complicated with housing funds.

If the project becomes successful, everything will be sold out in a year after commissioning, and we'll receive a small fee for undertaking a substantial risk. We don't consider this to be worthwhile, and we aren't ready to engage in such projects. Of course, financing of commercial real estate is also subject to risk, but we always have accumulations from income on other facilities that serve as a safety cushion.

An effective labour organisation has played an important role in achieving good results. For all main lines of business, we've been developing incentive systems for years. Our people care about the results of their work.

The bank also has a large securities portfolio, but some believe it creates additional risks. In your opinion, can the bank's reliability be evaluated based on this indicator?
I believe that the bank's reliability should primarily be evaluated according to the following indicators: capital adequacy, liquidity adequacy, profitability, absence of any restrictions on activities, both direct and indirect. To my mind, these are the main characteristics of a bank's reliability. The ability to manage a large securities portfolio is based on the know-how that we've been developing for the past 20 years.

Speaking about securities, during the last year the Nasdaq Stock Exchange named ABLV Bank as being among the best in Baltics in terms of investor relations. What is your formula?
We were noticed thanks to our complex and coherent approach to revealing information: publication of press releases, reports, etc. We've learned from the world's leading banks by analysing their methods of information processing. As we're the largest participant in the stock exchange, and the turnover of our bonds is one of the largest, we can't ignore relations with investors.

Last year, the ABLV Group opened a representative office in the US. Was it more of an image-building move or a business decision?
We opened a representative office of one of our subsidiaries. We primarily needed compliance specialists competent in the field — local professionals, familiar with American standards, which differ from European ones. They also help us to build relationships with regulators and other participants in the market: American banks and broker companies, etc. When conducting operations in dollars, questions related to compliance risks arise very often. Therefore, we consider it logical to have competent professionals within our own structures.

Did this factor also play a pivotal role in the opening of a subsidiary bank in Luxembourg?
Many of our clients conduct active operations through us, but the passive ones — through Swiss, Luxembourg or other banks. Many years ago, we asked ourselves a question: why couldn't we offer them an alternative?

In Luxembourg, the legislation concerning the provision of certain financial services is better, the environment is safer. Just over four years ago we obtained a banking license for ABLV Bank Luxembourg. Throughout this period, we were developing our private banking arm — a range of services related to managing assets and individual client portfolios. Now we're starting to think about servicing Luxembourg companies, but only those belonging to our existing customers. Our target regions remain the same; our current market is sufficient, its potential is still tremendous.

Where is the regulation tougher: in Riga or in Luxembourg?
It depends on what you focus on. For example, in terms of individual management of client portfolios, classic private banking, and fiduciary transactions, Luxembourg has decades of both legislative and regulatory experience,

as well as the desire to enact it. Luxembourg also has a double taxation avoidance regime, and the list of countries included is far greater than in Latvia.

Economists often criticize Latvian banks for their low contribution to the economy. Do you agree with that? What contribution does the ABLV Group make to the Latvian budget and to the development of the economy as a whole?
We are one of the largest taxpayers among Latvian banks. We actively lend, and the overwhelming part of our lending portfolio is comprised of Latvian projects. We're also developing the capital market — in the last year, in addition to issuing our bonds, we successfully participated in two issues of other participants' bonds. Within the group, the real estate business is developing, and soon, with our support, Riga will have a new business district. We have always created new jobs, even in the most difficult times. In addition, being essentially a bank with Latvian capital, we make maximum use of local resources: IT solutions, products and suppliers. We earn on servicing foreign clients, receive revenue from securities from all over the world, but the profit is spent mostly in Latvia.

Do you also invest in production?
We're ready to do so, it's interesting to us. We have transformed our private equity fund into a closed joint-stock company AmberStone, AS. We organized capital subscription, which now amounts to EUR 35 million. This money is used for the realization of industrial projects in agriculture and pharmaceutics; the company's capital is also invested in medicine, woodworking, and the hotel sector. All these projects have been implemented in Latvia, and most of the company's investors are our foreign clients.

What role do you think the financial system plays in society and what should the banking industry do to promote social development?
The main task of any business is to operate legally and pay taxes. For any large business, there is an additional notion of social responsibility. And it's not just about charity.

ABLV Bank management team (from left to right):
Ernests Bernis, CEO,
Aleksandrs Pāže, CCO,
Māris Kannenieks, CFO,
Rolands Citajevs, CIO,
Oļegs Fiļs, Chairman of the Council,
Edgars Pavlovičs, CRO,
Romans Surnačovs, COO,
Vadims Reinfelds, dCEO

The ability to manage a large securities portfolio is based on the know-how that we've been developing for the past 20 years.

For example, five years ago, we were surprised to find that in Latvia there was practically no independent economic opinion — no national economic institute or research centre, where one could get an expert analysis regarding the development of economy, demography, exports and imports, or the balance of payments, etc. Therefore, we expressed our willingness to find the opportunity and support a national research centre project with long-term orders. That is how the Certus think tank was created. By having the opportunity to plan projects two-three years ahead thanks to our support, Certus attracts qualified economists, researchers, and scientists. Now there is a possibility to outsource research in Latvia, and not only within the finance and banking industries. It was a big challenge for us, but it's an example of social responsibility.

What kind of people can impress you? What do you appreciate in others the most?
Attention to details. Firmness. The ability to both listen to others and defend your view. The ability to learn. Fortitude.

What is the formula for fortitude?
The ability not to feel sorry for yourself. As to the bank, our formula for fortitude is primarily based on seeing ourselves as an independent organisation. Yes, they make requirements, but only we decide how to meet them. The second element of our fortitude is the reliance on our own strengths and expertise. That also helps us to maintain a sensible view of things.

What helps you to stay strong on this long way?
The sense of responsibility. I'm responsible to the state for the organisation I lead; I'm responsible to my team, as many have expectations and plans; and I'm also responsible to my family. This awareness invigorates me.

Is it a hard burden to bear?
I share it with my fellow managers. Most of them started in low positions, and now they have been working at the bank for almost 20 years, doing a great share of the total work. Of course, sometimes we have heated debates, but we always find a compromise in the name of the common cause. The ability to come to an agreement strengthens the organisation from within and inspires confidence in the correctness of the chosen path.

Setting a Course for a Decent Future

"When they talk about competitive tax reform, I get associations with the concept of "being on the same level as others". However, Latvia needs to strive to be better than its competitors! Therefore, we will fight not only for a competitive tax policy, but also for the decent future of the country," says Oļegs Fiļs, Chairman of the Council at ABLV Bank, sharing his vision.

In your opinion, which events of 2016 will have a lasting effect?
Throughout 2016, there were ongoing discussions about a new tax reform. A real clash of opinions. One side was represented by the World Bank, which conducted large-scale research and rashly concluded that tax rates in Latvia are low and need to be raised urgently. I think that the conditions and the economic situation of Latvia weren't evaluated properly. The other side was represented by entrepreneurs — the Latvian Chamber of Commerce and Industry, and the Employers' Confederation of Latvia — who submitted their proposals, which were quite contradictory to the World Bank's position, and asserted that the reality of recent years shows that in terms of competitiveness, Latvia's tax system loses out to both neighbouring Lithuania and Estonia, as well as to Poland and other Eastern European countries.

Naturally, a lot of graphs and diagrams were shown during these discussions, displaying taxation in relation to GDP and comparing it with the average of other European countries, demonstrating that the tax burden in Latvia is low. However, that doesn't mean that we can carry it easily without doing anything for the business environment and the economy.

Both ABLV Bank and I, as a presidium member of the Latvian Chamber of Commerce, also participated in these tax reform discussions, trying to unite the positions of entrepreneurs and to formulate a common opinion on the matter. Thus, the disputes of 2016 acquired the form of a 300 page thick tax strategy and its main provisions.

How do you assess the present economic situation in Latvia?
In the past five years, there has been a desire to reduce taxes on wages, shifting them to consumption. However, we can't forget that the development of Latvia over the past 20 years has led us into the so-called middle-income trap. Our economic actions and measures to attract investments were mainly focused on those segments and sectors of economy that can be developed with fewer resources. This operating model has allowed us to promote employment and prevent at least part of the population from leaving by increasing average salaries. Unfortunately, local salaries still can't be compared to those in other European countries. Of course, the selected industries that are easier to develop are limited in growth and productivity.

We should think about the next stage of the country's development. The political situation is stable, but it doesn't promote the definition of common goals and evaluation of development scenarios. That is why we see an economic deceleration, and moreover, it's worth remembering that we will soon no longer be able to rely on funding from EU funds, especially given the likely effects of Brexit.

Until now, EU funds have been one of the main sources of investment and economic development methods, but we need to understand that the situation will change in the near future.

The new tax strategy is far more ambitious than a lot of previous ones. In your opinion, does it promote economic growth?
In general, the new tax policy of Latvia is decent. Despite the fact that it's not very modern and progressive, it took major efforts to come up with it, and includes methods tested by our neighbours: first of all, zero corporate income tax (CIT) on retained earnings, which we adopted from Estonia. This is a good step in terms of marketing, but you need to realize that the CIT in Latvia will never contribute as much as in America, where there are corporations with huge profits and a large market. Zero CIT has its pros and cons: it's good for business growth and equity increase, as well as for obtaining loans; however, it doesn't help to attract investments in the modern economy, as professional investors not only want to develop something, but also to receive dividends. Therefore, for large enterprises, the 0% CIT does more harm than good. Speaking about Latvia, there are a couple of hundred such companies.

It's also clear that this tax reform is supposed to patch a hole in the budget due to a small consumption tax increase and not allowing businesses to write off some items for costs, as could previously easily be done before the calculation of income tax. However, the aforementioned middle-income trap is not only related to business activities and salary sizes, but also to consumption. Therefore, the attempt to shift the tax burden to consumption won't produce the desired effect in our economic situation and developmental stage.

Our market is small, people don't receive large salaries and can't afford to consume much; therefore, there won't be any fiscal benefits. In general, our geographical position and cultural traditions aren't unique enough to become a significant advantage among other countries in attracting tourists. Due to emigration, the Latvian market has continuously decreased in the recent years, so there is no point in hoping that Latvian people will be able to produce a lot of goods and make huge profits from this, as is the case in countries with massive domestic markets. That's why the CIT cannot significantly replenish the budget. This is also confirmed by the list of the largest CIT payers — if we cross out some monopolists, whose prices are regulated by the government depending on the need for revenue in the state budget, there is not much left on the list.

In general, in the context of the tax reform, I would say that these actions should have been taken five years ago, although it's also important to look towards the challenges of the future.

How can the tax system help to kick start the economy?
The proposals put forward during the tax reform development are comparable to the recent attempts of the European Central Bank (ECB) to stimulate the economy. The ECB doesn't print money, but instead it unrestrictedly buys out the securities of European countries, offers banks an unlimited amount of money and keeps base rates at an abnormally low level, even below zero. It does this to stimulate business activity and consumption, because saving money on an account or depositing without interest is becoming unprofitable. To a certain extent, the activity of the ECB can be also attributed to our tax strategy, as the need for a stimulating component was emphasised in its development.

The common proposal of entrepreneurs regarding the tax policy is that, from an economic standpoint, it would be more reasonable and correct to stimulate business in a manner that will also help to attain consumption goals during development; only then should you try to change consumption taxes to increase revenue to the state budget. Basically, everybody is using excise goods, and it's possible to stimulate an efficient use of resources by using excise tax. The basic provisions on taxes, presented in the aforementioned 300-page document, show that the government has understood that it's impossible to achieve all other public revenue goals without growing business. It's also not possible to raise the country's well-being to the mythical Central European level. One has to bear in mind that there are significant differences in economic activity in Latvia between Riga region and the rest of the country. There are places where the population is declining and business activity is decreasing, and this factor should definitely be taken into account when developing a national tax policy.

The market can set the situation straight, but the government can always help by doing it faster and more accurately. It can offer incentive to encourage the relocation of traditional sectors or businesses with lower added value, for example, agriculture, food processing, woodworking and wood exports, as well as simple external services for business and service centres, outside Riga. By moving these segments out of Riga, employment and economic activity in the regions can be promoted. The second option is: in regions and places where it's realistically impossible for economic incentives to provide help for geographical or security reasons, to simply reduce tax rates or even exempt the people living there from some taxes, thus giving them a reason to remain there.

What should be done so that Latvia is ready for the challenges of the future, and not only trying to improve things that were ignored in previous reforms?

In the course of the last year's discussions, we understood that there are sectors, which you can infinitely develop in terms of both turnover and added value. A typical example: inventions or innovations, which can be sold at an early stage or developed to further stages, and then sold for a lot more money.

In 2016, Latvian government realised that the stimulation of production and exports isn't enough for an economic breakthrough, as this requires huge investments and a lot of time, and still doesn't guarantee results in 10 years' time. The situation is changing every day, and entrepreneurs themselves can't tell where they will produce their goods even one year ahead, because everyone calculates their costs and tries to optimize processes. So it's nice to see that the government has realised that if you develop our sector — the service sector — it can be competitive globally, making a great contribution to the economy.

Services may seem like they have intangible value, but the ratio of the production of goods to the service sector is approximately 80:20 in all developed countries, and, generally, the production of goods in Europe is decreasing every year. The flow of information regarding Brexit also helps the situation. We can see from the mass media that many countries, including our competitors, are trying to lure away the British financial sector. Notice how nobody is showing any interest in British furniture, food, or metalworking industries: everybody is interested in managing the top-class enterprises, marketing, logistics, distribution, and of course, financial services, which create very well-paid jobs.

Oļegs Fiļs, Chairman of the Council at ABLV Bank and Member of the Council at the Latvian Chamber of Commerce and Industry, participating in the EU Future After Brexit: Priorities, Possibilities and Challenges conference

If we don’t actively fight for our economy and our society in Latvia, and for new, interesting types of entrepreneurship, we’ll continue to suffer increasing losses.

This situation also means that there is homework for our ministries. Alongside the creation of a tax policy, they should also consider the steps necessary to attract desired and profitable industries and professionals. We have nothing to brag about in this regard, as all the initiatives are only at the developmental stage, but I hope that they are near completion, so that their implementation can begin over the course of the next 12 months. However, we have to understand whether our new tax policy will meet our future goals and objectives.

It’s obvious that our neighbours, Lithuania and Estonia, aren’t sitting idly by, but are trying to adjust their tax policy to the new conditions, to promote the development of their economies. The competition between countries is getting increasingly acute, especially because of Brexit. Whereas, previously both the experts from the World Bank and our Ministry of Finance said that no tax games are possible, now we can see that all countries are trying to respond to the new challenges by utilizing some game elements.

What segments or businesses should Latvia try to attract when setting rates in a new tax policy?
As to international tax games and rates, it’s time for us to understand that the global market is quite free. Any business or individual, especially if he’s a wealthy and well-educated person, has the freedom to choose where to live, work, and pay taxes. Moreover, the latter may not coincide with his place of residence. I would suggest not hesitating and to think about attracting these people. As the British Prime Minister Winston Churchill once said, while planning a second front against Nazi Germany, right before crossing the English Channel: “Remember, gentlemen, it’s not just France we are fighting for, it’s Champagne!” This is the attitude I would like to have when talking about Latvian tax policy.

If we don’t actively fight for our economy and our society in Latvia, and for new, interesting types of entrepreneurship, we’ll continue to suffer increasing losses. At the same time, this struggle is inseparable from the fight for well-off and well-educated people, who work in these industries and make investments, contributing to overall growth. Therefore, it’s worth considering whether our new tax policy is consistent with these global objectives. For example, there is still talk about the implementation of a higher tax rate for high-income earners — supposedly, to reduce inequality. If we want to compete in the global market, this is wrong. If we, on behalf of the state, want to tell wealthy people that there are so many of them they have to pay more taxes so the state can increase budget revenue, then I would like to get detailed calculations from the government as to whether there really are that many well-off people.

It's also worth considering if this is compatible with the desire to attract wealthy and well-educated professionals with high salaries, given that even existing wealthy residents can move to other countries in an unfavourable situation. You don't have to go far — there are specially developed regimes that are aimed at citizens of other countries. That's not only an activity for some islands in the Pacific or underdeveloped jurisdictions where it would be rough to live. Countries like Portugal, Spain, Italy, Malta, Sweden and Cyprus are now engaged in this, inviting citizens of other countries to pay taxes in these countries; we're talking about amounts over EUR 100,000 here. While developing this offer for private individuals, it's necessary to discuss the CIT, which, overall, isn't that large. It could be sacrificed for marketing purposes, announcing to the world that we welcome both big and medium companies, of course, subject to conditions that involve such businesses not only having their legal address here, but also offices, highly professional people, management, a certain number of employees and a minimum wage, that will be, for example, four times higher than the minimum wage in Latvia.

Attraction of business and people to Latvia is an interconnected process that requires courage and political agreement on the desire to develop Latvia, not only with internal resources by correcting the existing tax policy, but also through aspiring for more rapid, large-scale development. Without opening the door to the world, it's impossible to achieve higher goals. Every Latvian entrepreneur should consider this and consider whether he can open the doors to his business after the political signal has been sent out, and whether he has enough courage, and sees it not only as a risk, but also as an opportunity to reach a higher level of business growth. This alternative positioning is a challenge for a country and all its inhabitants; it requires a common understanding and commitment; targets and indicators need be identified, and real actions must be taken in the form of marketing and advertising.

Regardless of which development path Latvia chooses in 2018, with a little effort and application of the aspects I mentioned above, we have the chance to live differently — in a more modern and active way, getting even better economic results. The interaction also needs to be factored in, because industries affect one another in different ways, but it's necessary to choose industries that can help improving the well-being of the most people. Of course, that requires a lot of work, but it's worth it!

Compliance is the Most Valuable Competence

During the previous year, clients have clearly noticed that banks are starting to ask a lot more questions than before: they are demanding explanatory documents more often and refusing to carry out transactions without exhaustive information. What has changed in compliance and how should clients respond to this situation? These and other questions are answered by Vadims Reinfelds, Deputy Chief Executive Officer at ABLV Bank.

Are the strict requirements for banks a global trend or something exclusive to Latvia?
It's a global trend. The principles of bank regulation have changed significantly in recent years. Whereas previously it was sufficient to comply with certain rules, now this is no longer enough — you need to strive to achieve a goal that will satisfy the regulator. If you fail to do so, the fulfilment of formal requirements won't help to protect the business. There are no safe havens for banks anymore.

Compliance experts call this phenomenon "regulation by extermination", whereby the bank only learns about the compliance or non-compliance of its risk management system during the audit. Even if the audit is successful, and it's subsequently discovered that a client has exposed the bank to an increased risk, the institution can still expect to incur fines and restrictions.

One of the regulator's goals is to ensure that the financial system isn't used for criminal purposes. If any client makes a criminal transaction at the bank, this goal hasn't been achieved. Therefore today, the appetite for risks has decreased, but I believe that strict laws don't last forever. This is a time of change, but the intensity of regulation will revert to normal in years to come.

What has caused these changes?
The reasons are rooted in politics. Obviously, the perception that banks owe a debt to society for past crises is still present. This, in turn, leads to philosophical, but fundamental questions: where is the line of responsibility of banks or any other private sector companies for the actions of their clients? Is the bank responsible for the fact its client has broken the law? In my opinion, the answer is: no. A bank should only be held responsible for the performance of its duties. After all, no one argues with the fact that a manufacturer isn't responsible for the use of its products, be it a knife or a car, for unlawful purposes. In this regard, the expectations for banks are not only a lot higher, but sometimes even unrealistic.

And yet, if stricter requirements for banks leave society as a whole feeling safer, perhaps they are justified?
It should be noted that the "financial footprint" in particularly serious and dangerous crimes, including terrorism, isn't significant.

These crimes aren't committed in bank accounts; the financial behaviour of a potential criminal may hardly differ at all from that of a law abiding client.

In high risk industries and locations, the presumption of innocence doesn't apply to compliance. On the contrary, lack of evidence is often considered to constitute proof of shortcomings.

Therefore, amplified financial monitoring isn't very effective in preventing such violations.

Among the crimes that have lately been in the limelight, we should also mention fraud, corruption, smuggling, and tax crimes. The task of banks is to be competent in the identification of criminal activities by knowing the features specific to the activities and geography of the bank's target clients.

Given that, for over 20 years, the Latvian financial system has been a gate to the outside world for the economies of Russia and other CIS countries, Latvian banks have accumulated unique experience, which, I believe, is one of the greatest assets of our financial industry. Other countries have significantly less experience, therefore Latvia's role as a trade and financial centre not only exists, but will only increase. In this country, partners feel more confident during and after a transaction, because the risks are much smaller.

What is the damage caused by the increased compliance requirements for banks?
Unfortunately, law abiding clients suffer the most. For them everything is slower and more expensive. As usual in such situations, "the good pay for the bad". They need to answer numerous questions, submit additional information about transactions; they face difficulties opening accounts, whereby the process is delayed and requires additional investments. There is a frequent need for the involvement of experts, because the client doesn't possess the required knowledge about compliance, and a private banker can only ask questions, he isn't entitled to prompt clients with the right answers.

They say that if the rules change similarly for everyone, there is no reason for outrage. In general, banks themselves don't benefit from this: the amount of work and associated costs increase, profitability decreases. Of course, the client's dissatisfaction is directed, first of all, towards the bank, and not those who implement such requirements. None of this benefits the business, but that is the reality of our world. Sometimes, you can see banks competing more in terms of compliance than in other aspects of their business. Under these circumstances, the winner is the bank that can be more convenient while not exposing itself and its clients to too much risk.

What is the optimal solution in a situation where increased requirements for banks are an inevitable reality?
In a way, any bank is similar to a factory that has its own technological process, whereby the "creative approach" of an employee can often result in losses being incurred by all parties involved.

That's why we continue to improve our internal processes, creating a unified position for the bank in relation to the many matters related to compliance, so that our employees are clearly aware of the relevant requirements, thus ensuring that we can consistently provide stable and high quality services.

In a high risk environment, where fear often rules, vague formulations of rules lead to excessive demands, and to the fact that "by default" even a good client becomes a suspect with all the ensuing consequences. If the criteria are clear and specific, it will also be easier to use technological solutions to identify risks. This allows us to develop a unique skill and to reduce both expenses and the total costs of financial services. We understand that the fulfilment of bank requirements also requires the client's resources, and this is where we see an opportunity to become more efficient.

In these circumstances, how does ABLV Bank manage cooperation with clients?
We consider it our mission to protect the interests of our clients, increase their capital and help them to carry out their commercial activities. The first thing we can do is to be reliable and understanding partners. We operate on the principle that requesting bank documents and information isn't subject to the free choice and interpretation of the employee, but is done in accordance with the choice and methodology of the bank. Clients understand this and provide the necessary information and documents.

Unfortunately, in high risk industries and geographic locations, the presumption of innocence doesn't apply to the field of compliance. On the contrary, lack of evidence is often considered to constitute evidence of shortcomings. Therefore, the client's ability to explain the economic substance of his activities is crucial to alleviating suspicion. This is especially important for clients that use legal structures registered in countries where their activities are subject to a low level of regulation.

What happens if the client doesn't cooperate?
Naturally, the client may choose to decline to disclose the required information. In that case, the bank and the client part ways.

Vadims Reinfelds, Deputy Chief Executive Officer at ABLV Bank, at the Intax Expo Russia 2016 conference in Moscow

As experience shows, after "looking around the market", clients see that the requirements of other banks are similar, and come back to us.

Over the past year, we've restricted the provision of services or terminated relationships with clients that didn't express their readiness to be open with us for any reason. The regulation of the client base also leads to a reduction of the total business volume. This process is now complete.

As experience shows, after "looking around the market", the clients see that the requirements of other banks are similar, and come back to us.

What else should the clients consider?
As I already said, a private banker has no right to offer the client advice about meeting compliance requirements or to suggest answers. However, by asking questions, he can and should encourage the client to think about the best means to become safe and transparent for the bank and his partners. Our specialists make the client aware of well-known examples in international practice, and, in very complex cases, even recommend the most experienced legal experts and tax consultants.

The client should carefully choose the legal structures used. For international trade and other types of active business, a good solution is an enterprise based in Latvia, because this significantly reduces banking costs and many formalities.

In May 2016, ABLV Bank entered into an administrative agreement with a regulator, the Financial and Capital Market Commission (FCMC). What is your opinion about this?
The administrative agreement concluded is a significant achievement for both the bank and the regulator. Despite the fact that the bank paid a sizable fine under this agreement, it's positive in that, as a result, we arrived at a unified view of compliance requirements.

I would like to add that there have been no cases of money laundering in our clients' activities. All the accusations against us were due to insufficient control of clients' transactions in individual cases. Unfortunately, the requirements for reviewing and documenting transactions weren't detailed enough in previous years.

Soon after the administrative agreement, an audit of compliance risk management processes followed…
International consulting companies conducted an independent assessment of compliance risks at almost all Latvian banks. Extensive work was done: for over four weeks, a team of ten people worked in the bank, hundreds of pages of normative and technical documents were translated into English. We're satisfied with the results, and also received valuable recommendations, most of which have been already implemented.

These events won't significantly affect clients, as the recommendations made were mostly related to the organisation of internal processes. The most important thing is that this step has provided both us and our business partners with a sense of security about the quality of our AML programs. I should note that, in future, in accordance with the law, such assessment of compliance risks will be carried out once every 18 months.

By servicing clients from CIS countries for over 20 years, Latvian banks have accumulated unique experience

A Year of Surprises and Historical Records

Leonīds Aļšanskis, Senior Financial Markets Analyst at ABLV Asset Management, provides his assessment of the behaviour of global financial markets in 2016 and analyses to what extent unforeseen events affected the dynamics of the movement of market prices.

On the global financial market, 2016 was mostly notable for a chain of unexpected events, price movements that are hard to explain, and a significant number of historical extremes.

Very Dark Swans

The first events to mention that were quite unexpected for the markets were the victories of supporters of Brexit and Donald Trump in the two most important plebiscites of the year — the events that could undoubtedly be described as "very dark swans" if not "black swans".

The first of these victories not only shocked the ruling establishment in Brussels and London, but also caused a real storm in the European financial markets. After the Brexit referendum, leading European stock markets lost 5 to 10% of capitalisation upon opening. And while stock markets managed to claw back these losses, the pound was under pressure right until the end of the year. The pound suffered its greatest losses on the date of the referendum — 23 June — dropping by more than 10% against the US dollar in just a few hours. The second major attack on the pound was executed by speculators in October — after the new Prime Minister Theresa May announced that the process of leaving EU would be started no later than in March 2017.

Currently "a game against logic" is becoming a popular method of earning money on the market.

For the pound, this resulted in an annual loss of more than 16% against the US dollar (a drop in value second only to that which occurred during the crisis of 2008); in 2016, only the Mexican peso and the Turkish lira suffered a sharper decline against the US dollar. However, the predictions made by some influential analysts, including George Soros, about Brexit possibly triggering a global crisis similar to the one that broke out in 2008 do not stand up to scrutiny. Given the nature of the respective events and the scale of the markets' reaction to them, and crucially their catalytic power to trigger a chain reaction of panic selling on the global market, the collapse of Lehman Brothers and the outcome of the Brexit referendum cannot reasonably be compared.

No less sensational as far the global market was concerned was the outcome of the US presidential election in November. Common sense and the majority of analysts' forecasts (over 90% of them) suggested that the election of the unpredictable and market-hostile Trump should have caused a tsunami on the global financial market, resulting in a sharp drop in both the prices of stocks and the US dollar followed by a rise in bond and gold prices.

Although such trends were evident in the hours immediately after the election; once the dust had settled, the market revised its view of the event and prices started heading in the opposite direction. The following days witnessed a pure rally on the aforementioned markets, completely defying everyone's predictions, as a result of which prices soared far beyond their levels on Election Day.

Pricing Metamorphoses

During the course of 2016, in their response to the year's other major events, prices continued to behave illogically. For example, when, during its March meeting, the ECB announced that it was lowering rates and expanding its QE (Quantitative Easing) programme, the markets responded in unusual fashion. The German DAX stock index skyrocketed by more than 2% in just one hour after the announcement of the decisions, which was logical, but then proceeded to lose almost 4% of its value during the next four hours. In the minutes following the announcement, the euro exchange rate against the US dollar predictably dropped by one figure (100 points — editor's note). However, for some reason, it later rose by almost three figures.

In their desperation to find any kind of justification for these price movements, some analysts tried to attribute these metamorphoses to market participants reconsidering the decisions made or the events happening. When discussing the reaction to the ECB announcement, they spoke about delayed understanding of the threat to the stability of the banking sector, whereas in the case of Donald Trump's victory, the response was ascribed to the realisation (which strangely enough occurred only several hours later) of the inflationary fallout of his policy.

However, in our opinion, these movements can be quite reasonably explained by the exponentially speculative nature of modern financial markets. Currently "a game against logic" is becoming a popular method of earning money, because the market is flooded with armies of programmed robots competing for profits. And this is a factor that every investor should keep in mind when developing an investment strategy.

Breaking Records

2016 will also be remembered for the growth in volatility, which led to new historical extremes in many sectors of the market.

The stock market opened the year by continuing the considerable slide in prices that began in 2015, although this did not turn out to be a savage correction. Consequently, the MSCI World managed to close the year with quite good growth of 5.3% (opposed to a drop of 2.7% in 2015), reaching a new all-time high at year-end closing.

Market turbulence caused a lot of headaches for both ordinary investors and managers of large investment portfolios.

Meanwhile, the MSCI EM index of emerging markets achieved a notable return of 8.6% compared to its drop of 17% in 2015. Moreover, many leading indices updated their all-time highs, with the American NASDAQ closing the year above the maximum of the 2000 bubble for the very first time — an event so remarkable that just five years ago, it would have seemed either hardly feasible or, at best, only conceivable in the far distant future.

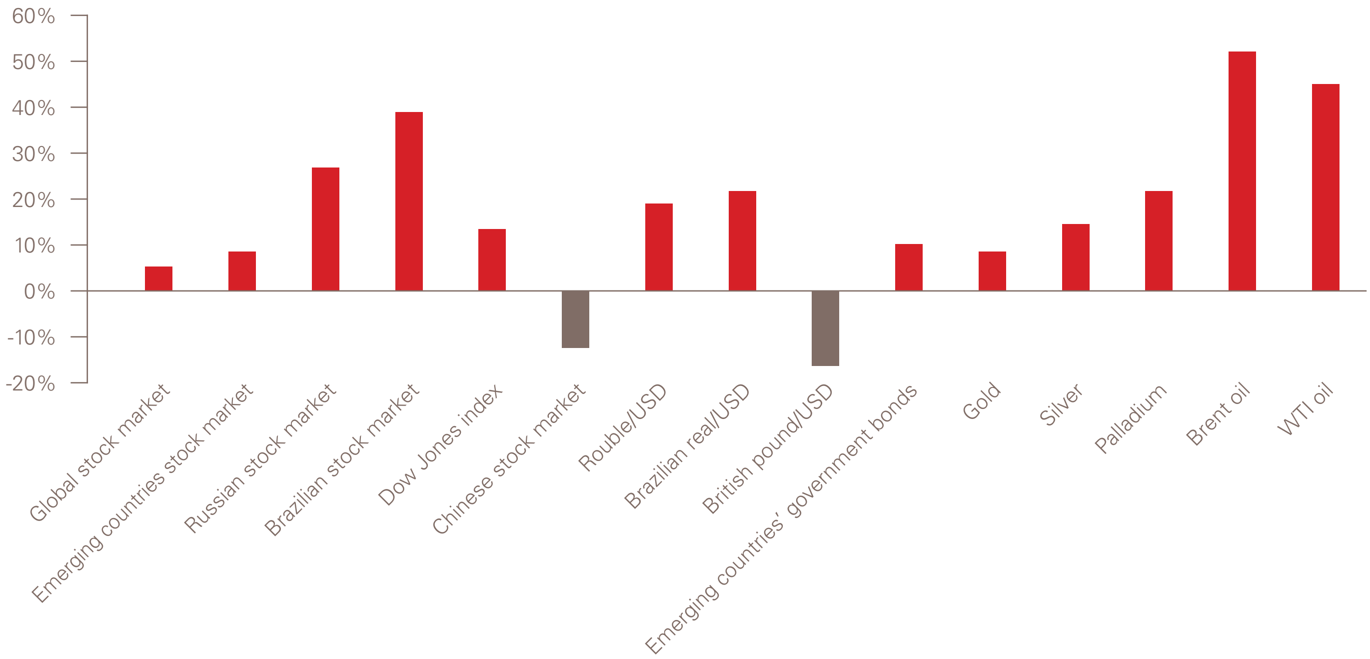
The British FTSE also reached a new all-time high, closing the year with the best result among indices in developed countries (+14.4%), thus proving just how erroneous expectations of a post-Brexit referendum crash were.

The Russian MICEX joined the team of record-breakers by finally setting an all-time high; for the first time exceeding its previous record value, which was achieved pre-crisis in 2007. The MICEX delivered a strong 27% return, which, taking into account the increased value of the rouble, amounted to a 46% rise in the value of this index in US dollars, only losing out in this competition to the Brazilian BOVESPA.

Bonds and Currencies on a Rollercoaster

Trading on global bond market was no less volatile. American treasuries started the year with a growth in prices

Movement of Key Indicators of Financial Markets in 2016



and a drop in the yield of 10-year bonds, reaching a new historical low of 1.32%. However, soon after that, prices started falling and the yield rose. This movement grew stronger after Donald Trump won the presidential election, and by the end of the year, the yield of 10-year bonds had risen to 2.44% compared to an initial figure of 2.28%.

It was also a rollercoaster year for German 10-year bonds, which started the year with price growth and a yield drop from 0.6% to negative figures, where they stayed throughout Q3. Subsequently though, prices started dropping in line with the treasuries, and by December, the yield of 10-year bonds had risen to 0.45%, closing the year at 0.21%.

In 2016, on the exchange market, for the third year in a row, the US dollar mostly continued to grow in relation to both leading developed and emerging currencies. However, unlike in years past, this time a list of emerging currencies rose against the dollar; in some cases, even demonstrating strong growth. The top two positions in this race were occupied by the Brazilian real and Russian rouble, which rocketed by 22% and 19% respectively over the course of the year.

Oil and Precious Metals Go Up

Last year saw extreme fluctuations in prices on the oil and precious metals' markets.

Gold, silver and platinum finally managed to enter a growth phase after falling for three years. However, this growth was not homogenous — amounting to 8.6%, 14.5% and 1% respectively. In H1 2016, gold prices grew by almost 30%, only for their rapid fall during Q4 to absorb much of that growth.

The movement of platinum has been truly extraordinary — the negative spread against the gold price grew from USD 168 to USD 251 in 2016 (and even reached USD 300 at some points during the year), despite the fact that prior to 2011, platinum had always traded a bit higher than gold.

2016 started dramatically for oil prices — with a drop to a new 13-year low of USD 27 per Brent barrel. However, soon afterwards, the trend changed suddenly and Brent prices demonstrated strong growth — rising 110% above the minimum and closing the year at USD 57 per barrel.

Such market turbulence caused a lot of headaches for both ordinary investors and managers of large investment portfolios. Yet those who managed to stay professional and patient were able to demonstrate very good results in 2016.

Tracking the Economic Climate of Investments

The bank's biggest asset is still the securities portfolio that comprises 51.1% of all assets. Māris Kannenieks, Chief Financial Officer at ABLV Bank, analyses the economic climate last year in the countries in whose securities we invested the most.

Our portfolio is conservative, with 99% of it consisting of fixed-income securities. Furthermore, it is diversified by issuers of securities; therefore there is no major risk exposure to any one issuer. The quality of the portfolio is undeniable — 90% is invested in securities with an investment level rating of BBB- and higher. Moreover, the portfolio has a low and manageable interest rate risk, since its average weighted duration is 2.45 years.

Despite its conservative nature, and interest rates and yield that remained low, 2016 turned out to be one of the most successful years in terms of the securities portfolio's operating results. Last year, the annual total yield of the portfolio came to 2.68%, which is the highest yield in the last five years. In light of the fact that it is inherently conservative, and given its volume and low base interest rate, this is a laudable result. The total income volume of the securities portfolio reached EUR 60.6 million of which coupon income amounted to EUR 45.3 million, because last year a significant proportion of income was generated by profits from trading financial instruments, and successfully implementation of financial instrument positions opened in previous years.

Our portfolio is conservative, with 99% of it consisting of fixed-income securities.

We predominantly invest in four countries: the USA, where our investments comprise 16.4% of our total securities portfolio; Germany — 15.2%; Latvia — 13.6%; and Russia — 11.3%. Naturally, we keep a close eye on the development of the economies in these countries.

USA

In 2016, GDP* growth in the USA slowed down in comparison to 2015, rising by just 1.6%, a figure strongly affected by low oil prices. Despite this, economic activity increased. Confirmation of this was provided by US labour market indicators, which continued to improve throughout 2016. An increase in the number of newly created jobs resulted in a fall in the unemployment level. Meanwhile, rising private consumption was also integral to the growth of GDP. At the end of 2016, in a reflection of the fact that the US economy was showing clear signs of overcoming the consequences of the crisis, the Federal Reserve System increased the base interest rate for only the second time in the past decade. Furthermore, the US central bank predicted that in 2017 the base interest rate could be increased as many as three more times, thus driving the growth in the value of the US dollar and US government bond interest rates.

The election of a new president, whose political views promised more fiscal incentives for the US national economy, additional government investment in infrastructure projects; deregulation of various sectors of the economy, thus fostering faster economic growth nationally; as well as good results for companies over the last year that exceeded the predicted levels of income, created fertile ground for stock indices in the USA to scale new all-time highs by the end of the year.

Germany

2016 was a really good year for the German economy — GDP continued to grow for the third year in a row, increasing by 1.7%. This is quite a big figure given the surprise results of the US presidential elections and the outcome of the referendum in the United Kingdom, as well as the long-standing influx of migrants into the country, which caused a sense of political uncertainty among consumers. In fact, due to the accommodation and displacement of refugees, the increase in government spending was higher than during the crisis years, and proved to be one of the driving forces behind the growth of the German economy. During the second half of the year, inflation started returning to normal, indicating that deflation risks had significantly declined. This was mainly attributable to the low (zero) interest rate and the "generous" asset purchase programme of the European Central Bank — monetary policy measures that the ECB plans to continue implementing in 2017.

The total amount of income of our securities portfolio reached EUR 60.6 million in 2016.

As it turned out, almost all leading macroeconomic indicators improved over the course of the year. These included export volumes, which were fuelled by the increased competitiveness of companies exporting to the USA.

It is anticipated that this growth will be maintained in 2017, due to the decreased EUR/USD exchange rate. This optimism resulted in the rise of the German stock market, which outperformed the vast majority of leading European stock markets, which, in turn, proved unable to regain the ground that they had lost over the course of the year.

Latvia

Preliminary macroeconomic indicators for 2016 consisted of mixed, albeit generally positive, results. In Q1, GDP volumes fell sharply, but thereafter the Latvian economy grew steadily, resulting in 2% annual growth at the end of the year. In comparison to 2015, the increase in GDP slowed, as a result of smaller volumes of investment due to delayed EU funding. This also resulted in a drop in turnover in the construction industry. However, in Q4, economic growth was substantially boosted by increased output in the manufacturing sector in which certain industries, including the engineering, woodworking, and construction materials sectors among others, returned distinctly promising results.

The value of export goods produced in Latvia also rose, which had a positive

Our investments in securities on a country by country basis by the end of 2016

USA	16.4%
Germany	15.2%
Latvia	13.6%
Russia	11.3%
Other	43.5%

impact on the pace of growth of the manufacturing sector. Parallel to this, and overall, turnover volumes among retail companies grew moderately.

Despite being one of the fastest growing economies in the EU, the state of the Latvian economy is greatly influenced by economic growth trends in external markets. It is anticipated that the pace of growth will increase in 2017, as unemployment gradually falls as a result of accelerating economic growth in external trade partnership states and Europe in general.

Russia

In 2016, the Russian economy demonstrated stronger resistance to impact of sanctions and low oil prices, and after two years of crisis, the green shoots of economic recovery finally began to appear. By the end of the year, GDP decreased by 0.2%, which was a considerable improvement on the 2.8% drop in GDP in 2015. The rapid economic slump was partly slowed by increasing oil prices, the growth of the industrial and agricultural sectors, the government's fiscal measures, as well as the monetary measures implemented by the central bank. The strengthening of the rouble exchange rate against all reserve currencies was an additional catalyst for economic recovery, reflecting one of the biggest increases in currency value among emerging countries.

In terms of a yearly overview, the retail sector suffered the most, experiencing a continuous drop in turnover volumes, but nevertheless showing signs of recovery. Declining turnovers were mainly related to the high level of inflation, although this had already considerably decreased by the end of 2016. It is anticipated that the slowing pace of inflation will take the pressure off consumers, and that private consumption growth will resume in 2017, which will, in turn, have a positive effect on retail volumes.

On the global stage, Russia stood out the most through the growth of its stock market, which was primarily driven by rising oil prices. An additional stimulus for growth was the outcome of the US presidential election, reflecting hopes that the political stance of the newly-elected president might lead to the repeal of sanctions against Russia, which would have a significant effect on direct foreign investments. Reflecting its awareness of the risks posed by low oil prices, by the end of the year Russia had joined OPEC countries in promising to reduce oil extraction volumes in order to stimulate a rise in prices, thus fuelling economic growth in 2017.

[*] Hereinafter, all GDP growth data are provided based on comparative prices.

Recognising Opportunities is a Skill

Long-term lending is rapidly picking up steam in the revitalised economy, and the last year was particularly productive for ABLV Bank specialists. Antons Marčenko, Head of the Project Financing Department at ABLV Bank, tells us about the achievements in the long-term lending market, the bank's philosophy for providing financing, and the success stories of clients who found a reliable long-term partner in the name of the bank.

In 2016, what trends dominated the project financing industry in the region and the Latvian market in particular? What were the working conditions?
As far as the Latvian market is concerned, I would split the year into two halves: pre-Brexit and post-Brexit. During the first half, there was fierce competition among banks for local clients. We were no exception and, in some cases, offered highly attractive lending terms. The second half was characterised by increased uncertainty in the euro area due to the results of the UK referendum on the withdrawal from the EU. Such a decision by Europe's second largest economy naturally alarmed the investment community, and consequently, the requirements of both investors and long-term project lenders increased.

Of course, the overall performance and profitability of the lending industry was also affected by negative interest rates. However, I think this cycle of negative rates in the euro will soon end, and Europe will be forced to both deal with increasing inflation and to globally compete with America, where the rates in dollars are positive and grew throughout last year. Our clients need to consider this when planning their cash flows in the coming years. One thing I can say for sure — this is the best possible time for lenders to attract funding under the optimal conditions.

The local clients we attract are usually those who already cooperate with some of the banks. Unfortunately, there's a lack of new projects in our country, and the demand for lending resources mainly comes from active companies. Therefore, in three cases out of five, we develop our loan portfolio by refinancing clients and existing loans from other banks.

So sometimes it's the bank that makes offers to clients?
Yes. The primary task of our department's loan officers is to properly evaluate and transform any interest into a deal. Bank employees hold a lot of personal meetings with clients, and the personal involvement of top management makes attracting large clients significantly easier. Water never flows under settled stones, therefore only a proactive policy is capable of producing results.

What kind of clients does the bank consider to be large and what kind of financial appetite is it ready to satisfy?
The average size of a project increases every year, and now surpasses EUR 2 million. This indicates that we're focusing on large transactions by Latvian market standards. That isn't even our desire, but rather a pattern — we attract and finance projects that have a long-term competitive advantage in their industry.

And in the small Latvian economy, a long-term competitive advantage is usually possessed by large companies with a tangible market share and sound management and, consequently, reliable shareholders and a good financial condition.

Business development with stable clients with a low risk for the bank is a strategy we have been deliberately implementing over the past six years. As the bank's brand recognition and opportunities increase, such clients are coming to us more and more often.

The bank's leverage isn't just a way to afford more than you can at the moment, but also an opportunity to increase the returns on your investment by buying assets. If you invest EUR 100 in a business that can yield EUR 10 a year, you get a return of 10%, but if you invest EUR 30, and borrow EUR 70 from the bank, your yield increases, because the bank asks less than 10% for its services.

What successes and interesting projects did 2016 bring?
Our primary achievement was definitely the work done on the diversification of our loan portfolio. In addition to the commercial real estate industry to which we traditionally make long-term loans, and which was the flagship of our portfolio's growth at the start of the decade, we focused our attention on financing clients from other key sectors of Latvian economy.

Thus, we issued a EUR 14 million loan to the leader of the Baltic pharmaceutical industry — Olainfarm — for the acquisition of another successfully operating business involved in the production of elastic materials and their products. Last year, the bank also strengthened its position in financing the leaders of the country's port sector, by providing long-term funding of EUR 35 million. Last year also brought us the experience of refinancing one of the leaders of Latvia's renewable energy sector that operates a set of wind power stations with a total capacity of 19.8 MW.

We also managed to expand our experience of participating in syndicated loans, whereby two banks, sharing risks, participate in large infrastructure projects. We made deals on both the local market and in Lithuania.

What is the purpose of syndicated loans?
This type of financing is good for large-scale projects, when the client wants and can afford more, and the banks want to split exposure to a client among themselves and to reduce the risk of individual credit institutions involved in the project. Generally, syndicated loans are common practice globally; they are just not that prominent a feature of our economy.

Last year a number of construction projects, financed by the bank several years ago, were completed.
Yes, several hotels were commissioned.

A loan should be a growth driver for the client not a burden.

We attract and finance projects that have a long-term competitive advantage in their industry.

We acted not only as a financial partner there, but also as a market maker, by working together with four groups of our clients to update the hotel industry in the Latvian capital. For many years, the development of this sector of the market was quite chaotic, with the exception of the Rezidor group, which consistently expanded its hotel network under the Radisson Blue brand, becoming a leader in Riga. Historically, the core guestroom inventory of this network has been located in reconstructed buildings built during the Soviet era.

There was a clear lack of modern hotels and a variety of strong local and international brands in Riga, so last year we helped clients to open the Ibis Riga Centre hotel, part of the largest French network Accor. At the end of December, a new brand called Park Inn was launched, which is a product of the aforementioned Rezidor group, and is intended for corporate clients. The client started this project from scratch in cooperation with the bank three years ago. The new building turned out to be very beautiful and greatly refreshed Pardaugava. Now the local hotel sector has become more competitive. The role of professional management and motivation of hoteliers to improve the standard of their operations have increased, and that means the city and its guests now have better choices!

Despite this diversified approach, did you continue to develop projects related to commercial real estate?

In regards to financing commercial real estate, the onus last year was on satisfying the growing interests of our bank's existing clients. When attracting clients to take out a first loan, we understand that we will participate in the growth of their business. By smartly increasing their investments and our leverage, the clients grow, earn, and reinvest their earnings in new projects.

One such example of business expansion involving an existing client that I'll mention was last year's opening of a EUR 10.5 million project comprised of a modern warehouse and Class A office space complex in Dreilini (a suburb of Riga — editor's note), built with our financial participation to meet the pre-agreed needs of future tenants. We met this client in 2010, when he invested in the capital of a manufacturing enterprise that was having trouble with loan servicing. The company restored its creditworthiness and continued developing, and, over the next six years of close teamwork, we increased the lending amount 15 times, and, as a result, became the main financial partner of the client's other businesses.

Do new clients have similar success stories?

Certainly. For example, in Ventspils, we helped to open, what is probably, the most technologically advanced flexible packaging material factory in Northern Europe, which is another example of the inflow of international capital to Latvia. For us this was a new client; we only met during the loan application process and saw an opportunity. Being one of the largest players in the Eastern European packaging market, the client chose Latvia as the platform for his new production in Europe. Our country competed with Poland, Hungary and other Baltic countries.

This is literally an exemplary case of expanding the customer base through a new product.

Yes, we have acquired a demanding but very interesting client, who fully conforms to the bank's chosen individual model for servicing private capital. The beneficiary is an established entrepreneur with experience, a team and international business based in Ukraine. I remember our first meeting when I asked if it was possible to visit their operating plant. The financial director was extremely surprised: "You're the first bank in Latvia to express such a desire." Then I explained that the ABLV Group has had permanent representation in Kiev since 2001, and bankers from Riga often visit their clients in person. In short, we heard each other. Before the bank decided to participate in the deal, we met in Kiev. Our client has a modern high-tech production facility, it's a leader in the production of packaging for the food industry, exporting its products to 35 countries, and the industry itself in Ukraine is quite large in terms of market size. The successful launch of the plant in Latvia within the agreed timescale and budget underlines that we made the right decision.

Given the considerable amounts of loans, can we say that the vector of long-term financing is specifically aimed at leaders in their fields?
Once again, we're interested in working with clients with a stable competitive advantage, and they, by definition, are large players. Our team of loan officers is a client "filter" — we lend money for a long period, and the success or failure of our decisions becomes visible after the maturity of the loan — on average, five to 20 years down the line. Therefore, the initial stage of choosing a partner is of high importance, as is sufficient cash flow from the financed project, the client's own participation, structure and amount of the proposed collateral — all of this creates an "airbag" between the risk of the bank and the amount of business financed.

How often is this "airbag" justified? What is the current percentage of bad loans in this field and what kind of activities, besides the main criteria, does the bank conduct to simultaneously secure itself and help client that fails to keep up with payments for any reason?
Last year, only one loan went to recovery, which, looking at the whole portfolio exceeding half a billion euros, is a quite good indicator. The project financing business contains an element of a default — the portfolio can be absolutely "dry" only in theory. Moreover, even this single loan didn't turn to be "bad" according to the results of the previous year, but due to a combination of accumulated factors, including the client's blatantly irresponsible behaviour. However, the loan is secured, and we expect to see the money return through the sale of collateral, while always leaving the opportunity for the client to fulfil their obligations voluntarily. Therefore, in general, our credit risk monitoring system works and provides good results.

The amount of overdue loans within the portfolio of long-term loans at the end of last year was less than half the corresponding figure for the previous year. If a client has difficulties making current payments, we provide our support in time and find a sensible solution that helps the client to repay us, and us to obtain our expected returns. One could say that our "remedial" activities are akin to the work of a doctor — if the borrower falls ill, we quickly give him some medicine, so the condition doesn't get any worse. Active involvement in the process of finding restructuring opportunities in the early stages of possible financial difficulties is one of our department's main tasks. You can't be uninvolved in long-term partnerships — the sooner we sense that the client is experiencing difficulties, the higher the probability that it'll be able to resolve them successfully with our support.

Park Inn, a new hotel brand, has become a considerable competitor for hotels in Riga

The bank's leverage isn't just a way to afford more, but also an opportunity to increase the returns on your investment.

Our loan officers communicate with clients — visit them, take the time to analyse their quarterly reports properly, and examine their non-financial performance, etc. All of this is a prerequisite for us to react promptly and, as a result, to avoid potential problems in the future. Firstly, this attitude increases customer loyalty. Secondly, we'll be in a position to respond to possible changes as soon as the need arises. Being closer and more accessible is the competitive edge that sets us apart from the other offers on the market.

What are your other advantages compared to similar services?
We're ready to offer market conditions and an individual approach not only during the application process and loan issuance, but also throughout the period right up to its repayment. We understand that project lending is chess, not checkers, and the game is played on multiple boards simultaneously: a first, second and third industry… Our task is to play all of these games skilfully. We try to make our money serve as a multiplier of the client's success, so that the profit received from the project exceeds the costs of borrowed funds. A loan should be a growth driver for the client not a burden — it should help the client to grow faster than it could without our assistance.

From which countries is the bank ready to make borrowers its clients? Are there any preferred regions?
We're traditional in our choice — we are primarily interested in Latvia. 87% of loans signed last year are, in one way or another, are investments in the local economy. Out of the country's leading banks, only two managed to grow their corporate loan portfolio by over EUR 100 million during the last year, i.e. they gave businesses more new money than they received in repayments in accordance with the current schedules of pre-existing loans. We were one of those banks. In terms of the growth rate of business lending over the past five years, we're number one in Latvia. As the largest independent local bank, we're investing funds raised in foreign markets to stimulate the growth of the Latvian economy.

During the past three years, we've financed Russia very modestly, and there were few deals last year. The main reasons were shrinking of the market and the economic recession in the country.

2016 was one of the best years in recent times for the Russian stock market, and we share the forecast for the resumption of economic growth. Therefore, this year we expect that the number of applications for financing projects in Russia will increase.

We successfully disbursed a loan in Georgia, which the client offered to repay early. According to the current payment schedules, exposures to pre-existing loans in Ukraine and Belarus were reduced; now they amount to no more than 3.2% of the Project Financing Department's loan portfolio.

Unfortunately, the economic situation of these countries is far from stable, so we aren't planning to significantly increase our lending there.

The bank has revived the commercial fleet financing program, and thanks to the financing received, clients were able to purchase vessels last year.
As far as the financing of shipping is concerned, last year was very successful — we concluded five deals. Our main clients are concentrated in the Mediterranean and Black Sea regions and earn money by transporting commodities ranging from metals and wheat to fertilizers and coal. There are also clients who work on larger ships in Asia, and it was predominantly Asian countries including India, China, and Indonesia that were the main drivers of global growth last year. This segment of our loan portfolio is notable for its quick turnover. These loans are issued for shorter periods ranging from four to eight years.

In 2016, Riga's first ever event for ship owners — the Riga Shipping Dinner — was held with your support. Was this another significant statement about your profile as an important player in the large business lending market?
The idea of such event had long been discussed among the few participants in the Latvian market, because Riga is a port city with rich maritime traditions. Last year, we found the courage to help in the realisation of this idea. It was nice to see the interest: industry players from Azov and Black Sea regions arrived, choosing Riga as a neutral territory of a sort. We also supported the event this year. Moreover, it's always useful to meet the industry representatives and discuss changes — it allows us to have our finger on the pulse and to be closer to our clients.

Is this what you call "the value within"?
Exactly. Every employee knows that the bank isn't only about annual reports, numbers, or even clients. The bank starts in the workplace, from a sense of belonging to the organisation, which is established not by an employment contract, but by the philosophy of like-minded people. If every link within a company has an internal understanding of where we're going and why our work is valuable — it gives the organisation a great competitive advantage. Moreover, when you realise that you come to work to create something more than you created yesterday, it's a special incentive for people in the lending industry.

You can't be uninvolved in long-term partnerships — we help the client to overcome difficulties if needed.

A loan officer begins to feel like a real professional only after about a decade in the business. That's why the widely held belief that you need to change your place of work every four years isn't applicable here. This, by the way, is also borne out by the average length of service in our department — 70% of our colleagues have been working in ABLV's lending business for over 10 years.

Speaking about numbers: last year the department celebrated its fifth anniversary. How do you assess the work accomplished to date?
We've always had a desire to create a lending business and a team that would set an example to the Latvian market. I believe we're moving in the right direction. This is confirmed by both the figures in the annual report, and by the growing trust of our clients, partners, colleagues, and shareholders.

Lending is a constant intellectual workout for the brain. You partially experience the changes that affect borrowers yourself. You can't leave for six months without a care in the world — the cycle of global technological progress, economic and political changes has become so short that you have to constantly be on your toes to keep up with the latest developments. That's why professionals don't end up working in the lending business by chance — a person must have an initial interest in doing this difficult work.

Considering that project financing is one of the bank's priority activities, how much growth do you expect in 2017?
In 2017, we'll focus not on quantitative, but on qualitative business growth. We see the demand for and are willing to offer more sophisticated products and comprehensive solutions for borrowers. All of our current clients can be sure that their growing needs will be met.

The role of the lending business within the structure of the bank's income is really growing. In lending, you can work in any market, no matter if it's falling or growing, because this is the time of opportunities. The most important thing is to put the wind in your sails at the right moment. Our accumulated experience helps us to act confidently and be able to notice new opportunities.

The new factory in Ventspils will export packaging materials across Europe

Trade Finance: a Swiss Approach in a Latvian Manner

Recently, ABLV Bank introduced a new service for its clients — commodity trade finance. Irina Duma-Jemeļjanova, Head of the Trade Financing Department at ABLV Bank, explains why it is based on the Swiss model and what the Latvian bank's advantages are.

To begin with, tell us please about the essence of the service and the target audience.
It's a crediting facility for traders operating with commodities. Initially, when we introduced the product, we chose only three groups of commodities: oil and refined oil products, various chemicals, and metals — ranging from ores and alloys to steel products. In 2016, we expanded the spectrum of financed commodities, and tapped into grains and their derivatives market.

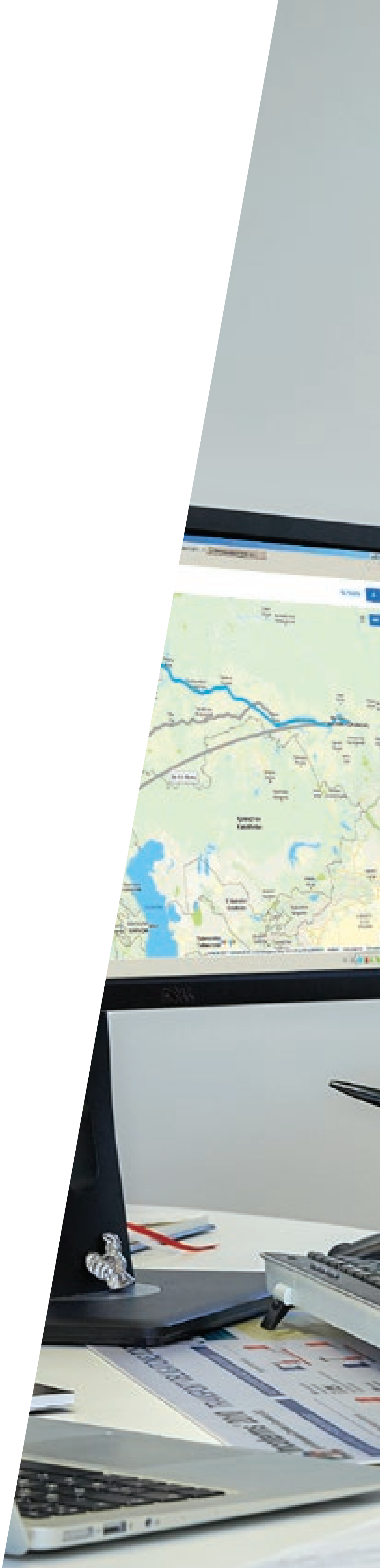
Let's clarify: we're talking about a service specifically intended for exporters, not an instrument for investors who want to outplay the price of a barrel of WTI or Brent?
Exactly, it's not intended for "price gamblers", but for those who are physically trading and delivering commodities. Such traders frequently encounter a "cash gap" between the moment when they purchase goods, often on advance payment terms, and the moment when they receive money from their buyer. We're ready to finance this "cash gap" throughout the whole supply chain — starting with the advance payment to the supplier, during transportation, including storage in warehouses, right through to the final sale to the buyer, including the deferred payment period.

Which client segment is trade finance aimed at?
We're catering to small and medium-sized traders with an annual turnover of several million euros and above. Our large clients mainly have a turnover of tens of millions.

Are there any other criteria?
Customers must have solid experience and a good reputation. If a company has been founded recently, its owners and executives, who make decisions, must have extensive background in the business, going back at least two or three years. They must understand the ins and outs of the market in which they operate and have well-established relationships with the parties involved: suppliers, buyers, carriers and warehouses, etc.

Is it fair to assume that oil traders are the most common clients?
Our clients are almost evenly spread among the three markets: oil and refined oil products, metals, and grain products and their derivatives.

Are these traders mostly from Russia and the CIS countries?
In terms of a company's country of incorporation, it's nearly always Europe — ranging from Estonia and Latvia to Switzerland. Our customers are actual European traders, who mostly buy their commodities in Russia and CIS countries, transport and resell them in the West. However, the "roots", or beneficiaries, are usually associated with Russia and the CIS.



What is the average sum of a contract?
About five million. The lower threshold starts at half a million, while very large clients are granted financing of tens of millions.

Are those who come to you for trade finance new or existing ABLV clients?
Approximately two thirds are those who have already been serviced in ABLV's settlement business and who have been informed about trade finance by our private bankers. The remaining third are new customers who come to ABLV bank specifically for this service. Sometimes, existing clients recommend us to their trade partners.

In 2015, you set a goal to have 10–20 financing contracts in your current portfolio.
This goal was achieved last year. In the first operating year, we had about ten clients we were financing, and each made three to five trade deals a year.

It's assumed that trade finance is a risky business for banks in times when commodity prices are falling. Early last year, the oil price fell to 27 dollars per barrel — an abysmal 13 year low. Did you encounter any specific problems in this regard?
The price risk wasn't relevant to us. ABLV's policy is to finance so-called "self-liquidating transactions". This means that the goods have already been sold to the next buyer, when we start our financing. This is why, typically, there is no price risk. However, if there is a price risk in the financed deals, it must be hedged.

What about the default risk, when a client fails to pay?
The statistics suggests that in trade finance such a risk is very small, even during a downturn. The distinguishing feature of CTF (commodity trade finance — editor's note) is that a bank primarily evaluates the structure of a transaction, not just the financial strength of the borrower. Since, as I noted before, our bank is financing self-liquidating deals, the sources of repayment are buyers' payments. Accordingly, the requirements for the borrower's ability to repay the loan are less stringent than they would be with other types of credit.

At the same time, it's crucial to evaluate the deal and all of the parties involved. For example, prepayment financing is only allowed for manufacturers with a flawless reputation. If a client wants to make an advance payment to an oil refinery for fuel delivery, we will find out what kind of refinery it is. There are reputable refineries that always deliver the goods, but there are also pre-default players.

It's the work of a credit manager to analyse the client's transactional structure and the information about the parties involved; to understand what risks are inherent to these deals, and to assess which risks we are ready to accept and which we are not. Of course, when you start operating in a specific market, you don't know who is a good or a bad player. That perspective comes with experience. After all, the main participants in any market segment — buyers, warehouses, suppliers — are well-known.

Over the last 20 years, commodity exporters from Russia and the CIS countries have surely set up trade financing schemes with foreign banks. Why is ABLV Bank attractive for them?
It's worth mentioning that ABLV's service is based on the same principles as the one of Swiss banks — it makes us stand out among our domestic competitors and, as a result, attracts clients. Switzerland has been the European centre of trade finance in recent years. Thus, in order to create an analogue product and service in Latvia, we recruited a Swiss bank consultant Vincent Alamartine, who is an experienced commodity trade finance expert.

In recent years, the situation in Switzerland and Western Europe has changed: banks operating in the trade finance segment have started to filter their clients, gradually weeding out traders, who are small by their standards.

The distinguishing feature of CTF is that a bank primarily evaluates the structure of a transaction, not just the financial strength of the borrower.

Our clients usually request credit lines of EUR 5–10 million for oil, metals, and grain deliveries.

What are the turnovers of the said traders?
Our clients apply to us for credit lines of EUR 5–10 million. Swiss banks aren't really interested in such volumes. For us, this is quite a comfortable level of financing. So, clients find us attractive and they can see that we work in accordance with customary European terms and conditions — this is reason number one.

The second reason is that for traders, it's considered proper to have credit lines for trade finance with several banks. This is customary: traders, especially the serious ones, don't want to depend on a single bank. That's why even large companies use our credit lines among others.

Thirdly: our bank has already been working with businesses based in the CIS countries for over 20 years; we have an excellent understanding of the specifics of the business environment. We speak one language, and sometimes even think similarly.

Have the European sanctions somehow affected this business?
Some Swiss banks left these markets, because of sanctions. Everybody heard about the case in which BNP Paribas was fined for violating the sanctions regime. As a result, as far as trade financing is concerned, they left the Russian market: they don't want to finance a commodity until it leaves the country. Nor do they finance Belarus where sanctions were also applied.

Traders financed by us mostly buy their commodities in Russia and CIS countries, before transporting them to the West

ABLV’s policy is to finance so-called “self-liquidating transactions” in which the goods have already been sold to the next buyer.

However, if we dig into details, it’s not forbidden to finance raw materials purchased from Russian companies. Thus, the client and the banks aren’t breaking any laws. However, every time it’s necessary to thoroughly examine the nuances of every deal to ensure that it doesn’t violate the sanctions regime. In Switzerland, they don’t want to go deeper, especially if the clients are small. In contrast, we’re ready to do due diligence and finance transactions that don’t break any laws.

Let’s get back to the Swiss consultant — what expertise did he share in particular?
Vincent explained the nuances of the Swiss approach such as pricing mechanism, deal structuring, and risk assessment. As far as some of our clients are concerned, we noticed that, in some cases, the principles of trade finance observed by European banks differ from the traditional Latvian approach. Vincent confirmed our assumptions.

In general, trade financing is considered to be a sophisticated banking product: the commodities are moving and changing location; contracts and owners vary. Was it difficult to master the specifics?
For many people, who aren’t involved in this field, it may seem very complicated. However, for professionals, who understand the ins and outs of it, it’s much simpler. From our perspective, as the employees of the Trade Financing Department, it’s comfortable and interesting to work in this field, because the potential for development is unlimited.

This service involves high operating expenses, there is a lot of paper work, innumerable details — it’s very important to understand the logistics, mutual settlements… We have the required knowledge, and we like to go deeper into the scheme of client’s business, to develop a customised financing structure that best suits a specific customer. And despite the fact that all the employees of the Trade Financing Department have vast professional experience, we’re learning all the time.

Are you only interested in financing goods that are physically transported through Latvia?
This was the case in the beginning, but now the geography of our operations is much more extensive. Our bank is ready to finance any commodity transactions involving CIS countries. Sometimes cargoes go via the Latvian ports: Riga, Ventspils or Liepaja. However, these could just as easily be Tallinn, Klaipeda, Ust-Luga, Vladivostok or Novorossiysk…

What are your set aims in this regard for the current year?
Our aim is to double the scope of finance. It’s a realistic goal, because right now, we are just starting out, and we’re already seeing substantial growth in terms of both the number of clients and their crediting capacity.

The Right Prerequisites for CTF Development

International expert in trade financing Vincent Alamartine lifts the veil on inside processes and gives a short description of the progress made by the ABLV Group in implementing the Swiss model of trade financing.

The new business model of Geneva CTF banks offers newcomers fantastic opportunities to fill the financing gap and provide bespoke trade finance services to small-to-medium size commodity traders exporting goods from Russia and CIS countries.

Located in Latvia, which is a traditional export route for such commodity flows, and with its historical knowledge and understanding of CIS markets where it benefits from local presence through nine representative offices of the group, ABLV Bank was a natural candidate to develop a commodity finance franchise.

I was happy to devote my knowledge and expertise to this project. Over the past two years, we have been implementing a model at ABLV Bank that matches the standards of the renowned CTF banks based in Western Europe, and in particular, Geneva, Switzerland, which is well known as the heart of global commodity trade finance.

While it would be neither possible nor appropriate simply to clone the Geneva banks' model, we have adapted their best practices to the size and culture of ABLV Bank, providing a solid structure in terms of the legal environment, specific documentation, an efficient organisation and a clear marketing strategy. Through training sessions with dedicated staff and practical case experience including on-site due diligence during the pilot phase, we have developed specific expertise within ABLV in terms of market intelligence, risk analysis, operational requirements and hedging.

The ABLV team is now in place and is working to expand the portfolio in accordance with a well-focused strategy in terms of commodities, countries, transaction size and types of risk.

The bank applies terms and conditions in line with international markets and is now ready to support and finance commodity traders on a transactional basis. The ABLV Bank's top management is fully committed to this new business line and I am confident the bank has the ability to become a key CTF player over the next two to three years.

Carte Blanche for Parents and a Safe Future for Children

Nothing ventured, nothing gained. It never goes out of style, even in relation to business risks. Naturally, blind bets on red or black, relying on destiny and hoping for fortune, only succeed in the movies. Still, every once in a while, all mere mortals want to loosen their chains of responsibility, but their sense of obligation to care for their children makes them think twice. Aleksejs Savko, Head of the Corporate and Private Clients Service Division at ABLV Bank, is confident that the new services offered by the bank offer reassuring protection against unforeseen scenarios — safeguarding the future of children by insuring them in advance against the consequences of their parents' unpredictability, passion for audacious adventures or accidental misfortunes.

The new set of services offered by the bank is aimed at your clients' children isn't it?

Let's put it this way, the product is still aimed at our clients, but is ultimately intended to benefit their children. Our first priority in developing this new product was to make life easier and more stable for our clients, offering them more comfort and confidence in the future.

How did you come up with the idea that children need their own bank cards, internetbank, deposit accounts and even access to stock market?

We're growing and becoming more mature along with our clients, their needs and the market. Given the direction in which society is developing, it's time to understand that the modern world has erased clear boundaries that seemed unshakeable as recently as the 20th century. It isn't so much the temptations as the possibilities that surround modern teenagers — possibilities to implement their ideas and plans independently. What decent parent would limit own child's development? Moreover, no one would deny that cash is being eclipsed by electronic means of payment. Therefore, we came up with the idea that children need their own plastic card.

Does this mean that a child will fully manage the funds made available to him?

First of all, this depends on the intentions of parents. We issue cards to children over the age of seven. We offer both a simple debit card and a credit card. The only restriction, a sort of protective measure, is the zero credit limit that even applies to the credit card. And one should bear in mind that the credit card will work even offline, for example, in an airplane. Even if there are no funds on the account at the given moment, such cards allow a negative balance. The debit card doesn't support this feature, so it won't work offline.

Will the children's card work on the internet? Will the child also have access to the internetbank?

Yes. A card issued to a child functions just like the card of a regular client, i.e. it also includes the option of access to the internetbank. Although we will leave it up to parents to decide whether they grant their child access to the internetbank, access to it is possible technically.

And so our clients have a convenient and modern option for issuing pocket money to the child, while retaining some degree of control over expenditures and the possibility to limit them. In order to avoid unpleasant surprises, in each individual case, parents can set restrictions, for example, on cash withdrawals or purchases.

No matter how developed modern society seems to be, children as young as seven years of age are still very simple at heart. Do you offer any protection?

I assume the absence of the credit limit is the main protection — one can't spend more than there is on the account. And there are transaction limits that I've already mentioned, and of course there are SMS notifications. Even if parents aren't nearby, they're always informed about what the child is doing with the money. I think you would agree that no matter how clever the child is at the age of seven, it's hard to resist a temptation to buy something he thinks is absolutely awesome, but which his parents might consider to be absolutely useless or even harmful. Therefore, when we issue a card to a seven year old, we realise that the transactions will be mainly performed under the supervision of parents or grandparents who will be there to offer advice.

For the child, the use of this card will be the first step towards financial literacy.

A payment card is more of a means of learning about spending. But what about learning to save up or even to earn?

It's never too early and never too late to take care of the financial welfare of children. We've also started offering a savings account that is mainly aimed at protecting parents from their daily business risks. By investing a certain amount of money into deposit programme for their children, they can ensure that the money will be kept safe for the child, because access to the money on such account will only be granted upon reaching adulthood. And since the account actually isn't held by the parent, it's safely protected against any risks the parent may incur such as bankruptcy or lawsuits. This is also a way to set an example to your child of a responsible attitude towards money.

What are the requirements for the deposit account?

Parents can transfer any amount to this account regularly or at once. You can deposit a big sum right away or add certain amounts every month — it's your choice. There's only one fundamental restriction — it's a one way interaction. Parents can't take the money back or use it under any circumstances. This is a certain financial guarantee for both the parent and the child in future.

Does the bank invest this money in anything? Does it earn interest?

No, we don't invest this money. This money earns a higher floating interest rate tied to current market rates. But this isn't the point of the savings account — it's intended to provide insurance against the risks entailed by the actions of parents and to ensure targeted saving.

Only the lawful representatives of the child are entitled to top up the account: under general conditions, even grandparents can't transfer money to such an account, let alone third parties.

And what if parents want the money to earn something, not just to be kept safe?

In that case, we offer an investment portfolio consisting of our mutual funds managed by ABLV Asset Management. If the investments are managed by the client himself, then he's constantly making decisions: which bonds or stocks to buy, or sell, and buy again. If the client doesn't have professional knowledge of financial instrument trading, the results could even result in losses.

A plastic card is a modern tool to provide a child with pocket money

The savings account and investment portfolio originally belong to the child, but access to them is only granted upon reaching adulthood.

In this case, we guard against this scenario by offering the assurance that the only decisions that parents make are made at the time of forming the portfolio. Subsequently, neither the parent nor the child, until reaching adulthood, can make any decisions in regard to the funds invested. That's why we form the investment portfolio solely comprised of our mutual funds. What does this mean in practice? The investment account of the minor is topped up by shares in mutual funds chosen by the parent and transferred from the parents' account, while an ABLV Asset Management specialist handles their subsequent management. The historical performance of such funds tells its own story and is at least able to compensate for inflationary processes, sometimes even providing a significant investment return.

What happens when the owner of the savings account and investment portfolio reaches adulthood?
As soon as the child turns 18, he is lawfully entitled to make decisions. He can open an account with the bank, become our legitimate client, receive access to the full range of our services and choose what to do with his investments. Moreover, when this child reaches adulthood and becomes a regular client of the bank, we offer to open and service his account free of charge until he reaches the age of 25. And I would like to remind that both the savings account and the investment portfolio are originally owned by the child. Access to the funds will be granted only when the owner of the account reaches the age of 18 or in accordance with a decision made by an orphans' court. Such restrictions are the most secure tools guaranteeing protection from the very first day: the money is solely intended for the child, with no exceptions to this rule. No matter who files a claim against the parents; they can't reach the funds kept in this account. This mitigates future risks in relation to this investment.

Save First, Earn Afterwards Is the Main Ten Year Goal

The aspirations of ABLV clients to preserve their savings and earn safely without great risk remain the same, regardless of crises or periods of rapid growth. Leonīds Kiļs, Chairman of the Board at ABLV Asset Management and ABLV Capital Markets, explains the potential main market trends in 2017 and why the Trump factor could lead to both growth and decline of markets. Last year was the 10th anniversary of the launch of these two companies that help ABLV clients in financial markets.

In these ten years, have your clients, their appetite for risk and preferences evolved?
People rarely change. As always, within every investor there is a conflict between greed and fear. When markets show double-digit returns, greed usually gets the upper hand. When returns are minimal, fear prevails. In this sense, nothing has changed: people still expect to be offered a reliable investment option. Moreover, they hope not only to not suffer any losses, but to actually earn something.

Has the volatility of the market — as witnessed during the crisis of 2008–2009 and the subsequent multi-year growth cycle in America — changed anything?
Personally, I've experienced several crises. Early on — in 1995, when Latvian banks "fell" one after another; then 1998, which was the aftermath of the crisis of 1997 that started in South Korea, followed by the dot-com crisis of 2000–2001. And, of course, there was the global collapse of 2008, which almost turned into a worldwide catastrophe. Most recently, there was November 2014, when sanctions against Russia were imposed, which affected our clients for geographical reasons. When military conflicts take place in the Middle East, it seems far away, but when it's in the east of Ukraine, it's no longer an abstract misfortune in the middle of nowhere, but a real problem literally next door...

And even in the face of this problem "next door" — did investment psychology remain the same?
It didn't change the main thing, which is an investor's attitude towards his money. People still try to find a quiet place to put their savings; they still want reliable profitability. The only thing that has changed is their perception of reliable profitability. A decade ago, making choices was a lot easier for investors. In 2006, deposit rates were at 4–5% per annum, and it was harder to offer alternatives to clients. When you go to a bank, and they give you 5% per annum — what else can you ask for? Now, when you come to a European bank, and they tell you how much extra you have to pay to recover the principal on the deposit, you start wondering, because it's somewhat illogical to pay interest on your own deposit. However, I have to admit that we're living in an illogical world.

Last year in the US, the S&P 500 rose by 9.5% and Dow Jones by 13.4%.
They did, but remember how much they lost before that!

For example, take the Russian RTS stock index, which grew by 52% in 2016. If you look at its results over a five-year period, it's down about 30% in foreign currency terms. I doubt any client would like to have been in Russia during the last five years, having invested a considerable amount of money there.

However, last year ABLV's clients must have been thinking about the option to "buy RTS", while reading in Kommersant and Vedomosti about how the Russian stock prices were rising due to the rise in crude oil prices and the potential lifting of sanctions.

Yes, we had such conversations with clients. Reflecting on 2015, when the sanctions were already in force, and Russian companies were denied the opportunity to borrow abroad — with the benefit of hindsight, that was a good time for entry. Because now, if sanctions are lifted, this could play against investors. In this case, it's better to wait for the first wave to pass and then see what happens. I'll even go as far as saying that if they announce today that sanctions have been lifted, I don't rule out that many will choose to sell Russian assets and wait for a further reaction.

Why?

Because the first reaction is euphoria and growth. And then the consequences set in: companies, previously devoid of Western funding, will return to the global markets in search of money. This should have a negative impact on financial asset prices.

In general, do you plan to start a separate fund of Russian stocks at ABLV?

No. The client can come and say that he wants to buy stocks in Russian companies, because he saw a graph, where the RTS grew by 52% in 2016… He may have a logical question: why wasn't I there? To which my reply will be: can you draw this graph further demonstrating growth of another 50%? Most importantly — how realistic is it? Just because you could have earned money yesterday, doesn't mean you can earn it tomorrow. It's better to earn less, but to do so wisely. Profitability of 5% is relatively easy and tangible.

How long do clients stay in selected funds and how often do they withdraw their savings?

They rarely withdraw. I'll tell you a story. In his youth, one of my colleagues loved to drive his powerful car at 180 kilometres per hour and was very proud of it.

A present for the 10th anniversary — a painting representing the two main exchange business participants: the bull and the bear

People are worried about reliability first, liquidity second, and finally profitability.

Our older manager also had a very expensive car with a powerful engine, but he complied with the law. When the subject of the reasoning for buying such a powerful car came up, he responded: I need to know that I have the ability to drive fast, and I can do so when necessary.

The same goes for funds: investors don't think about how they will show up once a year to collect their accumulated money or earnings; they merely want to know that they can do so if necessary. And if they need to do so — the money will be in their current account in three days. I would say that people are worried about reliability first, liquidity second, and finally profitability. Of course, profitability still interests everyone, but reliability comes first.

At the same time, in terms of profitability, investments are now similar to swimming in an ocean: you take three steps, and find yourself underwater after the fourth. There are reliable bonds, where you can easily make 2% a year — you can be 99.9% sure that you'll get your principal back plus this yield. However, if you want to get higher returns — you'll find yourself underwater.

With stock investors, it's clear. Did those clients, who trade through brokers, play around with riskier ideas in the form of Russian stocks or crude oil prices?
Of course. Some traded in oil, some in gold, silver, or stocks in specific companies… Some bought options on futures, stock market indices, or bonds.

For example, our "bestseller" last year was the subordinated bonds of the Russian VTB Bank. Retirement in 2049 — an "endless share" of sorts. Quite a few clients were asking: which bonds should we buy? I replied: I'll refrain from giving you advice, but personally, I bought these.

Funds and independent trading — are these different clients or different instruments of the same investors?
It varies, but they seldom overlap. One client says that he doesn't want to delve into anything; we earn 5% for him, meet once a year, discuss the results, and he is satisfied with everything. For such clients who don't operate in financial markets on a daily basis, the level of risk must be strictly limited. We strongly suggest that they should adopt a conservative approach. It's a different story when it comes to people who make investment decisions themselves, actively developing and trying out various strategies. It's their choice; we have no right to limit them.

Last year was unusually successful — for both stock markets and bonds. How did ABLV funds do?
Bonds did great. The profitability was at 7–10%. Here's why ABLV has a unique value compared to other Latvian companies: we have the experience of our Luxembourg colleagues, who are highly qualified experts.

There is a famous Chinese proverb, "When you are washing a cup — think about the cup." In other words, you should focus on the thing you're doing now, and the results will follow.

When developing an investment strategy, we can combine the experience and knowledge of Western and Eastern Europe. It's very convenient when you can broaden your horizons and develop a consolidated approach to the offerings we make to our clients.

We've always focused on balanced and moderate income. However, these are only words, without any maths behind them. For some, a balanced approach is when 50% of assets are invested in risky instruments and 50% in reliable ones. That is their balance between risk and peace of mind. For others, the balance is when you're calm about your money, and there can be no peace of mind when half of your money is invested in risky markets with high volatility.

Even the word "balance" itself means different things when talking about investing: in English, it's a reasonable combination of risk and aggression, but in Russian, it's something closer to being in a calm state.

After the Brexit referendum, selling was the order for the day on European exchanges — prices were falling for about two weeks. If we look at the German DAX, we can see that at the time it was easy to buy cheaper dividend shares like Allianz or BMW with a dividend yield of about 5%, which is a good indicator. How did you assess that moment? Yes, we can attract the attention of some clients, but without creating a designated fund?

Yes. Because you can't implement all of the good ideas; after all, management resources are limited. When a new vacancy for a fund manager appears at ABLV — and it happens once every three years — it's always involves choosing one person, who is right for us. We can't just take 20 excellent specialists at once to develop new investment ideas. All we can do is to focus on the essentials. There is a famous Chinese proverb, "When you are washing a cup — think about the cup." In other words, you should focus on the thing you're doing now, and the results will follow.

Last year, your bond funds grew by 7–10%, while stock index funds slid below zero. Why?

As far as stocks are concerned, it wasn't our best year, though three year performance is still positive. Once again, we became aware of the need to focus on specific segments where we're skilled enough to ensure very good results, delivering a better return than the average market performance. And these are bonds: government and corporate — in euros, roubles and US dollars. In this field, we understand perfectly well what and when to buy, and when to leave the market. By limiting risks and following the capital preservation policy, we recommend our stock index fund clients to invest not more than 10% of their portfolios in stocks. However, it's good to have at least some stocks.

A year ago, in February, when a barrel of WTI crude oil cost USD 30, you cautiously talked about the forecasts for "USD 50 per barrel" by the end of 2016, and were right in the end. What do you expect from core assets in 2017?

It's more likely that the euro and the dollar will reach parity, than return to the 1.20 point.

Deutsche Bank is even talking about EUR 0.95 for a dollar.

I guess that is already on the safe side. However, I believe that parity is quite possible. Most likely, it will go like this: if the market is psychologically ready for parity, in practice, 1.01 will be the barrier we won't be able to cross. Because when everyone already believes in parity and runs off to make bets, the market, according to Murphy's Law, will punish the more naïve speculators. That's one of the scenarios.

What do you expect from bonds?

I think the year will be calm. We won't be able to earn more than 5%.

What about gold?

Last year, our clients had very few deals involving gold, although the price fluctuations were large — from USD 1,055 to USD 1,350 per troy ounce. In other words, the fluctuation corridor was about 30%. That once again confirms that it's no safe haven. At the same time, we have quite a few customers who have become owners of gold bars or e-gold for prices much higher than today's…

I wouldn’t predict that gold will grow from USD 1,200 today to USD 1,600 tomorrow. However, growth to USD 1,300 is quite probable.

By the way, there are adherents of gold who keep it for years in the bank’s safe, without following the price — they say, leave it to their descendants, and let them decide what to do with it. That is also understandable: it won’t be lost. As for the fact that it’s 20% cheaper today — well, it might become 20% more expensive in the future.

Your prediction for crude oil — boring volatility between USD 50 and USD 60 per barrel?
Most likely. Perhaps by the end of the year it will rise to USD 65–67. I don’t believe in USD 70 at the moment. It is difficult to predict, because Trump’s “black swan” introduced a very big factor of uncertainty. We will have to live and work with it.

By the end of 2016, thanks to Trump’s victory, stock market investors had mostly became richer, not poorer.
The big question is — will they become poorer afterwards, if the Trump-related expectations aren’t be met? Right now, investors in America have drawn a picture of their bright future: return production from Mexico and China, begin the construction of infrastructure; everything will grow, there will be inflation, rates will rise, and companies will start showing good financial results…

In anticipation of this future, the US stock exchanges have already skyrocketed. What if tomorrow we see that these expectations haven’t been met? Then everything will drop a lot faster, than it rose previously. Therefore, Trump has brought a lot of uncertainty, and I wouldn’t count too much on the scenario that the S&P will continue to grow.

How do you feel, what scenario is more probable for the S&P in 2017: decline or growth?
So far, I’m inclined to believe that in 2017 the US market is more likely to grow by 8–10%, than to fall by the same 8–10%. However, I wouldn’t bet on it. You can cautiously buy and monitor the situation.

Thanks to the American economist Nassim Taleb, everyone knows what a “black swan” is. Now he has released a new book, continuing the same topic: how to live in these conditions. Here’s the funny part: investors are trying to predict future “black swans”. However, they’re missing the point — it’s impossible to predict them. It’s an event which shouldn’t occur under any circumstances.

Like the outcome of the Brexit referendum and the election of Trump…
Yes, everybody thought that these things couldn’t happen. However, now we’re living with this reality, and waiting for news everyday: how will Brexit happen? Under what conditions? What else Trump will do? There are multiple versions that no one can predict. That’s why it’s so difficult to accurately predict which scenarios are the most likely in 2017. The only thing I can suggest is — stay online.

What have been the main milestones and achievements of ABLV Asset Management and ABLV Capital Markets in their 10-year history?
In 2006, there was almost nothing related to investment in ABLV. Then the shareholders set us the task of making “business within business”, by offering clients services the bank didn’t provide before in the form of fully-fledged asset management in the financial market and brokerage services. Initially we had one manager, now there are four. That isn’t a lot, but we try to focus on quality, rather than quantity. I must say that the formation of the team wasn’t easy for us, because managing someone else’s money is one of the most difficult tasks psychologically. No wonder there is the concept of “trust management”.

People entrust the fund manager with their hard-earned money, and want us to justify their trust. We managed to form a team of professionals with 10 years of experience. Thanks to this, we were able to achieve the first results earlier than planned — the companies began operating at a profit after just 18 months.

As for brokerage services, we worked for a very long time to provide technological access to markets while preserving human communication, so it's possible to immediately resolve any problems that arise. That was the main bonus for our clients, which they themselves have pointed out — the opportunity to interact with a bank with a human face. I believe that we have successfully completed the shareholders' task.

What are your plans for the future?
In the second half of 2017, we plan to launch a second pillar pension plan. During the first stage — for our employees and clients. We calculated that on average we can provide a 3% yield, which is a good level compared to our colleagues.

As far as the second stage is concerned: we're evaluating options to offer customers even better access to the main financial markets, by being present there physically. Possibly by receiving a licence in New York, London or Moscow. This is still in the distant future, as we have to calculate everything.

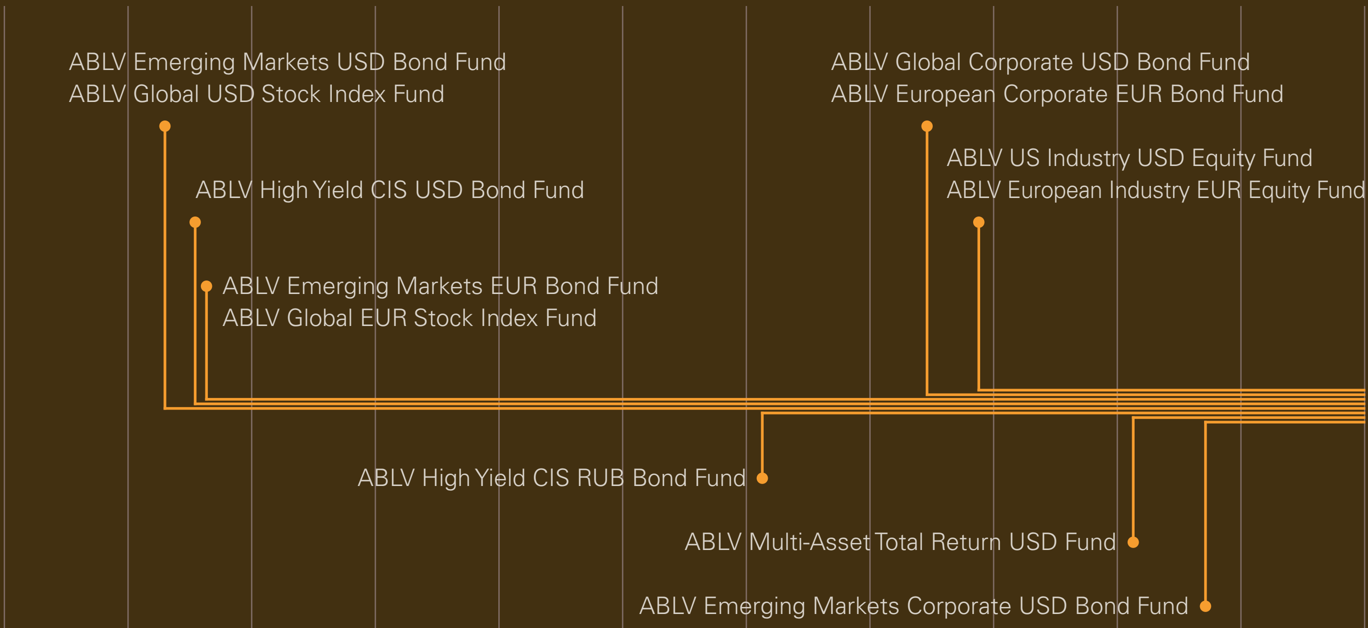
What is the point of that?
That means great asset protection, if a bank operates in the same US exchanges, not through an intermediary, but directly: the securities are kept at the bank's subsidiary, which has an account in the depositary — that way you're no longer exposed to the risk of some other broker going bankrupt. In 2011, there was a major story about the bankruptcy of a major British broker MF Global, which cost us quite a lot of money. If ABLV had been physically present in London through its subsidiary, that wouldn't have happened.

ABLV's shareholders subsequently decided to compensate customers for the losses caused by the bankruptcy of MF Global.
Yes. It was the right thing to do. The bank reimbursed clients for those "hanging" assets that were in MF Global from its own funds. We took on these problems and dealt with them ourselves, although many other banks opted out of that situation. That cost us about a million euros. However, that got us plenty of new clients who appreciated our loyalty. As a result, we made the lost money back in a year.

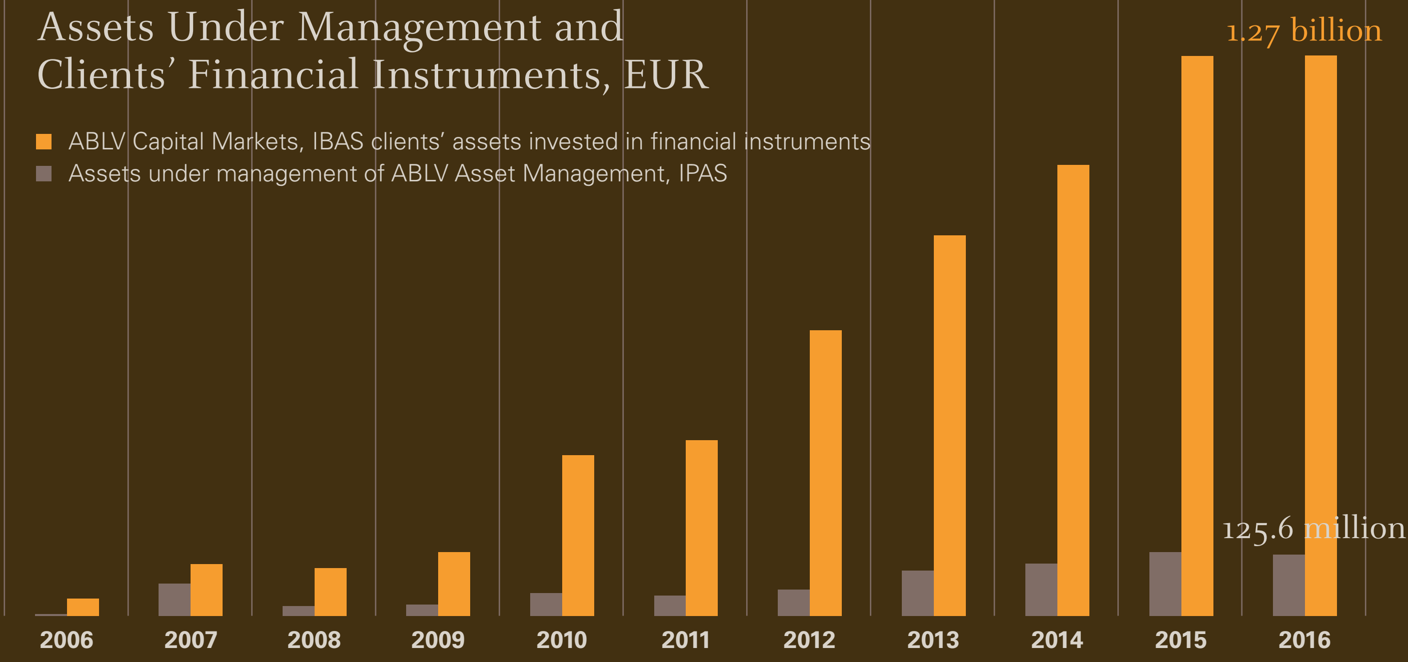
*The information above is a personal opinion, provided solely for informational purposes, and should not be regarded as a personal investment advice that takes into account the individual circumstances of the investor, or a general investment recommendation on possible investment strategies regarding one or multiple financial instruments. ABLV Bank, AS and ABLV Capital Markets, IBAS are not liable for any kind of losses that could arise as a result of using the information provided to make investment decisions.

ABLV Asset Management and ABLV Capital Markets Achievements for 10 Years

12 Investment Funds



Assets Under Management and Clients' Financial Instruments, EUR



A New Service: Bonds for a Growing Business

Last year, ABLV Bank offered a new service to Latvian companies — arranging bond issues — and has already conducted two bond issues for clients. What are the advantages of this type of financing compared with bank loans and private equity, and is it possible for the issuer to receive funding with 4-5% interest? These questions are going to be answered here by Žanna Jakovicka, Head of the Investment Products Development Department, and Ņikita Klemperts, Loan Manager of the Project Financing Department at ABLV Bank.

What were the first year's results after the launch of this new service?
Žanna Jakovicka: In 2016, we successfully completed two bond issues. The first one was arranged for the holding company Baltic RE Group that operates in the field of premium class real estate. In this issue, ABLV was the arranger providing the full service of preparing the necessary documents for the issue, and conducting the initial offering in which the total issue was worth EUR 4 million.

The second project was the issue of subordinated bonds for Citadele banka worth a total amount of EUR 40 million. Here, ABLV was a consultant advising on the preparation of the bond issue programme and the underwriter for an initial offering for EUR 20 million. At the time the project was launched, ABLV's involvement meant that the issuer Citadele banka could be sure that the issue would be taken up in this amount at least. When it came to the remaining EUR 20 million, the issuer was responsible for attracting investors.

Is this a common practice — to help arrange an issue for a competitor?
Ž. J.: The usual practice is to cooperate with one's partners. The issue of subordinated bonds for Citadele banka, whom we were consulting, is our valuable contribution to the development and strengthening of our partnership with Citadele banka. And it also happened to be a promising investment for us.

What does promising mean in terms of coupon yield?
Nikita Klemperts: It's 6.25% p.a. Of course, one should take into account that those are subordinated bonds. It's not easy to find stable bonds with a yield of more than 4–5% interest on the market.

What is the target audience for this service?
N. K.: Usually these are medium-sized and large Latvian companies. They should be well known on the market. A company may have sufficient cash flow to service its obligations, but insufficient collateral to take out a new loan from the bank. A company in this position can apply to us and obtain the necessary funding through a bond issue to develop its business without additional collateral.

What are the advantages of this type of financing?
N. K.: Bonds are much more convenient for the issuer rather than attracting private equity.

In the case of private equity, investors usually expect to get a return of about 15–25% p.a. In most cases, for the company's owners this means partial loss of control over their business if they let new shareholders in. In contrast, for a company with a moderate credit risk rating, bond coupon payments will cost about 4–8% p.a. Moreover, a bond issue is also a tool for promoting the company on the capital market. If the first issue goes well, and the issuer eventually settles its obligations on time, this will strengthen the trust of investors and subsequent issues will be placed with lower coupon rates.

Ž. J.: When a client applies to a bank for a business loan, the bank stipulates everything — the terms, the maturity, and the interest rate. In contrast, in the case of bonds, a client can obtain funds under market conditions.

N. K.: And there is one more thing — if a company takes out a loan from a bank, it usually means that the company will have to return the principal amount on a monthly or quarterly basis. Meanwhile, bonds usually imply returning the principal amount at maturity, which is two to five years depending on the term of the bond. It enables the company to ease the financial burden on the business and to implement the new projects they needed the money for. And the issuer can define the regularity of paying interest, i.e. the coupon — monthly, quarterly, every six months or annually.

What interest should the company expect to pay when it decides to make a bond issue for the first time? The Riga exchange has witnessed Latvenergo pay 1–2%, in contrast to fast-loan companies which offered 10–12% interest.
Ž. J.: We're only ready to work with companies that have a low or moderate risk profile. We aren't interested in high risk issuers, even though their coupon yield may reach double digit numbers. Therefore, the return on the unsecured bonds of our target issuers should be between 6–8% p.a. for the first issue. For subsequent issues, the coupon might constitute 4–6% p.a.

Why is ABLV not interested in the riskier segment when the arrangers earn their fee anyway?
Ž. J.: It's a different story when a client is only interested in preparing the documents for the issue. In the majority of cases, this is insufficient incentive to start doing business together.

Upon arranging the bond issue, ABLV provides full service, including initial offering. Therefore, it's very important to us that the product we offer our clients is reliable.

N. K.: Most of the investors who buy the bonds are clients of the bank, and in some cases, our business relationships with them go back years and years. We don't want to offer them bonds with a high risk rating, which may lead to financial losses.

A bond issue provides the necessary funding for business development without additional collateral.

Upon arranging the issue, we provide full service, including initial offering.

This is one of the reasons our management decided that the bank should participate in every client's issue together with other investors, i.e. the clients of the bank. It's our way to show that we're in the same boat. It's a good sign for the clients — they see that the bank also considers a particular investment to be attractive. And if the issuer ever faces any problems, we will be solving them together with all the other bond holders.

Apart from coupon payments, what other costs should the issuer count on upon when issuing bonds? How much do the services of the bank cost?
N. K.: Up to 2% of the volume of an issue are the costs of preparing and arranging the issue (upon agreement with the issuer, ABLV undertakes a partial or full placement of the issue — editor's note). The bigger the issue; the lower the fee.

Ž. J.: A potential issuer should bear in mind that the issued bonds are being registered in the central securities depository and at the exchange. Those are the costs of servicing the issue, even though they are rather small.

For what purposes do clients usually issue bonds? To finance their current business? New ambitious projects? Or to acquire a competitor?
Ž. J.: In most cases, they're seeking financing for a certain project. If a client is planning to acquire some business or object, bonds are an instrument with which to attract the required financing in advance, in order to have the money at its disposal by the time the deal is about to be closed or payment is due.

Apart from the fact that it should be stable and well-known, what other requirements are there for the potential issuer?
N. K.: Although we prefer not to do business with companies in certain sectors, pharmacy, logistics, manufacturing and real estate are the fields we're interested in. Another important criterion is the company's total amount of debt in relation to EBITDA (earnings before interest, taxes, depreciation and amortisation — editor's note). The amount of debt shouldn't exceed the industry limits. In addition, the issuer should have sufficient money flow to pay the coupons and the other credit obligations the issuer should service. In addition, there is another requirement for the issuer — its audited financial reports should be prepared in accordance with the International Financial Reporting Standards for the latest reporting period at least. Large companies usually do prepare such reports.

Are there any limits regarding the size of the business?
N. K.: We prefer medium-sized and large businesses. The minimum volume of the issue should be EUR 2 million. Below this number — there is no point in doing it, given the complex arrangement process and the costs for the issuer.


BALTIC MARKET AWARDS
BEST INVESTOR RELATIONS IN BALTICS AMONG BOND ISSUERS
ABLV BANK
3
THIRD PLACE
Nasdaq

We are among the best debt securities issuers in Baltics in terms of investor relations. Māris Kannenieks, CFO at ABLV Bank, receives an award from Daiga Auziņa-Melalksne, Chair of the Board at Nasdaq Riga

ABLV's experts assess the issuer, analyse its risk profile and tell investors about it.

There have been cases of foreign companies issuing bonds in Latvia. For example, the Riga exchange was quoting the bonds of a bank from Azerbaijan. Are you interested in such clients, or do you prefer local ones?
N. K.: Currently we're working with local Latvian companies only. But if a client approaches us, we're ready to work on other options.

Is the local business mature enough for an instrument of this kind? Do you happen to explain to shareholders what a bond issue is and what its advantages are?
N. K.: I think there are at least 30–40 companies in Latvia that could use this service. And the shareholders in those companies are well aware of what bonds are. There is one important idiosyncrasy: Latvian issuers usually don't have a Fitch or Moody's rating — these companies are relatively small on a global scale. Among their other tasks, this is what ABLV's experts have to do: they assess the issuer, analyse its risk profile and tell investors about it. This is the value that we add to this process.

How many corporate bond issues do you have under development right now?
N. K.: Currently we're working on one project in which the placement of the issue is planned to take place during the second half of 2017. Generally, we can see that interest in our service is growing. After the issue we arranged for Baltic RE Group, we've received requests from potential clients. There was also a request from an Estonian issuer. And even though we're currently focused on Latvia, we'll probably start working with Lithuanian and Estonian business in future.

Ž. J.: What's notable is that in Estonia, where the stock market is well-developed — new issuers appear quite regularly. However, the bond market is quite passive there — just a few issues are held. It's the opposite situation in Latvia.

They say that reluctance to issue shares and let any new shareholders into the company is a feature of the mentality of Latvian entrepreneurs that dates back to the 1990s. Yet they simply view bonds as a loan and feel positive about them.
Ž. J.: That's true. Currently in Latvia, shareholders are more willing to attract funds for a particular time — upon completion of the investment project, the bonds are redeemed and the relationships with the creditors, i. e. the bondholders, within the particular issue are over.

When you talk to the potential client, to what extent are they ready for this type of financing?
Ž. J.: The first issue that ABLV Bank held involved issuing its own bonds on the exchange in early 2012. Right after that, we received an award from Nasdaq Baltic for the development of the local financial instruments' market. In some respects, our move was the event of the year for the corporate bonds market. Five years down the line, looking at our client pool, we see growing interest in bonds from both potential issuers and investors.

In the case of the placement of the Baltic RE Group's bonds, demand from investors exceeded the offer by 25%.

If the development of company's business has been historically based on loans, it is usually in a relationship with a particular bank. During hard times in business, when they need to reconsider the terms, clients are used to turning to the bank and negotiating the necessary amendments in the terms of the loan. In the case of bonds, the issuer should be sure about the stability of its business for the entire term of the issue — right up to redemption.

What is the potential of this service? How many corporate bond issues do you plan to execute a year?
N. K.: It's going to be 3–4 issues a year, which is quite realistic given the growing interest of the clients to this service. As for the volumes, the ABLV Group is able to distribute issues with a total volume of EUR 60 million a year.

How much time does it take to prepare one?
Ž. J.: From the time that the company's shareholders decide to issue the bonds, it takes about five or six months.

N. K.: Europe has long recognised bonds as a mean of attracting capital for business development, and companies there are actively using this financial leverage, and now this means of growing capital is gaining in popularity here too.

How do you find buyers for the bonds? One would assume that those are the clients of the bank, first of all, aren't they?
Ž. J.: Right now, about 700 of the bank's clients own ABLV bonds. It's a rather loyal pool of investors. These clients are experienced in working with this instrument; they're ready for new investments, and are willing to diversify their portfolios — naturally, they're our target audience for future issues.

Are the buyers mainly individuals or foundations? Local or non-residents?
Ž. J.: Judging by the experience of the bank in this field — we issue bonds regularly three times a year in the volume of USD 75 million and EUR 25 million each time — more than 100 investors comprised of individuals and legal entities take part in each issue.

In the case of the placement of the Baltic RE Group's bonds, which was quite a small volume of four million — demand from investors exceeded the offer by 25%. As a result, 40 investors participated. As far as the profile of the buyer is concerned, individuals are more active on the local market, while among the buyers who are foreign clients, there we see both individuals and companies.

The Baltic RE Group's bonds were of a relatively small face value — just EUR 1,000. Were you expecting private investors?
Ž. J.: Yes, we were. Our task was to also let private individuals participate in the issue. We are interested in this group of clients. Moreover, the face value of EUR 1,000 is also convenient for transactions on the secondary market. In other words, the client can sell some of the bonds before redemption if he needs the money.

How is this done? The secondary market usually isn't very liquid on the exchange. Wouldn't it be better for the client to turn to the bank's broker for a direct deal?
Ž. J.: In this case, the client should contact his private banker or file an application on his own for the sale of bonds. But it's a rare occasion that a client would apply for selling bonds before maturity, on the contrary — they often ask when the next issue is going to be.

They say locals aren't willing to buy bonds because they are traditionally used to bank deposits — they keep the money there even if there is hardly any return. Is this situation changing?
Ž. J.: Gradually. Nowadays, bonds are a good alternative for deposits on the market. The difference is that, in the case of a deposit with a maturity of five years, one has to pay fine to the bank to take the funds back prematurely, whereas in the case of bonds one can sell them on the secondary market prematurely. If a client needs money for a short while, we offer day-to-day financing using the bond portfolio as collateral — this is a solution that allows the client to keep the initial investment.

As previously mentioned, ABLV Bank first started placing bonds on the exchange in 2012. Since then there have been about 40 public issues. Do you aim to replace long-term deposits with them?

Ž. J.: Yes, we do. This is how we diversify the structure of bank's liabilities and gradually replace the pool of deposits. In 2012, we offered deposits with a maturity of 3, 6, 12 and 24 months. The six-month and twelve-month deposits were the most sought after. Initially we were issuing bonds with a two-year maturity. This was a way to extend the terms of attracting the funds. This is important for keeping the balance — the bank uses the attracted funds to issue business loans, which are usually long-term ones.

N. K.: This is a logical move: deposits and loans should be balanced in terms of maturity. Moreover, there is synergy: investors who buy the bonds later on become clients of ABLV brokerage.

Do you have any vivid memories about these five years of dealing with public issues?

Ž. J.: In 2012, we often had to explain to our clients what bonds are. We recently dusted off the old files of the first issues, the closed ones, and reading them today, they felt like school notes. *(Laughs)* We have gone through three main stages: firstly — before entering the public market — in 2008 and 2010, we held closed issues with a yield of 6–10% without placement on the exchange. In 2011, we arranged the first public issues. That was the time when the regulator's requirements for the documents for public issue and for preparing the issue in general got more serious. Over the next few years, European regulations were also tightened up: prospectuses got thicker, and, in addition to local requirements, European regulations also became applicable. However, this is good for investors: many things are now standardized.

Judging by the ABLV bond yield on offer, your investment client chooses to retain the invested funds without major risks, albeit without significant profit.

Ž. J.: There are all kinds of clients. However, as far as our bonds are concerned, it's true that investors don't strive to take risks. They value confidence in the knowledge that, by the day of maturity, they will get their invested amount back and earn a little.

At the beginning of 2017, you received another award from Nasdaq Baltic.

Ž. J.: That's right. Earlier this year we were named among the best issuers of debt securities in the Baltics in terms of investor relations — this is a new award presented by the exchange.

N. K.: For investors, this award yet more proof that, on the bonds market, ABLV Bank is a clear and transparent issuer.

We Look Forward to Changes to Come

Marks Špungins, Head of the Corporate Support Department at ABLV Corporate Services, shares his opinion on the interaction between tax authorities and the banking sector, and offers an overview of the current situation in the automatic exchange of information under CRS.

The Right Growth

There is a concept in economics called a zero-sum game, which is an event or game with a winner and a loser in which the sum of the prize won equals the sum lost. Investments in stocks are usually considered to be a zero-sum game, i.e. whenever the price of a stock changes, one party wins, but another party loses. When the economy grows, countries and businesses can develop in line with general growth, instead of growing at the expense of other countries and businesses, thus making this a game with a positive sum. However, in the event of zero or negative growth, countries and businesses are forced to compete with each other for their share of the pie; in other words, they are forced to start playing a zero-sum game.

Logically, the result of the Brexit referendum in the UK and Trump's victory in the United States represent the reaction to the problem of the growth of the global economy. The philosophy of free trade, which should lead to a growth in welfare throughout the world according to neoclassical economic theory, has been replaced by protectionism and currency wars. For a short period, this may fuel the starving budgets of large capitalist countries, but the tariffs are actually a threat since they can easily be implemented by all countries.

Nails All Around You?

European bureaucracy still sees only one solution to the problems of the European economy — regulation. There is a saying, "If all you have is a hammer, everything looks like a nail". For the last five years, dozens of initiatives, regulations, treaties and bills have been created. There is no such science as the theory of taxation, so there is little theoretical or even practical basis behind these taxation initiatives. The simple desire of the Ministry of Finance of any country to raise taxes to feed the budget often leads to unexpected consequences.

Banks have always been an important instrument within the domestic and international economy. Performing payments quickly and effectively is crucial for international trade to live and breathe. Lines of credit are vitally important to any growing business. Every family needs to be able to deposit and save up funds in the certain knowledge that they are secure.

> Those countries that adjust and reach out to business, creating an accommodating environment, are going to prosper.

Given that a large share of the entire global economic activity is conducted via banks, tax authorities are very interested in obtaining that information. Under the aegis of fighting terrorism, their actions are tantamount to imposing the functions of tax agents on banks. According to the official narrative, offshore companies, which have always been an effective means of taking a business out of the inefficient domestic legislative environment, are now considered to be shameful.

Where will this pressure and pursuit of "grey money" get us all? The desire of tax authorities to pin businesses down and tax them to the full is logical. However, when the possibilities to use offshore instruments are taken away and a businessman is forced to name a single country, where he is living and where his business is located, and to which he pays his taxes, new factors emerge which have never been on the table. For example, which country is the most loyal to business? In which country is it best to live and retire? In which country do legislation and the court system lead to fair and socially-stabilising decisions? And, last but not least, in which country are collected taxes spent effectively and for the benefit of the public, avoiding excessive corrupt and administrative "tare and tret"?

A Shift in Priorities

In 2017, the first automatic exchange of information will take place under the CRS. The first exchange of information will primarily contain the accounts of individuals who are EU tax residents. By now, it is clear that the information communicated will not contain the promised sackfuls of money. The search for undeclared wealth continues, and in 2018, the first exchange of information about the accounts of legal entities will take place (although Russia is not participating in this exchange, because it has not signed all the necessary treaties). However, the emphasis is already shifting towards defining the competitive advantage of each country. Those countries that adjust and reach out to business, creating an accommodating environment, are going to prosper.
In contrast, countries, which keep on squeezing every penny out of their businessmen to feed ever-growing bureaucracy, are going to face stagnation and oblivion.

This is the root of the problem of how governmental bodies view businesses. Technological progress has made business extremely mobile. Just because a person with a new business idea lives in a certain place does not mean that he is going to do business there for the rest of his life. As an increasingly integral part of our lives, technology enables one to easily move a business from one place to another and from one country to another. And it is this fact that breaks the basic principles of 20th century taxation. If one is working in a small office in Hong Kong, while all the clients of this business are in the USA, where should one pay taxes? It has always been assumed that the taxes should be paid at the location of the office, but tax authorities in major markets have their doubts about the fairness of this approach.

To Be or Not to Be Good?

Anyone who has ever lived in the USSR is well aware that the simple and reflexive way how governments go about solving the problem of business mobility, i.e. by prohibiting or putting obstacles in the way of businesses or people seeking to leave, is futile.

There is another more complicated way to work that the authorities have not yet grown accustomed to, since they have gotten used to ruling, not serving. This complicated way would mean developing an offer for the entrepreneur in exactly the same way that an offer is devised for any other product to be launched on the market. To adopt this approach, the authorities need to do a lot of homework, revise their mechanism to the core and understand the needs of the entrepreneur, instead of continuing to exercise the tactic of frightening and prohibiting businesses.

Being Closer to Clients

For more than a decade, representative offices of ABLV subsidiaries have been successfully operating in various markets in Europe and Asia. The reasons for their story of success and the impact of globalization on the banking sector are explained by Mihails Ponomarenko, Chairman of the Board at ABLV Consulting Services.

Representative Offices as a Reliable Stronghold

To be closer to the client, to understand the business specifics of a particular region, to know the nuances of legislation and to provide advice to stakeholders on all areas of ABLV activities — these are the main goals of the various representative offices of ABLV Consulting Services. For most of our clients from the CIS countries, as well as Georgia and Ukraine, who work in a more risky, complex and volatile environment than in Europe, the main goal of opening an account and receiving services from the Latvian ABLV Bank is to preserve and diversify their funds. Our clients highly appreciate the bank's individual services in the form of private banking, a convenient internetbank, as well as reliable means of identification. Current clients are satisfied with the facilities and the quality of our services, and most of the new ones come upon the recommendation of clients who have already worked with us.

A Detached View of a Latvian Bank

Cooperation with a Latvian bank is now prestigious for clients from the CIS: having passed the procedure of client identification and opening an account, the bank acts as a client's guarantor in front of the entire world banking system. It is a reliable partner, and its income, business, reputation do not cause any doubts — ABLV Bank is under the supervision of the local Latvian regulator and the European Central Bank.

Our representative offices are a kind of stronghold where potential clients realise what kind of service and attitude they can expect from employees by working with ABLV Bank. The representative office specialists are ready to explain and provide consultations on virtually all the activities of the ABLV Group. Undoubtedly, first of all, on banking services, investments and tax issues. All representative office employees receive annually training from the parent company — ABLV Bank — covering such areas as client policy and acceptance of clients, products and services, changes in legislation and conditions for various transactions, including the exchange of information about financial accounts with the tax authorities of different countries, and tax residency. All representative office specialists are full-fledged experts on a number of issues related to the work of the ABLV Group.

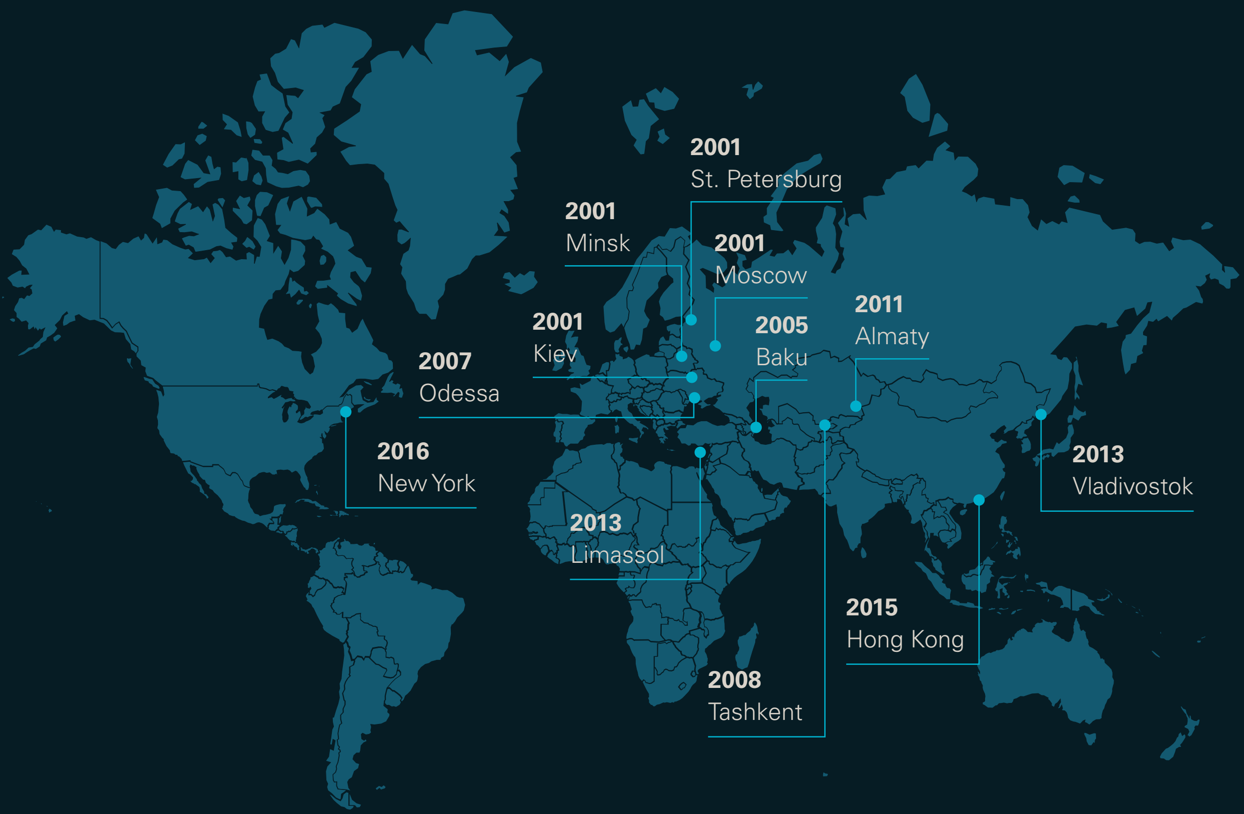
Now the globalization of the market is playing an increasing role — even a medium-size business can choose the country in which it wishes to organise production, conduct research, locate warehouses, and manage logistics.

We have never sought to rapidly expand our client base; the identity of our clients has always been important to us.

Each link in the chain — from production to consumer — can be located in its own region with its own taxation, territorial advantages for logistics and the supply of goods. Thus, many exporters of goods from Russia to Europe work with our bank, and often cooperation goes beyond simple money transfers for deliveries — customers start using other facilities: trade financing, accounting services and tax consultations.

The Geography of Our Representative Offices

At present, the ABLV Group has 12 regional representative offices. The first ones were opened a decade ago in Moscow and St. Petersburg, and the most recent — in 2016 in New York. The purpose of the US representative office is not to provide advice to potential clients, but to develop new target regions, establish mutually beneficial international contacts for the ABLV Group companies, and to study the US legal and regulatory framework.




DELL

Representatives of ABLV Consulting Services from different regions gather annually in Riga to undergo training on important banking sector issues

Representative offices of ABLV subsidiaries operate in regions where we are interested in developing our business.

Long-Time Clients Are Our Best Reviewers

One can get acquainted with the services of ABLV Bank not only in the representative offices of the group, but also through its partners — legal and consulting companies, law offices providing legal advice, accounting and audit services. This kind of cooperation began more than a decade ago with several companies that were clients of the bank and started recommending us. Over time, we acquired loyal and long-term partners working in the CIS countries and Europe. We regularly meet with each one of them, and tell about our new products. Once a year we hold a large conference, at which the management of the group tells delegates about current news, plans, and development strategies. We are the first to provide information about important issues in the field of servicing foreign clients; we maintain a dialogue and never leave questions unanswered.

Last year, the tenth anniversary meetings with ABLV Bank partners took place. The conferences organised by us and the following entertainment events have become tremendously popular among our partners. From year to year, the number of participants continues to grow — in 2016, more than 200 partners of the bank from 16 countries attended. If we analyse the topics discussed, then you will get a clear picture of the evolution of the financial sphere. Ten years ago, the issues of investment, lending, and short-term loans were the important issues of the day, but now these are the aspects of compliance, regulation, and automatic exchange of information.

We have never sought to rapidly expand our client base; the identity of our clients has always been important to us. Therefore, simple advertising is unlikely to bring us quality partners. We are recommended to our clients by experienced and professional lawyers, consultants, auditors with a good name and reputation, therefore, for our part, we provide them with comprehensive information about the bank and its services. The basis of our cooperation is trust and knowledge!

Neck to Neck With the Best

Our subsidiary bank ABLV Bank Luxembourg began offering its services to a wide range of clients in September 2013. In three years, the bank has significantly expanded its range of services, assembled a competent team of client service specialists and achieved impressive results. Aivars Rauska, Deputy Chief Executive Officer at ABLV Bank Luxembourg, reveals the recipe for success.

The subsidiary bank in Luxembourg was established in order to develop the client base and strengthen client loyalty by providing a broader range of investment and fiduciary services, as well as to attract new clients.

Among other things, the opening of the bank in Luxembourg was supposed to provide opportunities for existing clients to diversify their savings and investments in Western Europe by sending them through the bank, whose expertise and services they know very well, and which has proved its competence during the past 20 years.

ABLV Bank was the first financial institution in the Baltics to establish a subsidiary bank in one of the world's largest financial centres — Luxembourg.

The proof of the correctness of the strategy chosen by ABLV Bank Luxembourg is the fact that the assets and assets under management at the end of 2016 exceeded EUR 310 million.

Teamwork Is the Key to Success

Every beginning is hard, so ABLV Bank Luxembourg has diligently worked every day, gaining trust — first, the trust of their Riga colleagues, then that of their clients. They needed to be convinced that the services offered by the bank's subsidiary in Luxembourg meet the highest standards — on a par with those that the parent bank has been providing in Riga for more than two decades.

Client service in Luxembourg is organised in the image and likeness of the Riga model: a manager makes the initial contact with the client. After clarifying the client's risk profile and expected activities, and the services that the client wishes to use, an investment specialist helps to prepare the initial investment portfolio. Depending on the services chosen by the client, be it active investment advisory or discretionary portfolio management; further cooperation develops between the bank's specialists and the client. In the advisory version, the bank and client communicate on a monthly basis. In contrast, under the discretionary management model, the client decides how frequently communication occurs, which is at least once a year.

Our team is best characterised by its experience, self-management, willingness to find solutions for any needs of the client, as well as the desire to constantly improve skills and grow together with the bank. These employees have a twinkle in their eyes, are ready for new challenges, welcome changes and are mobile in the performance of their duties.

Relationships between team members are important to us. If there are conflicts, then the quality of service begins to suffer, which is unacceptable.

As a leader, I have an important role in the formation and maintenance of such relations within the team, which are aimed at mutual support, interest in achieving results and creating an atmosphere that promotes long-term cooperation between members of their team and the employees of other bank divisions. This becomes even more important, given that our team of 22 people is comprised of employees of 12 nationalities, which is quite typical for the multinational environment of Luxembourg.

Now the work of the entire ABLV Bank Luxembourg team is beginning to bear the first fruit of success, as a growing number of clients are increasing their initial investments, and new clients are choosing us as a reliable partner for capital management. We highly value the credit of trust given to us by our clients, partners, and the Riga private banking team.

Working in Luxembourg, it is necessary to account for the increased market requirements, corresponding to the country's status in the global financial arena. Therefore, a manager here should be akin to an asset manager, who is able to effectively balance the client's financial assets and to manage them, constantly improving his own knowledge in the field of investing. He also needs to be fluent in both Russian and English, understand which legal forms and structures of local market will be suitable for the client, familiar with the specifics of the client's activity, have a good knowledge of products and services and their pricing in order to find the most suitable solution for the client.

Although starting up in Luxembourg was quite difficult, even more exacting challenges await us in the future, when it will be necessary to ensure annual growth, which is an important outcome for both clients and the bank.

The office of ABLV Bank Luxembourg is situated both in the very heart of the city and in the centre of the European banking sector

In Luxembourg, it is necessary to account for the increased market requirements, corresponding to the country's status in the global financial arena.

More Diverse Solutions in the Range of Services

We do not try to sell clients things they do not need or understand, or whose use the client will not feel comfortable with. Such an approach is not conducive to building successful long-term relationships, especially when it comes to buying securities and creating a portfolio, with which the client might have no previous experience.

We start by determining the client's risk profile, his knowledge and experience of investing, and only then do we come up with an offer to create a conservative securities portfolio for investing in investment grade bonds and bond funds in minimal amounts. We let the client monitor the growth of the portfolio. Our task is to explain why this particular financial instrument was purchased for the client's portfolio, and what the patterns of its price changes are. In our opinion, providing the client with sufficient information is an essential element of a high quality service, because when the financial markets grow, everybody is happy, but when the value of a portfolio drops, it is important that the client is informed and understands the reasons why this is happening.

The changing environment, characterised by increasingly tight supervision, increasing price fluctuations and requirements for an acceptable level of risk, forces us to devote a lot of time and resources to developing more diverse and individual solutions as part of our services.

Our attention is mainly focused on attracting and servicing clients who wish to invest, thus trusting the bank to manage their available cash.

We started with advisory asset management and fiduciary deposits — placing clients' funds on deposit in European and CIS country banks, without the need to open a new account for the client. In 2015, we continued to engage in discretionary portfolio management.

Since we started offering these services, we have noticed that clients are increasingly choosing discretionary management. In all probability, there are several reasons for this. Our typical client is an economically active entrepreneur, who is developing his businesses, and simply does not have the time to actively manage his portfolio. Over the years, we have observed the increase of clients' trust in us, as well as their confidence that the bank will not only save, but also increase the capital that the client has entrusted the bank with.

In working with the invested funds of clients, the bank adheres to the constant principle: these funds are for capital preservation and easy access. At the moment, we are offering our clients four types of investment strategies: Capital Preservation, Defensive, Balanced and Growth.

Benoit Wtterwulghe, Chief Executive Officer at ABLV Bank Luxembourg, discussing operating issues with colleagues

Our basic private banking services are similar to those offered by most banks in major international financial centres such as Geneva, Zurich and London.

The clients have access to Lombard loans, which are loans on settlement accounts in the form of an overdraft issued against the security of investment portfolios under active advisory and discretionary management.

In addition to the aforementioned investment products, in 2016 our product palette has been augmented by new colours. Having obtained VISA Associate Membership status, ABLV Bank Luxembourg started issuing VISA Gold and Visa Gold Business cards in euros and US dollars. The design and technology of our cards are similar to ABLV Bank payment cards, including the contactless payment option.

Now the scope of our operations includes the provision of basic private banking services. They are similar to those offered by most banks in major international financial centres such as Geneva, Zurich, London, and other places around the world. However, there is one important distinction: our palette of products and services was created specifically for the target group of clients, whose servicing the bank has identified as a priority since the very beginning.

Our other advantages are clearly defined goals, a constant focus on the continuation of cooperation with clients, and the steadfast commitment to our duty, i.e. provision of high-quality services.

Our working style is characterised by the ability to understand clients and protect their individual interests. Therefore, we will continue improving our product range, expanding it in accordance with our clients' needs.

Our Employees Are the Greatest Asset

Complex trends in today's labour market pose challenges for employers not only regarding the development of the company, but also in providing additional benefits to employees. Dace Rūķīte-Kariņa, Head of the Human Resources Department at ABLV Bank, explains the importance of paid labour taxes for both employees and the state as a whole, and explains the principles behind the group's personnel recruitment.

Similar to financial markets, where everything is subjected to leading trends, the labour market also is fickle and forces you to consider various trends. Despite the fact that the unemployment situation in Latvia as a whole has improved due to employment growth, employers are increasingly confronted by a lack of qualified staff. However, the requirements of the latter for a comfortable and stable working environment are growing, along with the costs of a high-quality employee in the labour market. People are open to more favourable job offers. The coming years will be full of challenges for employers, and they need to be met properly in order to retain existing employees and attract new ones.

Such conditions are increasingly beneficial for those companies, which are following a socially responsible policy. These are the companies that pay taxes, create a safe working environment, and provide their employees with additional social protection not prescribed by any law, but which comes at the initiative of the employer, i.e. companies, which treat their employees as their greatest asset.

Banks Are Among the Largest Taxpayers

The banking sector in Latvia is one of the leading employers in the country, providing more than 22,000 jobs. Accordingly, banks are one of the main payers of wage-related taxes. The data summarised by the State Revenue Service shows that in 2016, the five largest Latvian banks paid almost EUR 67 million in labour taxes. This amount is comparable to the annual budget of the Ministry of Environmental Protection and Regional Development, and clearly demonstrates how important the annual revenues to the state budget from the financial sector are, as well as how transparent it is — the companies in this sector pay taxes in good faith, and therefore care about the welfare of their employees in the long run.

The same data indicates that our bank is significantly ahead of its closest colleagues in terms of the amount of taxes paid — almost EUR 20,000 per employee per year. The amount of labour taxes directly indicates the size of salaries, which signify the welfare of people employed in the industry, and indirectly, the fact that banks are in the "white" economy.

Regular employer contributions to the state social insurance budget provide the employee with the opportunity to use health insurance, receive a pension, sickness or childcare allowance, a disability pension, as well as an allowance in the event that he becomes unemployed.

Additional Benefits of the Employer

Employee salaries clearly play a significant role in the evaluation of the employer; however, the overall picture is also formed by a combination of elements of social responsibility — the additional employee benefits not covered in government regulations.

For example, this is exemplified by the care shown on the part of our management concerning the welfare of employees in the long term. Since 2010, a part of every employee bonus has been paid into endowment policies with a period of five years. The policy includes the accumulation of funds and life risk insurance. The amounts withheld are invested in our open funds, which are responsibly managed by our colleagues — the specialists at ABLV Asset Management.

Among the intangible motivating factors we can mention are our corporate events, which are excellent for team building. Every year we hold two events during the winter holidays — one for employees and another for their children. Both events play a big role in shaping our internal corporate culture and strengthening the sense of community. Over 800 people work in our group, but since we are territorially scattered, these holidays are a good opportunity to meet colleagues and communicate in an informal setting. The ABLV Group is represented in ten foreign countries, and almost all our foreign colleagues attend these events. For employees, it is also an opportunity to communicate with their managers outside work, and for managers — to get to know their subordinates.

I have noticed that if a company adopts a socially responsible position, employees become conscious members of society. Let us take, for example, the annual charity campaign of our partner — ABLV Charitable Foundation. This campaign is aimed at collecting donations at the end of the year, and our employees actively participate in it. Previously we held charity events in support of orphanages, and I will note that almost every Latvian orphanage has received our support.

Every member of society is welcome to participate in the charity events: our employees, customers, business partners. The amount of collected funds and the number of voluntary donors are growing with each year. A large proportion of donors are our employees.

Communication in a warm festive atmosphere unites colleagues and provides inspiration for work

The coming years will be full of challenges for employers, and they need to be met properly in order to retain existing employees and attract new ones.

Satisfaction Level Above the European Average

The degree of engagement and satisfaction of our employees with their employer is best demonstrated by surveys. To evaluate employees and their role in the development of the company, in cooperation with the leading company Kantar TNS, which is engaged in social, market and media research, every two years ABLV conducts a survey about the engagement and satisfaction of employees with their employer. The opinion of our employees helps to determine the priorities for improving the working environment and organisation of work. The latest study shows that 97% of employees are proud to belong to the ABLV Group, and consider it to be the best employer, and 99% would recommend ABLV as an employer to their friends and acquaintances. Such a high level of satisfaction significantly exceeds the overall performance in the Baltic countries and Europe as a whole, as well as the financial industry average. We do not consider the fact that since 2002, when such a survey was conducted for the first time, the level of satisfaction as a whole has remained consistently high, as a sign of stagnation, but instead as indicative of a properly functioning organism — similar to how the ideal temperature of the human body is 36.6 degrees.

For an organisation to develop, it needs different types of people. Therefore, our team consists of employees, characterised by various degrees of engagement and representing different personality types. Each type of employee has a role in the daily activities and growth of the organisation; their presence is vital to the development of the company. The main condition is that the number of employees of different types should be balanced.

Principles of Personnel Recruitment

In general, our employees are described as taking pride in belonging to ABLV. They rate the ABLV Group highly as an employer and have a high opinion about the overall reputation of the group. We feel this pride and appreciation every day: our employees actively attract new candidates to participate in the recruitment process held to fill vacancies, because they have an understanding of what kind of specialists fit into the team and will be able to work for the company successfully.

We have strong values and a stable corporate environment. Therefore, when selecting potential employees, we assess the candidate’s suitability not only for the team of the ABLV Group as a whole, but also to the specific structural unit. We carefully evaluate not only the professional qualities of candidates, but also their character traits — these are extremely important for the new employee if he or she is to successfully join the work environment and cooperate with colleagues. Only a well-coordinated team can achieve good results. Evidence of the results of this careful selection is reflected by the low staff turnover of only 5–6% a year.

If a company adopts a socially responsible position, employees become conscious members of society as well.

We are proud of our loyal employees. To a certain extent their fidelity to the company is a phenomenon. The facts speak for themselves: more than 100 of our employees have worked for the company for over 15 years, while, on average, employees spend seven years with the ABLV Group.

The ABLV Group's employees are our most valuable asset, and that is why we are extremely choosy when selecting candidates. On the labour market, we are known for our high level of requirements, but also for adequate benefits: salary, work environment, bonuses and social guarantees, etc. In addition, financial sector specialists, in whose work the bank is interested, offer a positive assessment of both the business vision and attitude towards work on the part of ABLV employees, and that is why we are able to attract eminent experts to create the best team of professionals.

We care about the professional growth of our employees. When a vacancy arises, we try to fill it, first of all, using the resources available, i. e. by organising internal contests. This is a long-term strategy, as the continuous development of personnel serves as an additional motivation for employees.

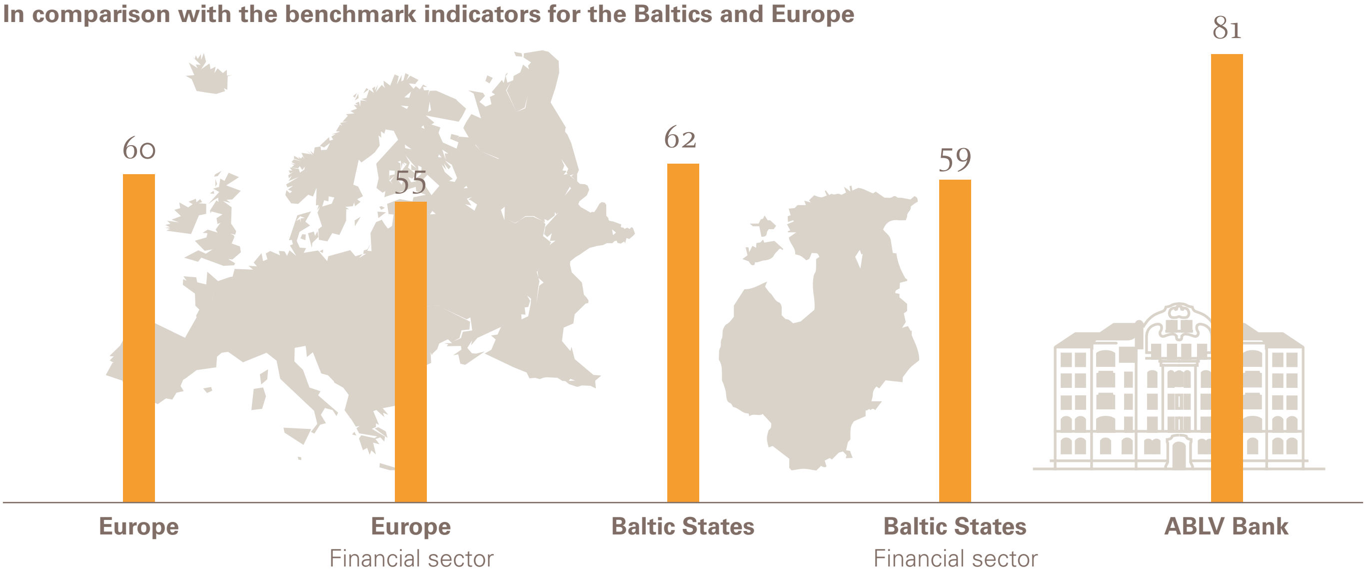
Future Prospects

The labour market is in continuous movement, demand creates supply. It is necessary to account for such factors as the demographic situation, the aging and the replacement of currently employed generations, the interaction between different generations and, of course, the general trends of the market.

Despite this, people with degrees in finance and a good knowledge of foreign languages will always be in demand. It is difficult to imagine a modern society that does not need such specialists. Therefore, I would like to emphasise that educated professionals with a positive attitude, ability to think and readiness to continually improve, will always be in demand on the labour market, and hence, within our company — the ABLV Group!

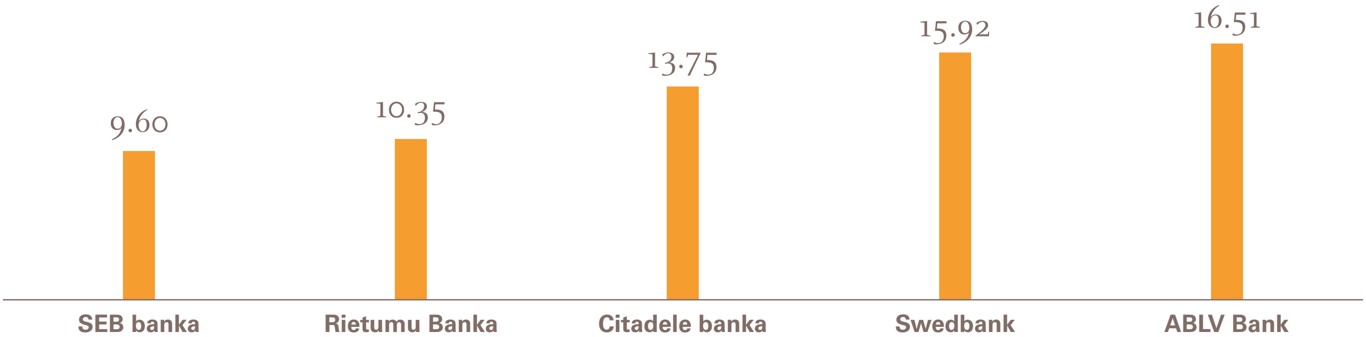
Employee Satisfaction and Engagement Index

In comparison with the benchmark indicators for the Baltics and Europe



Source: data from the latest available survey conducted in collaboration with Kantar TNS.

The Amount of Compulsory Contributions in State Social Insurance and Personal Income Tax from the Population in 2016, Million EUR



Source: State Revenue Service data.

Our Achievements and Events in Banking in 2016

Continued financing of the commercial fleet: loans of more than USD 20 million signed

As one of the key participants in the GOGREEN DHL programme, received a certificate acknowledging our efforts in offsetting greenhouse gas emissions

Became the major partner of a new event for shipowners — Riga Shipping Dinner

Expanded our experience in syndicated loans: the bank's share in concluded financing contracts exceeded EUR 58 million

The designers of the interior of our Mortgage Loans Service Department were awarded a prestigious Bronze A'Design Award 2015–2016

Total amount of assets and assets under management of ABLV Bank Luxembourg reached EUR 310.2 million

As a bank, we were ranked 2nd best employer of 2016 in the Latvian financial industry

Introduced contactless authorisation for our payment cards

Payments of up to EUR 1,000 within the Eurozone executed using our internetbank became free of charge for individuals and Latvian companies

Assisted our client in opening a hotel in Riga — Ibis Riga Centre — providing financing of EUR 4 million

The FCMC repeatedly named us among Latvia's systemically important banks

Assisted our client in building a modern warehouse and A-class office building, having issued financing of EUR 6 million

Ensured ROE of 27.26% for shareholders

Introduced new generation electronic code cards — Digipass GO 101

Our Summer Days 2016 event organisers were awarded at the Annual Latvian Event Prize 2016

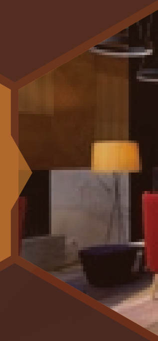
Started issuing payment cards in Luxembourg

Signed an administrative agreement with the FCMC regarding elimination of the deficiencies detected under 2015–2016 inspections

The bank's equity increased by EUR 38.2 million

Signed a long-term loan agreement of EUR 14 million with Olainfarm

Issued commercial loans of EUR 153 million for implementation of various projects



Our Input in the Development of Society in 2016

Celebrated 10-year anniversary of our long-term partner in philanthropy, ABLV Charitable Foundation

For the eighth year in a row, supported the Riga exhibition of Alexandre Vasilliev, a famous fashion historian

Took part in the third anniversary charity campaign of ABLV Charitable Foundation that raised over EUR 1 million in donations

Supported publication of Treasures of Latvia — Outstanding Export Brands and Inspiring Talents edition

For the eighth year in a row, held the ABLV Invitational Golf Tournament for clients, partners and employees

As a part of teambuilding, took part in bank tournaments and finished 1st in football and 2nd in basketball and volleyball

Helped approximately 258 people by holding the first ABLV Blood Donor Day in the history of the group

Took part in the Baltic Real Estate Leaders Forum 2016 conference for real estate experts

Started offering a card account and payment card to our clients' children from the age of seven

As a group of companies, we paid a total of EUR 22 million in taxes to the state budget

Profit amounted to EUR 79.3 million

Our Achievements in Investments in 2016

Issued ABLV Bank bonds in the amount of USD 225 million and EUR 80 million

By the end of 2016, assets of ABLV Capital Markets clients were invested in financial instruments worth a total amount of EUR 1.27 billion

Launched a service arranging bond issues for the clients

Improved management of the Forward currency exchange transactions portfolio

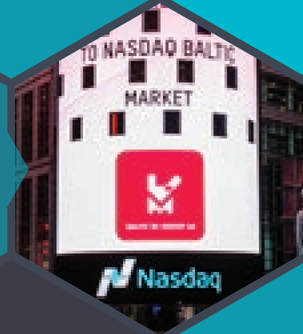
By the end of 2016, 21 issues of ABLV Bank bonds of total amount exceeding EUR 650 million were in public hands

Celebrated the 10th anniversary of ABLV Capital Markets and ABLV Asset Management

Consulted Citadele banka on issuing subordinated bonds and became an underwriter for EUR 20 million

Expanded our range of investment products by QTrader with direct access to the leading futures stock exchanges

Arranged a bond issue for Baltic Re Group, a real estate company



By the end of the year, the total amount of mutual funds under ABLV Asset Management exceeded EUR 125 million

Milestones of the Pillar Group in Real Estate in 2016

Founded a new investment company which has already purchased some profitable real estate objects

Supported the Annual Latvian Architecture Award for the fourth time

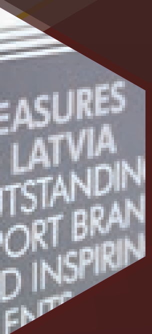
Closed more than 200 real estate deals worth a total amount of EUR 12.9 million

Launched the first stage of development of New Hanza, a finance and leisure centre

The Miera Park House project was recognised as the best new residential building at the Latvian Construction Industry Annual Award 2015

Obtained a permit for construction of the new ABLV Bank headquarters building

Our Achievements in Advisory Services in 2016



Opened a representative office for one of the ABLV Group companies in the USA

Took part in the Intax Forum Ukraine 2016 conference on asset structuring

Held the ABLV Group: Gateway Between Europe and Asia conference in Hong Kong in connection with the opening of a representative office there

Launched accounting services in new jurisdictions: Hong Kong, UAE, the British Virgin Islands, etc.

Took part in the Intax Expo Russia 2016 conference to discuss changes in international legislation

Who Drives the Organisation?

Timurs Čžou, Senior Human Resources Manager at ABLV Bank, classifies types of employees, characterises each of them, and presents the staff structure of the ABLV Group.

People make an organisation. Each person is a personality with a combination of traits he or she can be characterised by. Nevertheless, while merging in a working flow, individual traits create a general background characteristic of the particular organisation. This background may contribute to the development of the organisation or have a destructive influence on it. Researchers and practitioners wonder about special types of employees whose presence either strengthens the company or undermines its development.

Numerous such classifications of employee types exist: from naively subjective, for example, dividing up their employees according to their zodiac sign, to research-backed ones, received as a result of methodologically correctly organised studies.

Explore Yourself

ABLV in collaboration with Kantar TNS, the leading social, market and media research company, conducts regular surveys for the purposes of studying the attitude of employees to work and work conditions. The methodology being used, apart from standard measurements of the degree of satisfaction with different aspects of employment, allows us to distinguish between four types of employees characteristic of any company: *drivers*, *critics*, *residents* and *detached*.

Drivers are characterised by their high loyalty to the company, faith in the company's competitiveness, explicit wish to demonstrate initiative and cooperate, as well as to help and inspire colleagues.

Critics, as the name of the group indicates, are critically disposed and are therefore difficult to control, but they are interested in their individual professional development — and although they believe in the company's competitiveness and are ready to throw their weight behind changes, they will move to another organisation if they get an interesting proposal. Nevertheless, *critics* are an important resource of an organisation, because they have potential, which the company may use, if it gives *critics* a possibility to fulfil themselves. In this case, they may be reclassified as *drivers*.

Residents are satisfied with their employer and their work, which do well, but need guidance, because they do not demonstrate any particular initiative, appreciate stability and reliability and have a generally stabilising effect on the company.

Detached employees do not feel they have a connection to the company, are dissatisfied with important aspects of employment — its content, colleagues, work conditions and so on, and are a source of a negative microclimate. At the same time, the dissatisfaction of *detached* does not mean that they attempt to actively change their employer, and in this respect, they differ from *critics*. Colloquially speaking, a *detached* employee may exert an unsettling influence, exuding negativism, but at the same time being passive and unable to foster constructive decisions, when offered the chance to take the initiative.

The Formula for Success

Proportions of the aforementioned types of employees are important for the successful functioning of the company. It is assumed that an optimal relationship of *drivers* and *critics* is about 2:1 — two *drivers* per *critic*, making the team sufficiently dynamic. Furthermore, both of these groups must make up about 1/3 of the total number of employees. If there are more *drivers* and *critics*, the team becomes hard to control — the wish of *drivers* to implement something and the wish of *critics* to change something may interfere and disrupt the planned changes.

As *residents* and *drivers* together make a wing of satisfied employees, it is important to have two thirds of them in relation to dissatisfied employees. In regard to the combination of *residents* and *drivers*, the following ratio is quite productive: 2/3 — *residents* and 1/3 — *drivers*.

The number of *detached* should not exceed 1/3 of the total number of employees. Otherwise, work in the company will be paralysed and any endeavour will be ruined.

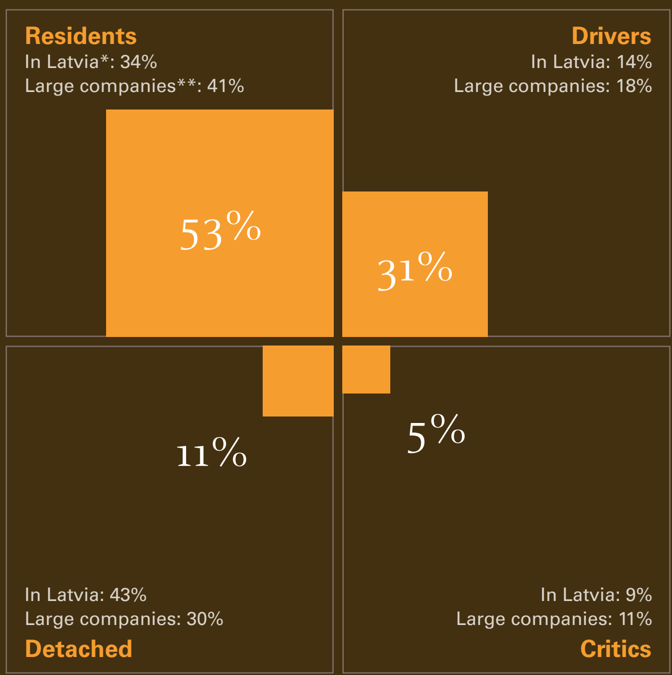
The Microclimate at ABLV

What do we get from surveys conducted at ABLV? The number of satisfied employees representing *residents* and *drivers* amounts to 84%, and these exceed the recommended level of 66%.

Detached employees make up 11% of personnel, which is considerably below the upper limit of the recommended level. It is impossible to completely avoid *detached* employees, and in this case the available number of this type of employees is acceptable. One third of employees in the group are *drivers*, ensuring excellent prospects for development, and just 5% are *critics*, providing evidence that colleagues highly support the ongoing processes.

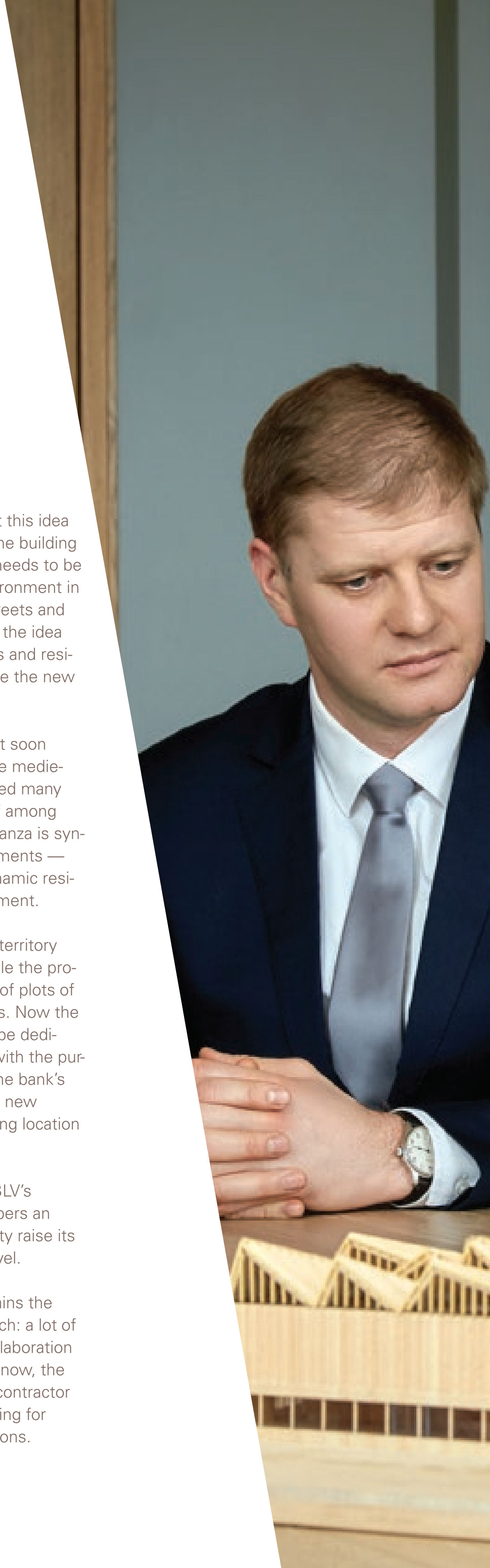
So, who drives the organisation? Half of all the staff are honest hard-working people who know their job well. A little over one third are inspirers and initiators of good things and positive changes. There are voices of dissatisfied sceptics among them, which it would be good to hear. And the small number of *detached* employees just have to think about whether some changes are needed. After all, it is said that the grass is always greener on the other side of the fence.

Results of the ABLV Staff Engagement Survey Jointly Conducted with Kantar TNS



* The results of the latest available survey of employed population in Latvia.
** The indicator, included data on the following major companies: ABLV, Accenture Latvija, airBaltic, Citadele banka, Lattelecom, Latvenergo, Latvijas Mobilais Telefons (LMT) and Latvijas Valsts meži.

New Hanza: the Latest Stage of Riga's Development



Years of preliminary works having been completed, construction of one of Latvia's biggest ever private property development projects, the New Hanza district, is now gaining momentum in Central Riga. What is it going to be like? What deep sense does it possess and when will it be completed? Ieva Valtere, Chief Executive Officer at Pillar Management and Jānis Lāčaunieks, Chief Executive Officer at Pillar Contractor, the general contractor, answer these questions and talk about the unparalleled tasks, in Latvian terms, challenging them in the development of this grand project.

Every new construction project has a story — some are epic novels, others are short stories. In regard to New Hanza, it is safe to say that it is a novel that will eventually turn into a bright and epic legend.

The developer of New Hanza — Pillar — is an ABLV Group company. "The bank's owners first took an interest in the plot of land in the centre of Riga (between Pulkveža Brieža Street, Hanzas Street, Skanstes Street and Sporta Street — editor's note) almost 15 years ago," recalls Ieva Valtere. "Even then, the management was already building a long-term strategy for the bank's development and they realised that in future they would need a large building to house all the employees of a growing financial organisation. Therefore, they decided to build the bank's new headquarters here."

The more they thought about this idea the more they realised that the building cannot stand alone there. It needs to be surrounded by a thriving environment in the form of infrastructure, streets and public buildings. So, they got the idea to create a full-scale business and residential area that is going to be the new landmark of Latvia's capital.

The name for the new project soon followed: it is named after the medieval Hansaetic Union that united many European trading cities, chief among them Riga. The name New Hanza is synonymous with Hansaetic elements — trade and finances, and a dynamic residential and business environment.

The first plots of land of that territory were purchased in 2003, while the process of forming the portfolio of plots of land took more than ten years. Now the group owns 23 ha of land to be dedicated to New Hanza. Along with the purchase of new plots of land, the bank's plans were supplemented by new details regarding this promising location in the centre of Riga.

In developing this project, ABLV's management has set developers an ambitious task: to help the city raise its international role to a new level.

The scale of the project explains the long wait for its physical launch: a lot of time was spent on detailed elaboration of the conceptual idea. Even now, the units of Pillar — the general contractor of the project — are still looking for interesting and optimal solutions.


Residential
101 Hotel Rooms

Now we can surely say that the New Hanza project has moved on from being a vision on paper to actually being implemented, can't we?
Jānis Lāčaunieks: Most definitely. The reference point of the actual works on the construction site of this future Riga business centre is 4th July 2016, when we started preparations for the first stage. In this phase, we're going to create part of the infrastructure including laying the necessary utility lines: rainwater drainage system, water supply and sewage system, as well as heating and electricity supply lines. Construction began with the building of the district's inner streets. By the end of the last winter, we managed to complete more than 65% of all infrastructure works planned for the first stage. Stage one is due to be completed during Q3 2017.

Under the first stage of infrastructure, we built a rainwater drainage system on a scale unprecedented in Latvia — the water is going to be collected under the future area of park. A pumping station will help to eliminate large puddles even in the event of torrential rain. An important part of the rainwater drainage system is a water reservoir of 13,000 m³, which amounts to 13 million litres. This water engineering construction is managed by LNK Industries, and as I've already mentioned — it's the first project of its kind in Latvia.

The total costs of this particular stage are going to come to about EUR 9.28 million. Moreover, by spring over EUR 30 million had already been invested in New Hanza including the costs of purchasing the plots of land and design work.

Ieva Valtere: Everything the companies of the Pillar Group — general contractor Pillar Contractor and architect firm Pillar Architekten — are working on now is just a preliminary stage before the construction of the first buildings. At the same time, we're continuing to design other new buildings, forming an effective professional team that is going to undertake the implementation of New Hanza for many years to come.

Naturally, at this stage of development, the key task for the last year was to build up a professional team to manage the construction and designing processes. So, last year 20 new specialists joined our team, and now we're in position to carry out all stages of the development of this project on our own.

What functions have been entrusted to Pillar Contractor?
J. L.: ABLV's management considered it to be prudent to retain all key control and implementation functions of the project in its own hands. Therefore, we created subsidiaries Pillar Contractor, Pillar Architekten and the utility services company Pillar RE Services in order to provide a complete range of professional services. As a result, we manage the construction, we're the general contractor, we supervise the designing process, and monitor execution of the work.

I. V.: And later on, we're going to undertake the maintenance of the complete buildings as they are commissioned.

By now, there are more than 30 people directly involved in the New Hanza project, while the Pillar units employ a total of about 60 people. The team is going to grow: in 2017, we're planning to hire more designers and professionals with wide-ranging experience in construction. This year we're going to start constructing the first buildings in the area.

Which buildings are going to be completed first?
I. V.: The first building to be completed is going to be the new headquarters of ABLV Bank, plans for which actually prompted the creation of the entire area.

The ABLV Bank building is going to have 16 floors with a distinguished lobby, comfortable client service area, working area and rest areas for about 900 employees.

The second building in this area is going to be a 6-storey A class office building. It's going to have a BREEAM certificate, certifying that it's sustainable and environmentally-friendly. We're going to offer vacant premises in this building on the rental market, because offices of this type in Riga are in short supply. It is worth noting that the building is designed to have green roofs available for employees. Construction could take 3–3.5 years.

Our estimates show that we're going to build about 50,000 m² of space during the first stage of development of New Hanza. This figure includes also a huge underground car park spanning almost one hectare.

However, before that, we're going to put another first stage object into use — the newly renovated former goods station.

Upon completion of the large-scale renovation, the station is going to take on a new lease of life as a unique multifunctional centre perfect for holding various festive events or exhibitions. The building is going to be renovated according to the conceptual design by architect Reinis Liepiņš of the Sudraba arhitektūra architects' firm. In accordance with his vision, public events held in the building are going to take place in a unique historical atmosphere.

Latvian art lovers have their own reason to be impatient about the implementation of New Hanza. They are looking forward to the construction of the Latvian Museum of Contemporary Art — the jewel of the area and the first building of its kind in the modern history of Latvia. What is the progress of this part of the project and how did you come up with the idea to create it?
I. V.: ABLV Bank has been in close partnership and patronage relationships with the Ministry of Culture for years.

And the idea of creating a place for the collections of contemporary art in Latvia has been mooted for quite some time now. The idea of a museum belongs to the owners of ABLV — the philanthropists Ernests Bernis and Oļegs Fiļs. It was a vision shared and supported by two other famous Latvian philanthropists Boris Teterev and Ināra Tetereva, who expressed their wish to take part in this good deed. Accordingly, it was decided to build the museum in the most appropriate setting, i. e. New Hanza.

According to the agreement concluded between the Latvian Museum of Contemporary Art Foundation and the Ministry of Culture, the Latvian Museum of Contemporary Art is going to open its doors by 2021. An international design competition has now been held to pick the conceptual exterior of the building. The competition was won by the British architects' firm Adjaye Associates, which applied in collaboration with its Latvian partner AB3D.

We can assure you that the museum is going to be one of the most iconic public buildings in Latvia in terms of architecture and technical specifications. Sir David Adjaye's firm has great experience in the execution of such projects. One of their latest creations is the National Museum of African American History and Culture in Washington, D.C.

Adjaye Associates are true global stars in their field. And the Latvian Museum of Contemporary Art is going to be a jewel in the architectural crown of our new area — its monumental exterior will immediately catch the eye of each and every visitor, not even mentioning the masterpieces of art that are going to be displayed there.

What other buildings are going to be located within the territory?
I. V.: The conceptual plan is to locate the business part of New Hanza closer to Pulkveža Brieža Street. While in the very centre of the area, we're going to create a park spanning about 1.5 hectares. On one side of the park will be the Latvian Museum of Contemporary Art, while on the other side we're going to build residential buildings.

We're proceeding slowly with the residential buildings, because they aren't on our list on priorities. Generally speaking, the residential part of New Hanza is going to look like this: first of all, there is going to be a residential building with a dynamic and active profile containing about 100 business class apartments. The idea for this building was developed by architect Uldis Balodis of Vizuālās modelēšanas studija (Visual Modelling Studio — editor's note), while the development of an appropriate construction project has been assigned to Pillar Architekten.

The first stage of works at New Hanza — laying utility lines

The second building is a premium class residential building. It's also going to contain about 100 apartments. The idea for this particular building was conceived by Juris Mitenbergs of the AB3D architects' firm, which is also going to develop the construction project.

I would like to reiterate that we're going to start working on the residential buildings no earlier than 2019, in order to complete them along with the construction of the office buildings.

In addition to the aforementioned plans, it's planned that New Hanza is going to host other offices, a hotel and a preschool facility.

Are you going to implement everything planned in full?
J. L.: There isn't a single construction in the world that hasn't changed in some way, manner or form during the course of work. However, in regard to the first stage of construction we're now focused on, it's going to be implemented completely. Naturally, as we move forward, the project is going to acquire new details.

I. V.: If you ask about the precise terms of completion of New Hanza, I wouldn't dare to set the date now. To a great extent, it depends on the economic situation in Latvia and globally. Despite that, taking into account the amount of investments and the funds being applied right now, there can be no doubt about the seriousness of our intentions.

Can you provide estimates of the financial volume of the entire project?
I. V.: Highly approximately. According to our calculations, by now the construction costs of the office buildings range between EUR 1,000 and EUR 1,500 per m^2. What the numbers are going to be in two or three years is still open to question. Moreover, the technical specifications of all buildings aren't available yet, therefore we can't assess the complexity of the work to be done.

According to the detailed planning we have now, we can build up to 225,000 m^2 of commercial premises and about 115,000 m^2 of residential premises in the New Hanza district. With these numbers, one can easily conclude that the budget of the entire project is going to exceed EUR 300 million. It's a huge project indeed: even if we take the new streets — they're going to be seven of them — they are going to take up almost five hectares in total. Now we're coordinating the names of the streets. Usually this is up to the city authorities, but we decided to offer our ideas.

We hope to honour outstanding Latvians by naming streets of New Hanza after them.

3D models of residential buildings and the ABLV headquarters that are going to appear at New Hanza very soon

We hope to honour the names of outstanding Latvians by naming streets of New Hanza after them.

Our application includes a proposal to name the streets of our area, for example, in the name of Mihails Tāls, a world chess champion, Gustavs Klucis, one of the creators of colour photomontage, Oskars Stroks, a composer who was proclaimed king of tango during his lifetime, Aleksandrs Laime, a naturalist who measured the Angel Falls — the highest waterfall in the world — and named the river it's located on… Those are some of our ideas, which we expect the authorities to approve.

There is a lot of work ahead, but we aren't afraid of that. Above all, we realise that every big modern city needs its own business centre. And we're glad to have the honour to be instrumental in its creation.

The New Hanza district is meant to be a totally autonomous place, complete with everything required to work and live there: from kindergartens and residential buildings to restaurants, cafés and workplaces. It's going to be a unique area in Riga with a homogenous environment that blends in well with the modern Skanstes area.

So you believe that Riga can become the new business centre for the Baltics?
I. V.: Of course! Yet one should understand that the city also has a lot of work to do. Unfortunately, in terms of attracting foreign businesses, our neighbours Tallinn and Vilnius are way ahead of us. But we're glad that Latvia has entrepreneurs who are ready to work on attracting the back-offices of foreign companies, foreign call centres, and representative offices here.

Riga is quite capable of becoming a North European metropolis, but it isn't going to happen overnight. There are certain obstacles that prevent it from developing at a faster pace: human resources, poor legislation and a lack of government support.

Any foreign company ready to shift its units to Latvia wants to be sure it can recruit well-rounded specialists. The lack of such specialists is one of this country's current weaknesses. We're witnessing a paradox here: unlike other countries, here the communication and cooperation between employers and higher education facilities is rather poor. Now we're involved to certain extent, because we're building an office that is going to need its tenants. We're trying to optimise the entire process by meeting employers and their employees to get a better understanding of the profile of our future tenants.

Yes, one could say that in some sense, it's a non-core activity for us, but at the same time this is a way to fill our future office buildings with tenants. Vilnius is presented excellently on foreign markets, and Riga should follow in its steps. As they say, you just have to keep putting one foot in front of the other. And Pillar sticks to this saying — New Hanza project will be completed!

The Art of Combining the New and the Verified

One of the postulates for our work is an individual approach to our clients' needs, which we try to observe, when introducing technological innovations at ABLV Bank. All innovations should be not only modern and convenient, but also tried and tested, ensuring the reliability of relationships with our clients. Sergejs Mazurs, Head of the Product Development Division at ABLV Bank, tells us about this paradox — the ability to combine the new and the verified.

Which recently introduced solutions and technologies are the most important?
Naturally, it's impossible to single out a specific product. The world is in a state of flux nowadays — in a way, we're trying to be ahead of our time, and to meet all needs of our clients. I'm not saying that we're in a hurry to introduce everything new — this is off limits from the point of view of security, but as we keep our finger on the pulse of state-of-the-art solutions, we introduce the very best in double quick time. For example, unlike simple code cards with reusable values, Digipass GO 101 electronic code cards ensure much better security, while their physical appearance is practically the same. Judge for yourself: the size, width and weight of the Digipass GO 101 are almost the same as those of a standard credit card.

This means that your clients almost never experience a situation in which they can't use online banking services, because they forgot their thick and uncomfortable calculator in the office.
There's more to it than that! Technologies don't stand still; in a way it's worth noting that GO 101 occupies space in your wallet. Now there is also a mobile Digipass, which, like any other software, weighs nothing at all. It's integrated into the latest version of the ABLV mobile internetbank for Apple tablets and phones, and you just have to remember a short PIN to use it. Incidentally, you can use the mobile Digipass offline to log into your internetbank on your computer.

Do you mean that clients can simply forget all those cards and calculators?
Software-based authorisation is certainly more convenient in daily work. Electronic code cards and calculators have already become an extra, backup means of accessing online banking. For security reasons, I wouldn't recommend forgetting about them completely. You can keep them at home or in your office, because they will be indispensable if you break or lose your phone.

How are new means of authorisation introduced?
Any new means of authorisation in the area of online banking, in particular, must be beta tested. Everything starts from the concept, from a blank sheet of paper — we evaluate the viability of the technology, and develop its deployment project. Next, it's tested and a pilot is run on a limited group of clients. And only when we've collected and processed feedback, when we're sure that all the necessary changes have been introduced and the technology itself has received our clients' support, do we start its implementation on a large scale.

Is the bank planning to introduce the increasingly popular electronic signature?
We're studying the implementation of the electronic signature in all the countries, where our group is represented. Almost every country has a law on the electronic signature; a body issuing the signature, which, in fact, will enable us to introduce remote account opening by any client in the future. In fact, there is no need to meet someone in person to open a new account when we can confirm his or her identity remotely. However, there are some nuances — specific tools used for the implementation of the digital signature vary across countries and are incompatible. For example, Latvia has an eID, a plastic chip card, and I don't think that it's very convenient. You need a reader; you should have it with you, connect it to your computer, and insert the card into it… So far, I haven't seen convenient solutions for phones either. This means that the use of eID is limited to computers. Yes, if these cards could be virtualised like payment cards, for example, when using Apply Pay, or when they become virtual, then their use will be more convenient and justified.

Hypothetically, could such a solution replace code cards and calculators on a national level?
I doubt it. For a bank, third party decisions, even official ones, are less conducive than its own means of client authorisation and authentication, because the validity of the document, certificates, operational performance of algorithms, the quality of product implementation in case of eID are out of our control and may have an unpredictable influence on the quality of client service. In contrast, we need to ensure that our clients can use internetbank in 24/7 mode.

What about vice versa? Lately, bank authorisation is being increasingly used for different services on the internet. Are you planning to propose a similar service for your clients?
As the bank is constantly offering new services, the need to interact with external service providers, including national ones, is increasing. We're considering such a possibility, but only in the context of the bank's services, in order to make it more convenient for our clients to interact with different national authorities, for instance.

All innovations at the bank are beta tested before their implementation

You just have to remember a short PIN to use the mobile Digipass.

One of the innovations in the internetbank, which is also aimed at increased convenience of use, is the possibility to manage the accounts of several clients at the same time. How does this work?
A client's representative, authorised to contact the bank on behalf of the client, is also entitled and able to become an internetbank user. If one person represents the interests of several clients at the bank, he is now able to connect each client's internetbank to his profile. Thus, multi-client access is ensured. It's important that if a representative has the right of access to an account, he can merge them on his own internetbank account and use one user profile to work with all accounts, which means one password, code calculator, etc. Indirect costs are thus reduced and managing several accounts becomes much easier.

Can several users work together with one client account?
Yes, our internetbank enables an unlimited number of users to work with one account, providing registration, history of actions — who signed what and when, who created, edited or sent a payment order, whether an additional signature is required, etc.

So, to a certain extent, the bank acts as a controller, which makes it possible to avoid mistakes and misunderstandings within a client's organisation?
You could say that. We also offer multilevel signature functionality, ensuring control of mandatory interaction between up to three client's representatives. Let's say, a chairman of the board and another board member should sign all documents together. In this case, ABLV not only enables connection of additional users to a client's profile and management of each of their individual rights, but also ensures the control of transaction confirmation, making sure that the transaction is signed by two representatives. Thus, the rights of authorised persons fully match the rights specified in the Register of Enterprises.

It seems that security is no longer an issue, doesn't it?
You must always think about security and your actions. For example, scams sometimes manage to mislead a client and make him transfer money to them. We have a Payment Card and Internetbank Transactions Supervision Department to tackle this. Employees notice financial behaviour, which isn't characteristic of a client, for example, when he attempts to make many small payments. Or, to the contrary, atypically large transactions are made. Thus, we frequently, at least, manage to caution the client against his own mistakes. If these actions are committed as part of a scam, his activity will be discontinued. Two types of monitoring can be emphasised — online and offline monitoring. The latter is used post factum, when the transaction has already been performed. There is also proactive monitoring. If any payment seems potentially suspicious to us, we start asking questions.

What is the most common type of fraud?
Probably, replacement of payment details, as a result of which, the client willingly transfers money to another account. Our system recognises that previous transactions with the receiver used other payment details; therefore we contact our client via an alternative communication channel and make sure that the payment is correct, how the client received the new details, and help to determine whether this has been a fraud. At first, clients considered this method to be somewhat intrusive, but eventually the service took hold. It has helped us to prevent fraudulent transactions worth almost EUR 2 million! Therefore, today we initiate a check through the second channel for most payments selected according to certain criteria.

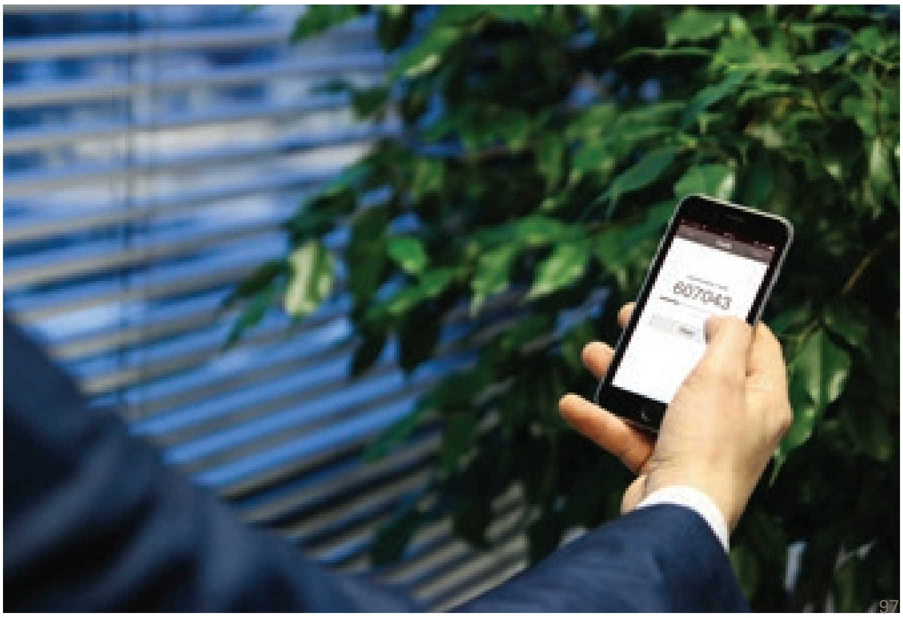
Does this mean that you contact your client to confirm the payment?
Yes, if the client has prepared a payment online via the internetbank using details, which weren't used before, we'll contact him — for example, by phone to confirm that this payment is bona fide. We use a phone connection in this situation, because if a scam has taken hold of the client's internetbank, he'll be able to confirm any request from the bank. Although we don't check all the payments, and the work is tedious — it's nevertheless valuable and our clients appreciate this. Thus, we realise that technologies can't resolve everything — they are good for performing certain tasks.

I'll share two real stories for illustrative purposes. Back in 2003, the fast fashion stores of one of the largest international networks still worked on floppy disks; yes, the very same floppy disks. With these floppy disks they collected information from cash registers about goods sold in shops during the day and transferred them to their Spanish headquarters via modem. This process had its own restrictions — one shop couldn't know what the other shop had, but this system was stable and made it possible to achieve the main goal. Since this shopping network has a quick turnover and models constantly change, it's totally pointless asking whether they're going to have some dress in a week's time — such predictions are impossible. At the same time, to the detriment of information technologies, the company invested most of its funds in shop design — shelves, lamps, and shop windows, in order to make clients feel comfortable. Despite the fact that they fulfil their set function, technologies are invisible to customers.

Since the introduction of proactive monitoring, it has helped us to prevent fraudulent transactions worth almost EUR 2 million.

And I'll give another, completely opposite, example. Another international fashion brand opened a superstore in New York at about the same time, where all the goods had their own radio labels making it possible to constantly keep track of the location of each specific thing, the availability of specific colours, sizes, etc. They built glass fitting rooms, which became dark or transparent at the push of a button. They also had electronic panels, which the customer could use to ask for a product of another size. However, there were problems in the first weeks following its opening — information about the location of products was delayed, buyers moved products faster than the system could keep track of them. Therefore, shop assistants were unable to find clothes of other sizes. Children thought that the electronic panel in the fitting room was just a game. And, to top it all, many customers thought that, at the push of a button, the fitting rooms became transparent from one side only.

Therefore, we hold the opinion that technology must strictly pursue a specific goal, and as long as this goal is met, there is no need for radical changes. The more complex the technology, the less stable it is.



Faster, more comfortable, more reliable — our clients have already appreciated the benefits of the mobile Digipass

Charity: a Decade of Work

ABLV Charitable Foundation, the major partner of the ABLV Group in philanthropy, was founded 10 years ago by philanthropists Ernests Bernis and Oļegs Fiļs. Zanda Zilgalve, Chairperson of the Board at ABLV Charitable Foundation, talks about the development of the foundation, as well as its achievements and future plans.

Any charitable foundation is based on an impulse to do good, and a sense of responsibility for the environment and the society we live in. This is what ABLV Charitable Foundation is guided by. We support creative people and organisations that contribute to reaching our ultimate aim — the creation of a united, safe and wealthy community.

Our founders, the philanthropists Ernests Bernis and Oļegs Fiļs, are entrepreneurs who plan, set goals and carefully analyse every situation and event before investing their money in any project. They also apply these principles to philanthropy. Since day one, we have paid special attention to the social and ethnical integration of the society, children and youth, support of culture and arts, development of education and civic society. All this has evolved into the four main work directions of the foundation: Children and Families, Contemporary Art, Education and Urban Environment.

In order to provide a better understanding of the results achieved during the past decade, here are some figures. To date, the foundation has supported about 300 various projects to which it has allocated financing of about EUR 3 million in total. We have invested about EUR 800,000 in children and families support programmes; contemporary art projects have been provided with about EUR 600,000;

Last year, every fourth citizen of Latvia was affected by the foundation's work, while virtually every citizen in the country has heard about its achievements!

education programmes have been supported in the amount of EUR 230,000, while urban environment development projects have received more than EUR 800,000. In addition, other projects have also received support. By the end of 2016, the foundation's assets amounted to EUR 6.3 million.

Year after year, more and more people get involved in the activities of the foundation, and spread the word about the organisation. Our estimates show that in 2016 the foundation's work has directly affected at least 470,000 people, while more than 2.2 million people were related to it indirectly. This means every fourth citizen of Latvia was affected by the foundation's work, while virtually every citizen in the country has heard about the organisation's achievements!

One of the Biggest Charitable Foundations

In the ten years of its existence, ABLV Charitable Foundation has evolved from an art support foundation to one of the biggest and most popular charitable foundations in Latvia working in the four aforementioned directions. Every direction has several programmes, for example, the Children and Families direction includes two major programmes: Let's Help Them to Hear! and Let's Help Them to Grow Up!, while under the Urban Environment direction, the New Riga programme was launched, which is aimed at establishing the Latvian Museum of Contemporary Art.

It should be mentioned that the creation of our foundation is closely related to the agreement on forming a collection for the Latvian Museum of Contemporary Art amounting to EUR 1.4 million, which was concluded in 2005 between ABLV Bank, then known as Aizkraukles Banka, and the Ministry of Culture. ABLV Charitable Foundation has been creating and servicing the collection for the museum, as well as contributing to the development of contemporary art in Latvia ever since it was first launched.

A year later, to augment the direction of arts, we launched a second direction, a social one, under which a programme Let's Help Them to Hear! was founded. It is still highly relevant — we continue to improve the quality of life of children with impaired hearing by providing them with high quality digital hearing aids. In the years since our partnership was first formed, we have proven to our partner that we are a reliable and transparent organisation, which has enabled us to provide one of the best hearing aids in the world to Latvian children at the cost of production. Given that applying the most advanced technology to the production of such hearing aids makes them very expensive, it is a rare family that is able to buy one for their child upon a doctor's recommendation.

In ten years, ABLV Charitable Foundation has evolved from an art support foundation to one of the biggest and most popular charitable foundations in Latvia.

Most of the funds for this programme are annually raised under the Christmas Charity Campaign, although we always remind potential donors that donations can be made throughout the year.

Thanks to the employees, clients and partners of the ABLV Group, as well as other donors who are deeply touched by the aims of the programme, the amount donated is growing every year. Moreover, the foundation is doubling the donated sum raised under the said campaign from its own funds. Nine years of dedicated work has helped us reach the point today, whereby thanks to the donated funds, we are now in a position to provide hearing aids to all children with impaired hearing in Latvia. This amounts to about 100 children a year, while the amount allocated to meet this aim is EUR 180,000 annually.

Thanks to the great response from donors, the high quality hearing aids presented to the children under the relevant programme help them to hear, which means better development of speech, and accordingly better integration into mainstream schools in future, better chances to learn languages and the profession of their choice, ultimately making them more competitive on the labour market.

A lot of effort goes into the creation and development of the programme Let's Help Them to Grow Up! Under this programme, we contribute to the development and integration of socially vulnerable children, support children and parents from low-income and poor families, as well as children with chronic diseases or risk group families from all around the country by giving them the chance to attend developmental and educational daytime or overnight camps. With the support of the foundation, over EUR 300,000 has been spent during the past five years to make it possible for more than 4,000 children and their parents from families at social risk to gain new experiences at 144 camps specially devised to meet their needs.

As I have already mentioned, originally the key purpose of creating the foundation was contemporary art, therefore throughout the past decade, ABLV Charitable Foundation has supported various exhibitions and events in this field. Since 2015, the foundation has been the main partner of the Latvian Pavilion at the Venice Biennale. Over the years, we have co-financed more than 80 contemporary art projects to the amount of more than EUR 600,000.

Notably, in September, to celebrate its 10th anniversary, ABLV Charitable Foundation organised an international symposium in Riga, Cross-training: 10 Exercises to Shape a Museum. The event invited participants to share their

To celebrate its 10th anniversary, ABLV Charitable Foundation organised Cross-Training: 10 Exercises to Shape a Museum, an international symposium consisting of lectures, discussions, presentations and workshops

insights regarding the Latvian Museum of Contemporary Art emphasising its potential to participate in art events on an international scale, as well as to become a tool of cultural and historical memory in our region. Among the guests were numerous leading specialists such as Katerina Chuchalina, a curator of Leonid Mikhelson's V-A-C Foundation, Grazia Quaroni, Director of the Collections of the Fondation Cartier pour l'Art Contemporain, Dace Melbārde, Minister for Culture of the Republic of Latvia, and many others.

Another important direction of the foundation's operations is the Education programme, under which we nurture and promote society's understanding of contemporary art. For example, in 2013, ABLV Bank arranged …for an occurrence to become an adventure..., an exhibition, which showcased contemporary art objects in the bank's collection for the forthcoming Latvian Museum of Contemporary Art. Specially for this exhibition, the foundation devised an interactive game for high school pupils to introduce them to contemporary art. Every Latvian school whose pupils tried them found the exhibition's educational games to be very interesting, and the games are still popular. You can find them and play them on our website www.ablv.org. Meanwhile we continue to support cultural and educational events, conferences and journalism projects every year.

In the run-up to the planned opening of the Latvian Museum of Contemporary Art in 2021, the foundation is going to keep informing the museum's future audience about the events in the world of contemporary art in order to stimulate their interest. We want to make the Latvian Museum of Contemporary Art the most visited museum in the Baltics.

Since 2015, we have also been involved in projects supporting civic improvements of Riga and the central part of the city. We called this direction Urban Environment, and under its auspices we are working on the development of socially significant projects that will improve the city's aesthetic and cultural surroundings, as well as contribute to a safe and comfortable environment.

Under this direction, we have supported the renovation of Riga's biggest interactive fountain in Kronvalda Park. Moreover, we have also financially supported the planting of nine Dutch lime trees on Elizabetes Street. With their green leaves, these trees now give shade to by-passers every summer. Despite the fact that Urban Environment is one of our most recently launched operating directions, we have already supported urban environment projects and museum development to the amount of EUR 800,000.

Working at a charitable foundation is not just a job; it is a lifestyle, and that is why we believe there is no challenge we cannot overcome.

Thinking of New Incentives

Even though a decade of work has given us vast experience, and we are now Latvia's leading organisation in terms of the work we do under the auspices of our operational directions, we always have new incentives in mind. For example, we are trying to attract as many people as possible to the topic of contemporary art by educating and informing them about this cultural layer within the framework of global trends. Of course, we are going to continue developing all the directions of our work.

Thanks to the growing trust and responsiveness of donors, by the end of 2016 we launched a new direction — Philanthropists Projects. The corresponding programmes are going to be carried out with the support of the families of both founders of the foundation: using personal funds, family funds and the funds of associated companies and organisations.

One charity programme has already been created under this direction, which is a programme launched by Ernests Bernis' family entitled Future. It is aimed at supporting various incentives in philanthropy. So, in 2017, this means that the foundation has a total of five operating directions with ten long-term programmes.

I have no doubt that the foundation's future development is assured, because over the past decade we have built a great team. All our employees work very productively, because working at a charitable foundation is not just a job, it is a lifestyle, and that is why I believe there is no challenge we cannot overcome.

We carefully follow the activities of charitable foundations all over the world and are proud to say that we are every bit as good both in terms of work organisation, and when it comes to setting and achieving goals. The biggest difference between local charitable foundations and their leading counterparts with a global reach is that we are limited in the possibilities we have to accrue the principal amount that would provide additional funds for financing foundations' administrative work without touching donations. Until now, we have managed to avoid this pitfall. ABLV Charitable Foundation has not spent a single euro of donations on administrative expenses, which is rather difficult to accomplish under our country's economic conditions. Accruing funds instead of promptly spending them is the key to the long-term prospects of a charitable foundation. And this is our aim.

Once again, I would like to say a sincere thank you to the philanthropists for the inspiration, to donors for their growing trust, and to the employees of the foundation for their tireless and dedicated efforts in implementing our programmes!

BANKING / INVESTMENTS \ ADVISORY

Consolidated and Separate Annual Report for 2016

Contents

Bank's Management Report

Ladies and gentlemen, dear shareholders of ABLV Bank, AS!

In 2016, development of the bank and other companies of ABLV Group was continued. We managed to achieve and surpass major financial indicators planned, and the bank's profit reached EUR 79.3 million.

Last year, economic growth slowed down globally, also on the bank's target markets. In 2016, financial markets were marked by several surprises, price fluctuations that were hard to explain, and historic turns. Latvian economy demonstrated relatively weak economic indicators and grew just by 2.0% last year. New Global Financial Centres Index brought some positive news for Latvian financial market. The capital of Latvia — Riga — was mentioned in it over again, this time ranked 52nd in the index. Compared with the previous index, Riga was ranked 19 places higher. Luxembourg, where our subsidiary bank is located, also demonstrates improving results — it was ranked 12th in the Global Financial Centres Index.

In the reporting period, regulatory requirements in banking sector became even more stringent. Their implementation required a lot of time and resources, and therefore business development was hindered. At the end of May, ABLV Bank and the Financial and Capital Market Commission (FCMC) made an administrative agreement to settle the differences and agree upon further measures to be taken by the bank to improve the bank's internal control system and strengthen its efficiency. Since the position regarding acceptable risk level had changed, the bank refused cooperation with some clients and continues thorough assessment of its client base. Therefore, the amount of deposits decreased by 23.5% over the year, which conforms to the planned values. The importance of settlement business is gradually declining, and even higher value is placed on business project financing, including structured financing involving raising of risk capital, operating capital and trade financing, as well as arrangement of securities issues. The bank possesses high competence in this area, has necessary expert resources, cooperation partner network, and accumulated significant experience. In the field of lending to business in Latvia, ABLV Bank currently is one of the most important banks. Following the initiative of the FCMC, Latvian banks that mostly render services to foreign clients, including ABLV Bank, underwent independent audit performed by the US advisory firms regarding the compliance with the US regulatory requirements; the audit was started in April 2016 and was intended for strengthening the internal control systems and processes in the banks. In our bank, the audit was performed by Navigant Consulting, Inc. This was one of the largest projects in our bank lately, which required considerable efforts and financial investments. In general, we are satisfied with the audit results: bank's strengths were evaluated, and the recommendations given can be implemented without substantial investments in technologies and process modifications. During the audit, we acquired new experience in terms of differing compliance requirements in the European Union and the US.

To improve capital adequacy and ensure funds required for development, another issue of ABLV Bank shares was performed at the beginning of 2016 for the sake of share capital increase. Under the issue, there were 2 700 000 registered voting shares issued and 300 000 personnel shares. Following the increase, ABLV Bank, AS share capital amounts to EUR 38.3 million and consists of 34 470 000 registered voting shares and 3 830 000 personnel shares. Continuing the bond issue programme, we performed 7 bond issues in 2016: six issues of ordinary bonds and one issue of subordinated bonds. The total amount of issues performed last year constituted USD 225 million and EUR 80 million. As at the end of 2016, there were 21 bonds issues included in the Nasdaq Riga Baltic Bond List.

In 2016, the number of jobs grew in both the bank and the group: by 11 in the bank and by 30 — in the group in total. As at 31 December, the number of the bank's employees reached 665, and the total number of employees of ABLV Group companies — 827.

Legal address of ABLV Bank, AS (reg. No. 50003149401) is at 23 Elizabetes Street, Riga, LV-1010, Latvia. The bank's license was issued on 9 September 1993 and is registered with the FCMC licence register under No. 06.01.05.001/313.

During the reporting period no changes in the board were made, yet the council was appointed repeatedly, setting a new term of office. Bank's council consists of Chairman of the Council Oļegs Fiļs, Deputy Chairman of the Council Jānis Krīgers, Member of the Council Igors Rapoports. Bank's board consists of Chairman of the Board Ernests Bernis, Deputy Chairman of the Board Vadims Reinfelds, Board Members — Aleksandrs Pāže, Edgars Pavlovičs, Māris Kannenieks, Rolands Citajevs, Romans Surnačovs.

Financial results

ABLV Bank, AS remains the largest bank in Latvia with local capital and is ranked second in terms of the amount of assets.

- The bank's profit for 2016 amounted to EUR 79.3 million, which is historically the highest one so far and exceeds the profit for 2015 by EUR 10.3 million.
- The bank's operating income[1] totalled EUR 141.9 million. Compared with 2015, operating income has increased by 12.3%.
- The amount of the clients' deposits equalled EUR 2.90 billion as at the end of the reporting period.

The bank's profit for 2016 amounted to EUR 79.3 million, which is historically the highest one so far and exceeds the profit for 2015 by EUR 10.3 million.

- The amount of issued debt securities reached EUR 528.3 million.
- As at 31 December 2016, the amount of the bank's assets was EUR 3.85 billion.
- The bank's loan portfolio equalled EUR 1.00 billion, as at the end of December.
- The bank's capital and reserves amounted to EUR 321.8 million.
- As at 31 December 2016, common equity Tier 1 capital adequacy ratio was equal to 12.90%, bank's capital adequacy ratio was 19.58%, and liquidity — 78.40%.
- ROE reached 27.26%, and ROA — 1.85%, as at 31 December 2016[2] .
- Taxes paid by the group to the state budget amounted to EUR 22.0 million.

Upon their operation, the group and the bank are exposed to various risks, the most important of them being credit risk, concentration risk, market risk, liquidity risk, operational risk, risk of money laundering and terrorism financing and other quantitatively undefinable operational risks, including reputation risk, compliance risk, strategy and business risk, commission fee income and expenses uncertainty risk. More information on ABLV group's risk management is set out in notes 34 through 37 of this year's annual report.

ABLV maintains conservative strategy regarding investments in securities. Investments in elevated credit risk securities should not exceed 30% of the total amount of securities portfolio, thus limiting the credit risk and liquidity risk.

The total amount of the securities portfolio was equal to EUR 1.98 billion, as at 31 December 2016.

1 Operating income is calculated as the total of net interest income, net commission and fee income, net gain from transactions with financial instruments and foreign exchange, dividend income, net other income and expense, minus expenses of impairment of financial assets.

2 The indicators are calculated in accordance with the principles set out in FCMC Regulations No 145 "Regulations for the Preparation of Public Quarterly Reports for Credit Institutions.

Open-end mutual funds managed by ABLV Asset Management, IPAS demonstrated good results. As at the end of 2016, their total asset value amounted to EUR 125.6 million.

A part of securities in the amount of EUR 10.2 million are classified as loans and receivables. The bank's securities portfolio is mostly composed of fixed-income debt securities, and 88.9% of the portfolio is constituted by securities having investment level credit rating. In terms of major countries, the securities are allocated as follows: US — 16.4%, Germany — 15.2%, Latvia — 13.7%, Russia — 11.3%, Canada — 11.1%, Sweden — 6.8%, Netherlands — 3.7%, Finland — 2.6%, Norway — 2.2% and Austria — 2.1%. Whereas 4.8% is constituted by securities issued by international institutions. In the reporting period, average annual yield[3] of the securities portfolio amounted to 2.68%.
ABLV Bank is limiting exposure of its available-for-sale portfolio to the interest rates' risk, controlling its weighted average modified duration[4], which cannot exceed 3.

In Q2 2016, VISA Europe Ltd. share buyback transaction was completed, under which the stake owned by the bank was sold to VISA Inc. Following the transaction, the income gained by ABLV Bank from selling the said stake amounted to approximately EUR 16.4 million. The transaction also affected the profit for 2016. Additionally, 4 750 class C preferred shares of Visa Inc. were allocated to the bank, and their fair value amounted to EUR 2.7 million.

Various improvements to the bank's services have been performed. From 1 October 2016, individuals and Latvian legal entities are provided with free of charge outgoing standard and urgent payments in euro within the European Economic Area, provided those are made via Internetbank and their amount does not exceed EUR 1 000.

3 Yield of the securities portfolio is calculated as the ratio of income gained from the securities to the average securities balance in the reporting period. The result is annualized and expressed as a percentage. The income gained from the securities is constituted by coupon income, securities revaluation reserve, securities trading result, and changes in the allowances.

4 Weighted average modified duration expresses changes in value of security upon change of interest rates. The modified duration is calculated only against interest rate risk sensitive debt securities, setting the sensitivity of debt security value against the interest rate changes per 100 bp (1%). It is assumed that the interest rates and prices of debt securities change in opposite directions.

We have also cancelled express payments in the US dollars and simplified the rates and charges on USD payments for foreign legal entities. From June 2016, we offer the clients to perform payments in three new currencies: United Arab Emirates dirham (AED), New Zealand dollar (NZD), and South African rand (ZAR). Following this innovation, our clients can now perform payments in 27 different currencies.

From June 2016, all the client's Forward transactions are combined in one portfolio, to which multicurrency security account is linked. The funds held in this account and the total revaluation result of all concluded Forward transactions serve as single collateral of all Forward transactions in the portfolio. In the reporting period, we introduced payment cards enabling contactless authorization. To promote the financial literacy of youngsters, we started offering our clients to opening card accounts and obtaining payment cards for their children from seven years of age. Thus, children can acquire experience in financial matters, and their parents are able to manage the children's spending.

Given the bank's long-term experience and knowledge of debt securities issuance, in the reporting period we launched a new service — arrangement of bond issues on behalf of the clients. Bond issues enable companies to raise additional financing both with the collateral and without collateral, as well as for longer term than is possible in case of loans. The costs of raising such type of funding are relatively lower, and diversification of investor base is possible as well. Using the new service, our client — real estate holding company AS Baltic RE Group — performed the issue of straight bonds amounting to EUR 4 million. ABLV Bank arranged the initial offering and ensured complete underwriting. ABLV Bank provided advice to AS Citadele banka on subordinated bond issue program, ensuring the underwriting to EUR 20 million within the initial placement.

Investments

In 2016, intense turbulence was still observed at global financial markets, regularly causing strong price fluctuations. Nevertheless, open-end mutual funds managed by ABLV Asset Management, IPAS demonstrated good results. As at the end of 2016, their total asset value amounted to EUR 125.6 million.

The year 2016 was also successful for ABLV Capital Markets, IBAS, which executes clients' instructions for purchasing and selling all types of financial instruments. Profit of ABLV Capital Markets, IBAS amounted to EUR 3.1 million. As at 31 December 2016, total assets of the company's clients invested in financial instruments were equal to EUR 1.27 billion.

Developing the investment services, we offer the clients financing secured by pledge of investment portfolio in two new currencies. In addition to USD, EUR and RUB currencies, now clients can obtain financing in the British pounds (GBP) and Swiss francs (CHF). The obtained financing secured by pledge of investment portfolio can be used by the clients to acquire new financial instruments or for other activities, without the need to sell the securities held in the portfolio. As at 31 December 2016, the total amount of loans granted by the bank against the pledge of financial instruments constituted EUR 88.9 million.

Last year we began offering new trading platform QTrader to the clients wishing to independently explore the trading opportunities provided by futures exchanges. This platform ensures direct access to major futures exchanges — Chicago Mercantile Exchange (CME), Chicago Board of Trade (CBOT), New York Mercantile Exchange (NYMEX), Commodity Exchange, Inc. (COMEX), ICE Futures Europe Commodities.

Real estate

In 2016, real estate group Pillar continued selling its property portfolio. In uniform buildings, 106 apartments were sold: 77 of those in Riga and 29 outside Riga, as well as 13 apartments in new and renovated projects were sold. Good results were also achieved under selling private houses and land plots — there were 38 private houses and 37 land plots sold. During 2016, Pillar sold 6 commercial properties of different size. Overall, Pillar made more than 200 sale transactions in 2016, their total amount being EUR 12.9 million.

Due to decreasing the property portfolio, resources become available, and Pillar is able to allocate those to the large-scale future project — construction of New Hanza area. On 4 July 2016, construction of the first stage of New Hanza infrastructure was started. On 9 December 2016, ABLV Bank established a new company — ABLV Building Complex, SIA. Construction of ABLV Bank headquarters group of buildings will be ordered and accepted by this new company.

Advisory

Expanding the offer, in 2016, ABLV Group company ABLV Corporate Services actively developed the accounting services rendered. The accounting services are rendered following the International Financial Reporting Standards (IFRS), ensuring transparent, high-quality, and internationally-comparable financial statements, thus also enabling the companies to raise financial resources from various sources.

Expanding to new regions and building closer relationships with the business partners, in the reporting period ABLV Group company ABLV Advisory Services, SIA opened the representative office in the United States of America. The representative office works on establishing mutually beneficial international business contacts for the companies of ABLV Group and on studying the US regulatory environment.

Currently, ABLV Group is represented in 10 foreign countries — Azerbaijan, Belarus, Kazakhstan, Cyprus, Russia, Ukraine, Uzbekistan, United States of America, Hong Kong and Luxembourg.

Luxembourg

Our subsidiary bank in Luxembourg, ABLV Bank Luxembourg, S.A., renders services to the clients for already more than three years. The bank was established for the sake of ensuring wider range of investment services to the clients. As at 31 December 2016, ABLV Bank Luxembourg assets and assets under management reached EUR 310.2 million.

In the reporting period, ABLV Bank Luxembourg started issuing payment cards to its clients. Currently, the bank issues VISA Gold and VISA Gold Business cards in euros and US dollars.

Under the charitable fund campaign timed to coincide with the 10th anniversary of ABLV Charitable Foundation, the amount of donations exceeded EUR 1 million with considerable share being provided by the bank's foreign clients as well.

For society

According to the bank’s policy, ABLV Bank does not make direct donations to particular charity projects. All funds intended for charity are transferred to charitable organizations, which ensure professional and methodical administration of these funds according to their objectives and programmes.

Besides donating its funds, the bank encourages the employees and clients to do so. Under the charitable fund campaign timed to coincide with the 10th anniversary of ABLV Charitable Foundation, the amount of donations exceeded EUR 1 million with considerable share being provided by the bank's foreign clients as well.

The social commitment of the bank’s and the group’s employees goes beyond monetary donations to the charitable programmes of ABLV Charitable Foundation. On 3 June 2016, Blood Donation Day was held in the bank for the first time in the history of ABLV Group. 86 employees donated blood, and this means we helped about 250 people.

On 10 November 2016, export support movement Red Jackets, together with Minister of Culture Dace Melbārde and the representatives of the prominent Latvian export brands, including ABLV Bank, presented the book “Treasures of Latvia — Outstanding Export Brands and Inspiring Talents“. The book publishing was supported by ABLV Bank, and the book presents the information on the prominent Latvian export brands that won The Red Jackets title in 2015, as well as The Rising Stars.

ABLV Bank provides support to the social organizations that strive to improve banking sector and overall business environment in Latvia, as well as engage in their operations. Among those, it is worth mentioning the Association of Commercial Banks of Latvia, the Latvian Chamber of Commerce and Industry, the Employers' Confederation of Latvia, and other organizations. We supported the activity of Certus think tank and plan to continue this project, since we believe that such authoritative high potential research centre is vital for Latvian development.

The share of settlement business is decreased, since this area is associated with higher risks, and we will pay increasingly more attention to professional wealth management services with high added value.

Plans for 2017

To ensure stable growth in the future, the focus on different lines of business will be gradually changed. The share of settlement business is decreased, since this area is associated with higher risks, and we will pay increasingly more attention to professional wealth management services with high added value, such as arrangement of securities issuance, lending to companies, support under complex trade transactions, and investment services. Our employees possess necessary expert qualification and experience, and this is our advantage.

Due to client base assessment and refusal to cooperate with the clients associated with high risk level, the fee income from account opening and maintenance, as well as performance of payments, especially in the US dollars, is expected to decrease for a short term. The profit is also planned to be lower than in 2016. Nevertheless, we intend to implement all development projects as planned. Stable increase in the amount of deposits and number of clients of the bank is expected to be resume approximately in three years.

We express our gratitude to our shareholders and clients for their loyalty and to all employees for their contribution to the bank's and the group's growth!

Chairman of the Council
Oļegs Fiļs

Chairman of the Board
Ernests Bernis

Riga, 16 March 2017

The council and the board

The council of the bank:

Chairman of the Council: Oļegs Fiļs	Term of office: 02.05.2016.—01.05.2019.
Deputy Chairman of the Council: Jānis Krīgers	Term of office: 02.05.2016.—01.05.2019.
Council Member: Igors Rapoports	Term of office: 02.05.2016.—01.05.2019.

The board of the bank:

Deputy Chairman of the Board: Ernests Bernis — Chief Executive Officer (CEO)	Term of office: 01.05.2014.—01.05.2017.
Deputy Chairman of the Board: Vadims Reinfelds — Deputy Chief Executive Officer (dCEO)	Term of office: 01.05.2014.—01.05.2017.
Board Members:	Term of office:
Aleksandrs Pāže — Chief Compliance Officer (CCO)	01.05.2014.—01.05.2017.
Edgars Pavlovičs — Chief Risk Officer (CRO)	01.05.2014.—01.05.2017.
Māris Kannenieks — Chief Financial Officer (CFO)	01.05.2014.—01.05.2017.
Rolands Citajevs — Chief IT Officer (CIO)	01.05.2014.—01.05.2017.
Romans Surnačovs — Chief Operating Officer (COO)	01.05.2014.—01.05.2017.

There have been no changes in the board of the bank during the reporting period, but the council was re-appointed in the above structure, with a new term of office.

Statement of management's responsibility

The council and the board of ABLV Bank, AS (hereinafter — the bank) are responsible for the preparation of the financial statements of the bank as well as for the preparation of the consolidated financial statements of the bank and its subsidiaries (hereinafter — the group).

The financial statements and notes thereto set out on pages 115 to 221 are prepared in accordance with the source documents and present truly and fairly the financial position of the bank and the group as at 31 December 2016 and 2015, and the results of their operations, changes in the shareholders' equity and cash flows for the years then ended.

The aforementioned financial statements are prepared on a going concern basis in conformity with International Financial Reporting Standards as adopted by the European Union. Prudent and reasonable judgements and estimates have been made by the management in the preparation of the financial statements.

The council and the board of the bank (hereinafter — the management) are responsible for the maintenance of proper accounting records, the safeguarding of the group's assets, and the prevention and detection of fraud and other irregularities in the group. The management of the bank are also responsible for operating the group and the bank in compliance with the Law of the Republic of Latvia on Credit Institutions, Regulations of the Bank of Latvia and the Financial and Capital Market Commission, and other laws of the Republic of Latvia as well as European Union Regulations applicable to credit institutions.

Chairman of the Council
Oļegs Fiļs

Chairman of the Board
Ernests Bernis

Riga, 16 March 2017

Statements of comprehensive income

EUR '000

	Notes	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Interest income	3	86,019	85,548	84,208	83,547
Interest expense	3	(21,442)	(20,589)	(21,493)	(20,508)
Net interest income		**64,577**	**64,959**	**62,715**	**63,039**
Commision and fee income	4	53,082	65,564	45,403	55,778
Commision and fee expense	4	(8,475)	(10,431)	(14,115)	(15,543)
Net commision and fee income		**44,607**	**55,133**	**31,288**	**40,235**
Net gain on transactions with financial instruments and foreign exchange	5	45,397	21,499	45,190	21,304
Net result on transactions with repossessed real estate	6	(2,423)	(2,272)	-	-
Other income	7	5,861	9,581	4,078	3,646
Other expense	7	(2,833)	(6,522)	(1,449)	(1,264)
Income from dividends		169	259	6,274	9,352
Impairment allowance for loans	8	332	(5,888)	57	(5,483)
Allowances for impairment of investments in subsidiaries	18	-	-	(6,225)	(2,840)
Allowances for impairment of financial instruments		(53)	(1,670)	(53)	(1,670)
Operating income		**155,634**	**135,079**	**141,875**	**126,319**
Personnel expense	9	(45,917)	(43,099)	(36,865)	(33,955)
Other administrative expense	9	(24,355)	(18,952)	(19,907)	(14,661)
Amortisation and depreciation		(4,059)	(5,019)	(3,142)	(3,377)
Impairment reversal		-	237	-	237
Profit before corporate income tax		**81,303**	**68,246**	**81,961**	**74,563**
Corporate income tax	10	(2,487)	(6,372)	(2,624)	(5,524)
Net profit for the year		**78,816**	**61,874**	**79,337**	**69,039**
Attributable to:					
Equity holders of the bank		78,594	61,277		
Non-controlling interests		222	597		
Other comprehensive income which has been or is to be reclassified to profit or loss					
Changes in fair value revaluation reserve of available-for-sale financial assets		13,489	11,921	13,384	11,828
Change to income statement as a result of sale of available-for-sale securities		(22,031)	(1,763)	(21,950)	(1,711)
Change to income statement due to recognised impairment of available-for-sale securities		286	1,111	286	1,111
Changes in deferred corporate income tax		(78)	(304)	(78)	(304)
Other comprehensive income, total		**(8,334)**	**10,965**	**(8,358)**	**10,924**
Total comprehensive income		**70,482**	**72,839**	**70,979**	**79,963**
Attributable to:					
Equity holders of the bank		70,260	72,242		
Non-controlling interests		222	597		

Riga, 16 March 2017

Chairman of the Council
Oļegs Fiļs

Chairman of the Board
Ernests Bernis

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Statements of financial position

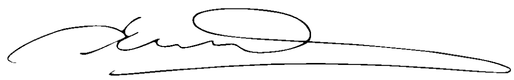
EUR '000

Assets	Notes	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Cash and deposits with central banks	11	414,431	449,136	413,047	448,187
Balances due from credit institutions	12	272,520	669,980	281,504	671,772
Derivatives	16	624	121	80	121
Financial assets at fair value through profit or loss	13	28,416	26,121	21,010	22,286
Available-for-sale financial assets	14	1,042,574	1,833,073	957,094	1,780,554
Loans and receivables	17	1,029,944	874,003	1,012,146	873,499
Held-to-maturity investments	15	1,053,987	1,015,047	989,710	965,253
Investments in subsidiaries	18	-	-	119,945	111,266
Investments in associates	18	9,117	9,068	8,635	8,770
Investment properties	19	34,690	22,976	25,058	25,069
Property and equipment	20	27,267	23,867	9,461	9,529
Intangible assets	20	6,060	6,365	5,826	6,036
Current corporate income tax receivables		3,134	3,148	2,360	3,042
Deferred corporate income tax	10	1,401	379	-	-
Repossessed real estate	6	41,276	52,312	-	-
Other assets	21	7,882	5,992	3,710	2,737
Total assets		**3,973,323**	**4,991,588**	**3,849,586**	**4,928,121**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

EUR '000

Liabilities	Notes	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Derivatives	16	42	365	42	365
Balances held with Bank of Latvia	22	50,000	180,072	50,000	180,072
Demand deposits from credit institutions	22	16,463	49,154	20,375	63,294
Deposits	23	3,027,772	3,875,455	2,901,824	3,793,192
Current corporate income tax liabilities		334	322	-	-
Other liabilities	27	22,922	41,737	11,083	35,072
Deferred corporate income tax	10	1,366	1,016	1,346	1,001
Issued securities	24	521,281	550,877	528,304	558,411
Subordinated deposits	25	14,810	15,261	14,810	15,261
Total liabilities		**3,654,990**	**4,714,259**	**3,527,784**	**4,646,668**
Shareholders' equity					
Paid-in share capital	26	38,300	35,300	38,300	35,300
Share premium		132,423	96,918	132,423	96,918
Reserve capital and other reserves		2,217	2,238	2,134	2,134
Fair value revaluation reserve of available-for-sale financial assets		1,127	9,461	1,139	9,497
Retained earnings brought forward		63,401	71,259	68,469	68,565
Retained earnings for the period		78,594	61,277	79,337	69,039
Attributable to the equity holders of the bank		**316,062**	**276,453**	**321,802**	**281,453**
Non-controlling interests		**2,271**	**876**	**-**	**-**
Total shareholders' equity		**318,333**	**277,329**	**321,802**	**281,453**
Total liabilities and shareholders' equity		**3,973,323**	**4,991,588**	**3,849,586**	**4,928,121**
Memorandum items					
Contingent liabilities	28	10,015	9,949	9,928	9,516
Financial commitments	28	132,405	75,610	126,632	68,907



Riga, 16 March 2017

Chairman of the Council
Oļegs Fiļs

Chairman of the Board
Ernests Bernis

Statement of changes in shareholder's equity of the group

EUR '000

	Paid-in share capital	Share premium	Reserve capital and other reserves	Fair value revaluation reserve of available-for-sale financial assets	Retained earnings	Attributable to the equity holders of the bank	Non-controlling interests	Total shareholders' equity
01.01.2015.	**32,650**	**66,270**	**2,174**	**(1,504)**	**130,115**	**229,705**	**12,337**	**242,042**
Net profit for the year	-	-	-	-	61,277	61,277	597	61,874
Other comprehensive income/(expense) for the year	-	-	-	10,965	-	10,965	-	10,965
Total comprehensive income	**-**	**-**	**-**	**10,965**	**61,277**	**72,242**	**597**	**72,839**
Increase in reserves	-	-	64	-	-	64	-	64
Dividends paid	-	-	-	-	(58,555)	(58,555)	(292)	(58,847)
Issue of personnel shares (see Note 26)	265	-	-	-	(301)	(36)	36	-
Issue of shares (see Note 26)	2,385	30,648	-	-	-	33,033	126	33,159
Decrease in non-controlling interests (see Note 18)	-	-	-	-	-	-	(11,928)	(11,928)
31.12.2015.	**35,300**	**96,918**	**2,238**	**9,461**	**132,536**	**276,453**	**876**	**277,329**
01.01.2016.	**35,300**	**96,918**	**2,238**	**9,461**	**132,536**	**276,453**	**876**	**277,329**
Net profit for the year	-	-	-	-	78,594	78,594	222	78,816
Other comprehensive income/(expense) for the year	-	-	-	(8,334)	-	(8,334)	-	(8,334)
Total comprehensive income	**-**	**-**	**-**	**(8,334)**	**78,594**	**70,260**	**222**	**70,482**
Decrease in reserves	-	-	(21)	-	-	(21)	-	(21)
Dividends paid	-	-	-	-	(68,835)	(68,835)	(550)	(69,385)
Issue of personnel shares (see Note 26)	300	-	-	-	(300)	-	-	-
Issue of shares (see Note 26)	2,700	35,505	-	-	-	38,205	1,674	39,879
Increase in non-controlling interests (see Note 18)	-	-	-	-	-	-	49	49
31.12.2016.	**38,300**	**132,423**	**2,217**	**1,127**	**141,995**	**316,062**	**2,271**	**318,333**

Statement of changes in shareholders' equity of the bank

EUR '000

	Paid-in share capital	Share premium	Share premium Share premium	Fair value revaluation reserve	Retained earnings	Total shareholders' equity
01.01.2015.	**32,650**	**66,270**	**2,134**	**(1,427)**	**127,274**	**226,901**
Net profit for the year	-	-	-	-	69,039	69,039
Other comprehensive income/(expense) for the year	-	-	-	10,924	-	10,924
Total comprehensive income for the year	**-**	**-**	**-**	**10,924**	**69,039**	**79,963**
Dividends paid (see Note 26)	-	-	-	-	(58,444)	(58,444)
Issue of personnel shares (see Note 26)	265	-	-	-	(265)	-
Issue of shares (see Note 26)	2,385	30,648	-	-	-	33,033
31.12.2015.	**35,300**	**96,918**	**2,134**	**9,497**	**137,604**	**281,453**
01.01.2016.	**35,300**	**96,918**	**2,134**	**9,497**	**137,604**	**281,453**
Net profit for the year	-	-	-	-	79,337	79,337
Other comprehensive income/(expense) for the year	-	-	-	(8,358)	-	(8,358)
Total comprehensive income for the year	**-**	**-**	**-**	**(8,358)**	**79,337**	**70,979**
Dividends paid (see Note 26)	-	-	-	-	(68,835)	(68,835)
Issue of personnel shares (see Note 26)	300	-	-	-	(300)	-
Issue of shares (see Note 26)	2,700	35,505	-	-	-	38,205
31.12.2016.	**38,300**	**132,423**	**2,134**	**1,139**	**147,806**	**321,802**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Statement of cash flows

EUR '000

Cash flows from operating activities	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Profit before corporate income tax	81,303	68,246	81,961	74,563
Dividend income	(169)	(259)	(6,274)	(9,352)
Amortisation and depreciation of fixed assets and investment properties	4,059	5,019	3,142	3,377
Impairment allowance for loans	(332)	5,888	(57)	5,483
Impairment of financial instruments	53	1,670	53	1,670
Interest (income)	(86,019)	(85,548)	(84,208)	(83,547)
Interest expense	21,442	20,589	21,493	20,508
Other non-cash items*	(20,294)	(1,737)	(13,850)	1,546
Net cash flows from operating activities before changes in assets and liabilities	**43**	**13,868**	**2,260**	**14,248**
(Increase) in balances due from credit institutions	(19,292)	(7,878)	(19,292)	(12,831)
(Increase) in loans	(147,145)	(70,698)	(131,823)	(69,656)
(Increase)/decrease in financial assets at fair value through profit or loss	314	(4,901)	3,885	(7,063)
Decrease/(increase) in other assets	8,988	9,879	(971)	2,902
Increase/(decrease) in balances due to credit institutions	(130,001)	156,890	(130,000)	160,238
(Decrease)/increase in deposits	(902,677)	175,238	(946,362)	175,459
(Decrease) in derivatives	(826)	(1,307)	(282)	(1,307)
(Decrease)/increase in other liabilities	(19,115)	11,837	(24,269)	21,747
Net cash flows from operating activities before corporate income tax	**(1,209,711)**	**282,928**	**(1,246,854)**	**283,737**
Interest received in the reporting year	87,408	87,170	87,295	85,170
Interest (paid) in the reporting year	(21,921)	(19,937)	(21,973)	(19,857)
Corporate income tax (paid)	(2,987)	(3,237)	(1,612)	(2,952)
Net cash flows from operating activities	**(1,147,211)**	**346,924**	**(1,183,144)**	**346,098**
Cash flows from investing activities				
(Purchase) of held-to-maturity investments	(97,680)	(118,729)	(81,925)	(97,391)
Redemption of held-to-maturity investments	83,890	141,209	80,990	140,009
(Purchase) of available-for-sale financial assets	(313,809)	(1,373,698)	(266,403)	(1,288,302)
Sale of available-for-sale financial assets	1,143,893	957,295	1,128,577	859,890
(Purchase) of intangible and tangible fixed assets and investment properties	(19,448)	(4,435)	(2,926)	(3,718)
Sale of intangible and tangible fixed assets and investment properties	580	122	73	1,046
Dividends received	169	259	6,274	9,352
Decrease in investments in subsidiaries and associates	135	-	10,234	3,321
(Decrease) in cash and cash quivalents due to loss of control	-	(282)	-	-
(Increase) in investments in subsidiaries and associates	-	-	(25,003)	(11,098)
Net cash flows from investing activities	**797,730**	**(398,259)**	**849,891**	**(386,891)**
Cash flows from financing activities				
Proceeds from subordinated loans	600	1,560	600	1,560
(Repayment) of subordinated loans	(1,345)	(1,600)	(1,345)	(1,600)
Proceeds from issued securities	239,533	239,691	241,533	239,691
(Repurchase) of issued securities	(281,654)	(168,522)	(284,163)	(173,972)
Dividends (paid)	(69,385)	(58,847)	(68,840)	(58,443)
Increase in non-controlling interest	1,674	126	-	-
Issue of shares	38,205	33,033	38,205	33,033
Net cash flows from financing activities	**(72,372)**	**45,441**	**(74,010)**	**40,269**
(Decrease)/increase in cash and cash equivalents	**(421,853)**	**(5,894)**	**(407,263)**	**(524)**
Cash and cash equivalents at the beginning of the year	**1,014,984**	**1,009,756**	**1,002,126**	**987,436**
Result from revaluation of foreign currency positions	1,506	11,122	3,899	15,214
Cash and cash equivalents at the end of the year	**594,637**	**1,014,984**	**598,762**	**1,002,126**

* Significant part of other non-cash items that do not affect the cash flows in the reporting period consist of VISA Europe Ltd. share buyback transaction with VISA Inc. amounting to EUR 16.4 million.

EUR '000

Cash and cash equivalents	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Cash and deposits with central banks	414,431	449,136	413,047	448,187
Balances due from credit institutions	196,669	615,002	206,090	617,233
Balances due to credit institutions	(16,463)	(49,154)	(20,375)	(63,294)
Total cash and cash equivalents	**594,637**	**1,014,984**	**598,762**	**1,002,126**

Information about balances due from credit institutions other than cash equivalents is presented in Note 12.

Notes to the financial statements

Note 1

General information

ABLV Bank, AS reg. No. 50003149401 (hereinafter — the bank) was registered in Aizkraukle, Republic of Latvia, on 17 September 1993, as a joint stock company. At present, the legal address of the bank is Elizabetes Street 23, Riga, LV-1010, Latvia.

The bank operates in accordance with the laws and regulations of the Republic of Latvia and the licence issued by the Financial and Capital Market Commission that allows the bank to render all the financial services specified in the Law on Credit Institutions. The bank was issued licence on 9 September 1993 by the Bank of Latvia, it was later re-registered with the Financial and Capital Market Commission under No. 06.01.05.001/313.

These consolidated and separate financial statements contain the financial information about ABLV Bank, AS and its subsidiaries (hereinafter — the group). The separate financial statements of the bank are included alongside these consolidated financial statements to comply with legal requirements. The bank is the parent entity of the group.

The group's and bank's main scope of activity is financial and investment services, asset management, financial consultations and real estate management.

The bank operates the central office and one lending centre in Riga. The most important subsidiaries of the bank are: ABLV Bank, Luxembourg S.A. (Luxembourg), ABLV Asset Management, IPAS, ABLV Capital Markets, IBAS, Pillar Holding Company, KS.The list of all group's subsidiaries is presented in Note 18. The Group operates foreign representation offices/territorial structural units in Azerbaijan (Baku), in Belarus (Minsk), in Kazakhstan (Almaty), in Cyprus (Limassol), in Russia (Moscow, St. Petersburg and Vladivostok), in Ukraine (representative office in Kyiv and a separate representative office in Odessa), in Uzbekistan (Tashkent), United States of America (New York) and Hong Kong.

The following abbreviations are used in the notes to these financial statements: International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), International Accounting Standards Board (IASB), International Financial Reporting Interpretations Committee (IFRIC), Financial and Capital Market Commission of the Republic of Latvia (FCMC), European Monetary Union (EMU), European Union (EU), Organisation for Economic Cooperation and Development (OECD), European Central Bank (ECB), Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (Regulation).

The consolidated financial statements of the group and the separate financial statements of the bank for the year ended 31 December 2016 are approved by the Bank's Board and Council on 16 March 2017 (see paragraph v)).

Performance indicators of the Bank

Performance indicators		2016	2015	Change, %	2014	2013	2012
Total assets	EUR '000	3,849,586	4,928,121	(21.89)	4,169,844	3,315,366	3,043,830
Loans and receivables	EUR '000	1,012,146	873,499	15.87	790,247	761,268	716,574
Deposits	EUR '000	2,901,824	3,793,192	(23.50)	3,406,032	2,776,457	2,659,191
Total shareholders' equity	EUR '000	321,802	281,453	14.34	226,901	187,037	151,965
Operating income*	EUR '000	141,875	126,319	12.31	108,959	96,688	64,877
Net profit for the year	EUR '000	79,337	69,039	14.92	58,674	43,676	23,412
Return on equity indicator (ROE)**	%	27.26	27.76	(1.77)	28.82	26.29	16.64
Return on assets indicator (ROA)**	%	1.85	1.49	24.17	1.60	1.36	0.82
Liquidity indicator***	%	78.40	82.68	(5.18)	74.74	79.20	62.51
Common equity tier 1 capital ratio (CET 1)	%	12.90	10.79	19.55	11.86	11.73	10.64
Total capital ratio (CAR)	%	19.58	17.27	13.43	18.80	17.53	16.04

* The indicator is calculated as the sum of net interest income, net commission and fee income, net gain on transactions with financial instruments and foreign exchange, dividend income, other income and expense minus impairment of financial assets.

** The indicators are calculated according to the principles defined by the FCMC in Regulation No. 145 on the preparation of public quarterly reports of credit institutions.

*** The indicator is calculated according to the Regulation No.195 on the liquidity requirement, its implementation procedure and liquidity risk management issued by the FCMC.

Note 2

Information on principal accounting policies

a) Basis of preparation

These group`s/bank`s consolidated and separate financial statements are based on the accounting records made pursuant to the legislative requirements and prepared in conformity with IFRS as adopted by the European Union, on a going concern basis.

These financial statements are prepared on a historical cost basis, except for certain financial assets and liabilities (available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss and derivatives) which are reported at fair value. The financial statements give a structured view of the financial position of the group and the bank and their financial performance and cash flows.

During the year ended 31 December 2016, the group and the bank consistently applied accounting policies in line with those disclosed in the prior-year financial statements, except for the changes in IFRS that came effective in the reporting period.

The accounting policies are applied consistently by all entities of the group.

The functional currency of the bank and its subsidiaries is EUR. The presentation currency of the group and the bank is EUR.

These consolidated and separate financial statements are reported in thousands of the euro (EUR '000), unless otherwise stated. Information given herein in brackets represents comparative figures for the year ended 31 December 2015 or for the twelve-month period ended 31 December 2015.

b) Significant Estimates and Assumptions

The preparation of financial statements in accordance with IFRS as adopted by the EU requires the management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expense, and disclosure of contingencies. Future events occur which cause the assumptions used in arriving at the estimates to change. Such estimates and assumptions are based on most reliable information available to the management in respect of specific events and actions. The effect of any changes in estimates will be recorded in the financial statements when determinable.

The significant areas of estimation and assumptions relate to the calculation of deferred corporate income tax (see paragraph i)), determining the impairment allowance for loans (see paragraph o)) and the collateral (pledge) value (see Note 35), estimation of impairment of other assets, including investments in subsidiaries (see paragraph p)) and the fair value of assets and liabilities (see paragraph e) and Note 32), assumptions regarding control and significant influence on subsidiaries and associates respectively (see paragraph c)), as well as evaluation of the group's ability to exercise significant influence over the operation of open-ended investment funds (see paragraph c)).

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

c) Basis of Consolidation
These consolidated financial statements include the bank and all subsidiaries controlled by the bank (the parent entity), i.e. the bank has the power to govern the financial and operating policies of an entity so as to obtain economic benefits. Subsidiaries are consolidated from the date on which control is transferred to the parent and are no longer consolidated from the date that control ceases. The entities of the group are listed in Note 18.

Investments in subsidiaries are presented in the Bank's separate financial statements in accordance with the cost method.

Associates are companies over which the group has significant influence, however, there is no control over their financial and business policies. Interests in associates and the joint ventures are accounted for using the equity method. They are initially recognised at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the group's share of the profit or loss and OCI in equity-accounted investees, until the date on which significant influence or joint control ceases.

Goodwill represents the excess of the cost of a business combination over the group's interest in the fair value of the net identifiable assets and contingent liabilities of the acquired subsidiary at the acquisition date. Goodwill on acquisitions of business operation is included in intangible assets. The carrying amount of associates' goodwill in equity is included in the carrying amount of investment in associate. Goodwill is allocated to cash-generating units and is stated at cost less impairment losses.
Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired and is carried at cost less accumulated impairment losses. Gains or losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.
Negative goodwill arising on an acquisition is recognised immediately in the consolidated statement of income.

The bank's and its subsidiaries' financial statements are consolidated in the group's financial statements using the full consolidation method, by adding together like items of assets and liabilities at the period end, as well as income and expenses. For the purposes of consolidation, intragroup balances and intragroup transactions, including interest income and expense, and unrealised profit and loss resulting from intragroup transactions are eliminated, unless there exists any indication of impairment. Non-controlling (minority) interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the bank. Non-controlling interests are presented separately in the consolidated statement of comprehensive income and equity interests are presented in the consolidated statement of financial position separately from equity of the parent company. Non-controlling interest is measured according to its proportional interest in net assets.
The bank's subsidiaries comply with the bank's policies and risk management methods.

The bank's investments in open-ended investment funds as structured entities are disclosed in the separate financial statements (Note 13) as investments in open-ended investment funds.

Meanwhile, in the consolidated financial statements the investments in open-ended investment funds, which the bank has the power to govern and in which the bank owns the major part (at least 30% or above) of net assets, are consolidated according to the full consolidation method. The shares of funds owned by third parties are recognised in the consolidated financial statements as other liabilities.

d) Recognition and Derecognition of Financial Assets and Liabilities

A financial asset is any asset that is cash, an equity instrument of another entity, a contractual right to receive cash or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity or a contract that will or may be settled in the entity's own equity instruments and is a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or a contract that will or may be settled in the entity's own equity instruments and is a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

The group recognises financial assets and liabilities in its statement of financial position when, and only when, the group or the bank becomes a party to the contractual provisions of the instrument.

All purchases and sales of financial assets, except for loans issued to non-bank customers, are recognised and derecognised on the settlement date. Loans to non-bank customers are recognised in the statement of financial position when cash is transferred to the customer's current account.

A financial asset is derecognised only when the contractual rights to receive cash flows from the asset have expired, or the group and the bank have transferred the financial asset and substantially all the risks and rewards of the asset to the counterparty.

A financial liability is derecognised only when the obligation under the liability is discharged according to the contract or cancelled or expires.

e) Fair Value of Financial Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value of financial assets and liabilities is quoted prices in an active market. If the market for a financial asset or liability is inactive, fair value is established by using several valuation models, including discounted cash flow analysis, recent transactions that are substantially the same, as well as management estimates and assumptions. The comparison of carrying amounts and fair values of the group's and bank's financial assets and liabilities is presented in Note 32.

f) Offsetting of Financial Assets and Financial Liabilities

Financial assets and financial liabilities are offset and the net amount reported in the consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

g) Income and Expense Recognition

All major income and expense items are recognised on an accrual basis.

Interest income/expense is recognised in the statement of comprehensive income for financial assets/liabilities measured at amortised cost using the effective interest method. The effective interest rate is a method of calculating the amortized cost of a financial asset or liability, which is based on the recognition of interest income and expenses over a specific period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument.

Interest income also comprises coupon payments, which are recognised for fixed income securities. Interest income on loans whose recoverability is doubtful is recognised using the effective interest rate, which is the rate that exactly discounts estimated future cash flows to the recoverable amount of loans.

Commission and fee income and expense are included in the statement of comprehensive income over the period or at a specific time, except for commission and fee income/expense directly attributable to financial assets/liabilities measured at amortised cost. For these assets/liabilities the respective commission and fee income/expense form an integral part of the effective interest rate.

Commission and fee income received once in a year for the whole reporting period is recognised in the statement of comprehensive income systematically on a straight-line basis during the period.

Income and expense other than interest and/or commission and fee income/expense represent items associated with the core business of non-banking entities of the group.

h) Foreign currency revaluation
Monetary assets and liabilities denominated in foreign currencies are translated into EUR at the exchange rate set by the ECB, while non-monetary assets in foreign currencies are translated into EUR at the official exchange rate set by the ECB at the transaction date. REUTERS exchange rates are applied to the foreign currencies having no EUR foreign exchange reference rates published by the ECB. Transactions denominated in foreign currencies are recorded in EUR at exchange rates set by the ECB or REUTERS at the date of the transaction. Any gain or loss resulting from a change in exchange rates subsequent to the transaction date is included in the statement of comprehensive income as gain or loss from revaluation of foreign currency positions.
Paragraph a) provides information on functional and presentation currency of the group's and bank's companies.

i) Taxation
Corporate income tax is calculated in accordance with Latvian tax regulations at the rate of 15% and is based on the taxable income reported for the taxation period.
Deferred taxation arising from temporary differences in the timing of the recognition of items in the tax returns and these financial statements is calculated using the liability method. Deferred taxation relates to the future tax consequences of all events that have been recognised in the bank's and group's financial statements or tax returns. The deferred tax liability is determined based on the tax rates that are expected to apply when the temporary differences reverse. The principal temporary differences arise from differing rates of accounting and tax depreciation on fixed assets, accrual for employee vacation pay, and revaluation of items of the statement of financial position, including securities revaluation and fair value revaluation reserve, and tax losses carried forward for the subsequent years. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. Therefore, deferred tax asset is only recognised if it is justifiably expected to be recovered.

j) Financial Instruments
Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:
- those that the group and the bank intend to sell immediately or in the near term and those that the group and the bank upon initial recognition designate as at fair value through profit or loss;
- those that the group and the bank, upon initial recognition, designate as available for sale or
- those for which the group and the bank may not recover substantially all of its initial investment, other than because of credit deterioration.

This portfolio includes loans and balances due from credit institutions which are carried at amortised cost using the effective interest method less the allowance for credit losses (impairment expense) as presented in Note 8. Gains or losses are recognised in the statement of comprehensive income upon derecognition or impairment of these assets, as well as through amortisation. Gains and losses are recognised in the statement of comprehensive income as interest income/expense when the liabilities are derecognised through the amortisation process.

For the purposes of these financial statements, finance lease receivables are classified as loans.

Held-to-maturity investments
The held-to-maturity portfolio represents non-derivative financial assets with fixed or determinable payments and fixed maturities that are quoted in an active market. The group/bank has the intention to hold the financial assets included in the held-to-maturity portfolio to maturity with the purpose of generating profit from coupon and principal payments.
The financial assets of the held-to-maturity portfolio are initially recognised at cost and subsequently measured at amortised cost using the effective interest method, less impairment loss. Gains or losses are recognised in the statement of comprehensive income upon derecognition or impairment of these assets, as well as through the amortisation process. Gains and losses are recognised in the statement of comprehensive income as interest income/expense when the liabilities are derecognised through the amortisation process.

Available-for-sale financial assets
The group and the bank acquire available-for-sale securities to hold them for an undefined period. The available-for-sale portfolio includes fixed income securities, investments in shares and investment funds.

Available-for-sale securities are divided into two portfolios:
- liquidity portfolio, which is aimed at forming the bank's liquidity reserve with a minimum interest rate risk and credit risk;
- investments' held for undefined period portfolio, which consists of investments not classified as part of other portfolios.

Available-for-sale securities are initially measured at fair value including direct transaction costs. Subsequent to initial measurement, available-for-sale securities are revalued at fair value and the result of revaluation to fair value is charged to capital and reserves as a fair value revaluation reserve of available-for-sale securities. Financial assets having no quoted prices available and whose fair value cannot be determined reliably using other models are stated at cost.

For available-for-sale securities acquired at a discount (premium), the respective discount (premium) amount is amortised on a systematic basis, using the effective interest method. Amortised amounts are charged to the statement of comprehensive income as interest income from debt securities.

Any gain or loss resulting from disposal of available-for-sale securities and the fair value revaluation reserve accrued until such disposal are included in the statement of comprehensive income as "Net realised gain/(loss) from available-for-sale financial assets".

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are assets that are held for trading. Financial assets held for trading are included in the trading portfolio. Non-fixed income securities of the trading portfolio are held by the group and the bank for the purpose of selling and/or acquired for generating profit in the near term from the expected spread between purchasing and selling prices. The financial assets and liabilities to be included in the trading portfolio are defined by the bank's trading portfolio policy.

Securities held for trading purposes are initially stated at fair value and further marked-to-market on the basis of quoted market prices. Any gain or loss resulting from revaluation of securities at fair value as well as any gain or loss resulting from disposal of the above securities is included in the statement of comprehensive income under "Net gain/(loss) from financial assets at fair value through profit or loss". Meanwhile, interest income earned and/or accrued is charged to the statement of comprehensive income as interest income from debt securities using the effective interest rate method, while dividend income is recorded as income from dividends if the right to the payment is established.

Derivatives

In the ordinary course of business, the group and the bank use derivative financial instruments — currency swaps, futures, and forward foreign exchange rate contracts. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Derivative financial instruments are carried at cost and restated at fair value at the date of recognition and beyond. Derivative financial instruments are presented in the statement of financial position in a separate caption "Derivatives" under assets and liabilities respectively. The mark-to-market value is defined based on the quoted market prices or discounted cash flow models. Any gain or loss resulting from fair value movements of derivatives is recognised in the statement of comprehensive income as "Net gain/(loss) from financial assets at fair value through profit or loss".

Securities repo agreements

Securities repo agreements are secured financing transactions in which the group and the bank are involved as the seller of securities that are subsequently repurchased by them. The sold securities are continued to be recognised by the group and the bank on the balance sheet as pledged assets according to relevant accounting principles. Proceeds from the sale are recognized as a liability to the purchaser of the securities. Interest income generated by the transaction is recognised in the statement of comprehensive income as interest income over the term of the respective contract using the effective interest rate.

Issued debt securities

The group and the bank recognise issued debt securities at the date when the respective funds are received. After initial recognition when these financial liabilities are stated at fair value, including direct transaction costs, those are subsequently carried at amortised cost using the effective interest method. When issued debt securities are sold at a discount, the difference is amortised applying the effective interest method until the debt matures and charged to the statement of comprehensive income as interest expense.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Other financial liabilities measured at amortised cost

Other financial liabilities measured at amortised cost are mostly liabilities due to credit institutions and non-banking investments. These financial liabilities are recognised at amortised cost, using the effective interest rate.

k) Repossessed real estate

Repossessed real estate represent real estate taken over by the group/bank for the purpose of selling as collateral for the outstanding loans or acquired in the ordinary course of business. Such assets are accounted as inventories and are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

l) Finance Leases — Where the Bank is Lessor

Finance lease is a long-term arrangement, which transfers substantially all the rights and duties incidental to the use of a leased item to the lessee. Finance lease receivables are recognised as assets at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Income from finance leases is recognised over the lease term to produce a constant periodic return on the remaining balance of the liability.
Lease payments are charged to the statement of comprehensive income on a straight-line basis over the lease term.

m) Off-balance Sheet Financial Commitments and Contingent Liabilities

In the ordinary course of business, the group and the bank are involved in off-balance sheet financial instruments comprising loan and credit line commitments, financial guarantees, as well as commercial letters of credit. These financial instruments are presented in the financial statements as memorandum items upon the conclusion of the respective agreements. The methodology for provisioning against off-balance sheet financial commitments and contingent liabilities is consistent with that described in paragraph n) below.

n) Provisions

Provisions are recognised when the group or the bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
The amount of provisions is based on the best management's estimate and assumptions at the year end concerning economic benefits required to settle the present obligation, considering the likelihood of the outflow and recovery of resources from related sources.

o) Impairment of Financial Assets and Financial Commitments

The group/bank issues loans to its customers. Troubled debts are defined as loans and financial commitments with regard to which, based on the monitoring activities performed or other information obtained, the management of the group and the bank believe that the contractual interest and principal due might not be collected or customers might default on other contractual conditions, which might result in an outflow of resources embodying economic benefits.

According to the approved impairment assessment policy, the group and the bank determine allowance for credit losses (impairment allowance). When a loan has been classified as troubled, an allowance for credit losses is established for that specific loan or amount of the outstanding balance, which is deemed impaired. The level of the allowance is based on the present value of expected future cash flows considering relevant factors including, but not limited to, the group's and bank's past loan loss experience, known and inherent risks in the portfolio of loans and advances, adverse situations that

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

may affect the borrowers' ability to repay, the collateral value and current economic conditions as well as other relevant factors affecting loan and advances collectability and collateral values. Ultimate losses may vary from the current estimates. The value of the collateral held in connection with loans and advances is based on the estimated realisable value of the asset. This value is taken into account when determining expected cash flows and, accordingly, the allowance. The group and the bank determine individual and collective (portfolio) impairment.

The above estimates are reviewed periodically. As changes to the allowance become necessary as a result of the review made, respective allowance changes are taken to the statement of comprehensive income of the reporting period. The management of the group and the bank have made their best estimates of losses and believe the estimates presented in the financial statements to be reasonable in the light of the available facts and information.

The individual impairment allowance is determined after individually reviewing all credits for potentially uncollectable amounts. Individual assessment is made for credits that individually have objective evidence of impairment, based on the borrower's financial position, value of collateral, and fulfilment of the loan agreement.

Deterioration in credit quality is estimated by discounting cash flows from loans and receivable balances outstanding, applying the effective interest rate. The required level of the allowance is determined as the difference between the outstanding balance and discounted cash flows from loans and receivable balances outstanding.
Collateral loans are assessed on the basis of estimated cash flows that may result from the realisation of collateral less related realisation costs.

The collective (portfolio) allowance relates to existing credit losses, as well as those 'incurred, but not yet known to the bank'. A group of loans is deemed to be impaired if future cash flows have decreased since the initial recognition of loans and such impairment can be determined reliably, although it cannot be yet attributed to individual loans.
The collective impairment allowance is estimated based upon historical pattern of losses in the loan portfolio, as well as taking into account changes in collateral values, and general economic and market conditions or events that have occurred prior to the reporting date and that indicate an adverse impact on the future cash flows from certain loans and receivable balances outstanding. This method permits attributing each group of loans with similar credit characteristics to historical loss experience and observable market data reflecting current circumstances.

For the purposes of the collective assessment, the bank defines homogeneous pools of loans with similar risk characteristics (source of repayment, collateral type, past-due status).

In determining the rates of allowances for homogeneous pools of mortgage loans, the bank relies on the recoverable amount of loans and the historical number of loans, which become collectible over a certain period, and which in 12 months are brought to the pool with the highest credit risk (incl. the status of collectible loans). When determining the rate for impairment allowances 'incurred, but not yet known to the bank', the identification period of a loss event is assumed to be 3 months. In determining the rates of allowances for individually assessed business loans which have no individual impairment, the bank relies on the historical proportion of loans, which become collectible over a 12 month period and the recoverable value of these loans. When determining the rate for impairment allowances 'incurred, but not yet known to the bank', the identification period of a loss event is assumed to be 6 months.

In determining the amount of allowance for unsecured balances of current accounts and payment cards, it is assumed that these loans become non-recoverable after a specified number of days of delay (between 15—60 days of delay).

The existing allowances are decreased, if any of the following occurs:
- the bank obtains reliable information about additional sources of loan repayment;
- the recoverable amount of the loan has increased as a result of the improvement of the borrower's financial situation or growth of the collateral value. Changes in the market value of collateral may be taken into consideration only if the growth is observed for at least three months.

When loans cannot be recovered, they are written off and charged against allowances for credit losses. They are not written off until all the necessary legal procedures have been completed and the ultimate amount of the loss is determined.

Quantitative and qualitative criteria for the identification of credit quality deterioration, the methodology for estimating future cash flows for individually impaired loans, the establishment of homogeneous pools of loans and the calculation of the rate of collective impairment allowances are laid down in the bank's regulations.

The group/bank conducts an analysis and measures held-to-maturity investments on a regular basis and determines the amount of individual allowances according to the following principles:
- if objective evidence exists that a listed financial instrument is impaired the amount of allowance to be recognised is determined as the difference between the carrying amount and the current market value of the security;
- financial instruments that have been defaulted are measured based on the information at the group's/bank's

disposal concerning debt restructuring. In this case, the amount of allowance is determined as the difference between the carrying amount of the security and the present value of the expected future cash flows expected to be received as a result of debt restructuring;
- if objective evidence exists that a held-to-maturity investment is impaired the required amount of allowance is determined using the discounted cash flow analysis as the difference between the carrying amount of the security and the present value of the expected future cash flows discounted at the effective interest rate of a similar financial asset.

Allowances for incurred but unknown losses are made under the held-to-maturity securities that are rated below investment grade by external credit assessment institutions (credit rating agencies). The allowance rate is determined considering the statistics summarized by external credit assessment institutions (credit rating agencies) regarding possible default on obligations in each rating group and the group's/bank's prior-period losses.

Impairment of held-to-maturity investments is recognised in the statement of comprehensive income as "impairment of financial instruments".

For available-for-sale financial assets, the group/bank assesses regularly, if there is an indication that the assets may be impaired. If there are objective evidence of significant and permanent impairment, then the incurred fair value revaluation reserve is recognised in the statement of comprehensive income as "impairment of financial instruments".
Impairment loss recognised in profit or loss is not reversed through profit or loss. If, in a subsequent period, the fair value of a financial instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss.

p) Impairment of Non-financial Assets

It is assessed at each reporting date if events or changes in circumstances indicate that there is an indication that a non-financial asset may be impaired. This assessment is carried out more often, if there are events or changes in circumstances that indicate that a non-financial asset may be impaired. If any such indication exists, the bank makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down to its recoverable amount. This written down amount constitutes an impairment loss.

For non-financial assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If any such indication exists, the recoverable amount is estimated.

A previously recognised impairment loss is reversed only if there has been a change in the estimate used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. This increase constitutes to reversal of impairment losses.
The recoverable amount of investments in subsidiaries is the higher of their fair value less costs to sell and the value in use. The fair value of investments, if available, is based on binding sales agreements and best information available about similar transactions on the market. The value in use of investments is determined by discounting future estimated cash flows derived from continuing operations of the entity, applying the current market discount rate that reflects current market assessments of the time value of money and the risks specific to the investment.

q) Intangible Assets

Apart from goodwill, intangible assets comprise the purchased software that does not constitute an integral part of hardware, and licences. Amortisation is provided using the straight-line method over the period of acquired rights or over the estimated useful life of the asset.
The group and the bank have applied the annual rates ranging from 10% (10%) to 20% (20%) to amortise their intangible assets.

r) Property and equipment

Property and equipment are recorded at cost less accumulated depreciation and accumulated impairment losses. Depreciation is provided using the straight-line method over the estimated useful life of the asset. When calculating depreciation of the buildings that are classified as tangible fixed assets, the buildings are divided in separate parts (components). Each component is depreciated separately over its estimated useful life. Those assets, including leasehold improvements under construction and preparation, are not depreciated. Land is not subject to depreciation.

The group and the bank have applied the following depreciation rates:

Category	Annual rate
Buildings and property improvements	1,25%—20%
Vehicles	14%
Office equipment, EDP equipment and software	10%—50%

Costs of maintenance and repair are charged to profit and loss as incurred. Leasehold improvements are capitalised and amortised over the remaining period of lease contracts on a straight-line basis.

s) Investment Properties

Investment properties comprise land and buildings, as well as costs of the investment property development project in progress that are not used by the group and the bank, and are held with the main purpose to earn rentals, as well as gain on value appreciation. Such investments are classified as investment property and are accounted for using the cost model of accounting for investment properties. Investment properties are carried in the statement of financial position at their cost value less accumulated depreciation and accumulated impairment losses. The annual depreciation rate applied to investment properties, except for land which is not depreciated, is from 2% to 5%.

t) Employee Benefits

Short-term employee benefits, including salary, statutory social insurance contributions, bonuses and benefits, as well as life insurance premiums are charged to the statement of comprehensive income as administrative expense in the period when the services are provided.
The accrual for employee vacation pay is estimated for the group's or bank's personnel based on the total number of vacation days earned but not taken, multiplied by the average daily remuneration expense pursuant to the Latvian Labour Law, and adding the related statutory social insurance contributions payable by the employer.

u) Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, and balances due from central banks and other credit institutions with a contractual original maturity of three months or less. The cash balance is reduced by the amount of demand deposits from the above institutions. Cash and cash equivalents are short-term, highly liquid assets that are readily convertible to known amounts of cash and that are subject to an insignificant risk of change in value.

v) Adjustments to financial statements after their publication

Following the issuance of financial statements to their approval at shareholders' meeting the shareholders of the bank are entitled to amend these statements.

w) Subsequent events

Post-year-end events that provide additional information about the group's/bank's position at the reporting date (adjusting events) are reflected in these financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

x) Adoption of new and/or changed IFRS and IFRIC interpretations in the reporting year

The group has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2016.

The application of new standards and amendments did not have any impact on these consolidated financial statements:

- IFRS 11 — Accounting for Acquisitions of Interests in Joint Operations;
- IAS 1 — Presentation of Financial Statements;
- IAS 16 — Property, Plant and Equipment and IAS 38 – Intangible Assets;
- IAS 19 — Defined Benefit Plans: Employee Contributions;
- IAS 27 — Separate Financial Statements;
- Annual Improvements to IFRSs.

When the adoption of the standard or interpretation is deemed to have an impact on the consolidated and separate financial statements or performance of the group/bank, its impact is described below.

y) Standards issued but not yet effective and not early adopted
Standards that are issued, but not yet effective or not endorsed by the EU, and which are not applied prior to their official date of validity.
The group and the bank has not applied the following IFRS and IFRIC interpretations that have been issued to the date of these financial statements, but which are not yet effective:

IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2018).

Implementation of IFRS 9
As the potential impact of IFRS 9 on the group's/bank's financial statements and equity is expected to be material, in July 2016 the management of the group/bank decided to establish an IFRS 9 implementation working group. The working group involves two board members of the bank — CRO and CFO who are charged with supervising the project. The working group also involves employees of the Risk Management Division, Financial Records Management, Operational Accounting Department, Business Technologies Department, which aims to provide for cooperation in the implementation of IFRS 9 from model development to implementation in the accounting system. The conformity of the models to the new standard is assessed by external advisers who were engaged to express their opinion on the interpretation of IFRS 9. The working group holds regular meetings to review the status of development of the methodology, assess the reasonableness of assumptions and to make decisions on further action.

The group/bank has set deadlines for stages in the implementation of the new standard. Currently, the initial business models have been defined and calculation principles have been developed for expected credit loss. The next steps include making changes to internal documents of the group/bank, approve these documents with relevant decision-makers and carry out tests and evaluations of the models. One of the tasks for the nearest future is to specify business requirements for changes in the bank's information system.

The group/bank has defined what resources are required to implement the new standard. These primarily are human resources required to develop methodologies and make changes to the bank's information system. These activities are expected to require a considerable amount of work from the bank's staff and it has been taken into account when workloads were planned. The amount of services provided by external suppliers of the information system is not expected to be material. There is a dedicated budget for external advisers.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Classification and measurement
From classification and measurement perspective, the new standard will require all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.
The IAS 39 measurement categories will be replaced by:
- Fair value through profit or loss (FVPL);
- fair value through other comprehensive income (FVOCI); and
- amortised cost.

IFRS 9 will also allow entities to continue to irrevocably designate instruments that qualify for amortised cost or fair value through OCI as FVPL, if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Equity instrument that is not held for trading may be irrevocably designated as FVOCI, with no subsequent reclassification of gains or losses to the income statement.
The accounting for financial liabilities will largely be the same as the requirements of IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated as FVPL. Such movements will be presented in OCI with no subsequent reclassification to the income statements, unless an accounting mismatch in profit or loss would arise.

Having completed its initial assessment, the group/bank has concluded that:
- Loans and balances due from credit institutions that are classified as loans and receivables under IAS 39 are expected to be measured at amortised cost under IFRS 9;
- Financial assets and liabilities held for trading and financial assets and liabilities designated at FVPL are expected to continue to be measured at FVPL;
- The majority of the debt securities classified as available for sale under IAS 39 are expected to be measured at FVOCI;
- It is expected that the majority of the debt securities classified as held to maturity will remain recognised at amortised cost, while the remaining part will be measured at FVOCI;
- Some securities, however, which are classified as available-for-sale or held to maturity under IAS 39, will be classified as FVPL, because of their contractual cash flow characteristics.

Impairment of financial assets
IFRS 9 will also fundamentally change the loan loss impairment methodology. The standard will replace IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. The group/bank will be required to record an allowance for expected loss for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the expected credit loss associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination, in which case, the allowance is based on the probability of default over the life of the asset.
The group/bank is developing a methodology to perform an assessment at the end of each reporting period of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument.
In comparison to IAS 39, the group/bank expects the impairment charge under IFRS 9 to be more volatile and result in an increase in the total level of current impairment allowances.
The group/bank is planning to group its loans into Stage 1, Stage 2 and Stage 3, based on the applied impairment methodology, as described below:
- Stage 1 — Performing loans: when loans are fist recognized, the group/bank recognizes an allowance based on twelve months expected credit losses. Under IAS 39 the group/bank has been recording an allowance for Incurred But Not Identified (IBNI) impairment losses. The change is expected to increase the impairment allowance compared to the current IBNI approach.
- Stage 2 — Loans with significant increase in credit risk: when a loan shows a significant increase in credit risk since initial recognition, the group/bank records an allowance for the lifetime expected credit loss. Since this is a new concept compared to IAS 39, it will result in an increase in the allowance as most such assets are not considered to be credit-impaired under IAS 39. The group/bank intends to evaluate increase in credit risk by comparing the lifetime probability of default upon initial recognition of the asset against the risk of a default occurring on the asset as at the end of each reporting period. In accordance with IFRS 9, a significant increase in credit risk is assumed to have taken place if the borrower falls more than 30 days past due in making its contractual payments, the loan is restructured or other events have been identified that indicate increased credit risk.
- Stage 3 — Impaired loans. Financial assets are recognized in Stage 3 when there is objective evidence that the loan is impaired or payments have been overdue for more than 90 days. The group/bank recognizes the lifetime expected credit losses for these loans and in addition, the bank accrues interest income on the amortised cost of the loan net of allowances. As the criteria of objective evidence are similar to those under IAS 39 methodology, the group/bank does not expect a significant increase in impairment allowances. The individual impairment allowance will continue to be calculated on the same basis as under IAS 39, and collateral values will be adjusted to reflect the amounts that can be expected to be realized.

The group/bank will record impairment for FVOCI debt securities depending on whether they are classified as Stage 1, 2, or 3, as explained above. The expected credit losses will not reduce the carrying amount of these financial assets in the statements of financial position which remain at fair value. Instead, an amount equal to the allowance that would arise if the asset were measured at amortised cost will be recognized in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

For FVOCI debt securities considered to be ‘low risk’, the group/bank intends to apply a policy which assumes that the credit risk on the instrument has not increased significantly since initial recognition and will calculate ECL as explained in Stage 1 above. Such instruments will generally include trade, investment grade securities where the borrower has strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

Transition

According to the conditions of IFRS 9, the group and the bank do not plan to apply full retrospective adjustment when introducing the standard. The adjustments in carrying amount of financial assets as a result from applying the IFRS 9 will be recognized in retained earnings and reserves as at January 1, 2018. The group and the bank expects that it will be possible to disclose the impact stemming from the introduction of IFRS9 and corresponding quantitative information in the interim financial reports of 2017.

IFRS 15 — Revenue from Contracts with Customers (effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.)
IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.
IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The group and the bank has completed an initial review of the potential impact of the adoption of IFRS 15 on its consolidated and separate financial statements. This focused on a review of fees and commission income.
The group and the bank earn fee and commission income (other than fees included in the calculation of the effective interest rate) on provision of the following services:

- payment processing;
- account servicing;
- payment card processing;
- brokerage;
- asset management.

The initial review indicates that IFRS 15 will not have a material impact on the timing of recognition or measurement of fees and commission income. The group and the bank are currently performing a detailed impact assessment and expects to disclose additional information in its 2017 interim financial statements.

IFRS 16 Leases — (Effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15)
IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use (ROU) asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard- i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases - Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The group and the bank have started an initial assessment of the potential impact on its consolidated and separate financial statements. So far, the most significant impact identified is that the Group and the Bank will recognise new assets and liabilities for its operating leases of office premises. In addition, the nature of expenses related to those leases will now change because IFRS 16 replaces the straightline operating lease expense with a depreciation charge for ROU assets and interest expense on lease liabilities. The group and the bank have not yet decided whether it will use the optional exemptions. No significant impact is expected for the group's and the bank’s finance leases. The group and the bank are also in the process of assessing the impact on its CET1 ratio, particularly in respect of ROU assets in leases where the group is a lessee.

Transition

The group and the bank currently plan to apply IFRS 16 initially on 1 January 2019. As a lessee, the group and the bank can either apply the standard using a:

- retrospective approach; or
- modified retrospective approach with optional practical expedients.

The lessee applies the election consistently to all of its leases. The group and the bank have not yet determined which transition approach to apply. As a lessor, the group and the bank are not required to make any adjustments for leases except where it is an intermediate lessor in a sub-lease.
The group and the bank have not yet quantified the impact on its reported assets and liabilities of the adoption of IFRS 16. The quantitative effect will depend on, inter alia, the transition method chosen, the extent to which the group and the bank use the practical expedients and recognition exemptions, and any additional leases that the group and the bank enter into. The group /bank expect to disclose its transition approach and quantitative information before adoption.

Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively. Earlier application is permitted.)
The amendments clarify share-based payment accounting on the following areas:

- the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;
- share-based payment transactions with a net settlement feature for withholding tax obligations; and
- a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity settled.

It is expected that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the group and the bank.

Amendments to IFRS 10 and IAS 28 Sale or contribution of assets between an investor and its associate or joint venture (The effective date has not yet been determined by the IASB, however earlier adoption is permitted.)

The Amendments clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business, such that:

- a full gain or loss is recognised when a transaction between an investor and its associate or joint venture involves the transfer of an asset or assets which constitute a business (whether it is housed in a subsidiary or not), while
- a partial gain or loss is recognised when a transaction between an investor and its associate or joint venture involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

It is expected that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the group and the bank.

Amendments to IAS 7 (Effective for annual periods beginning on or after 1 January 2017, to be applied prospectively. Earlier application is permitted.)
The amendments require new disclosures that help users to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes (such as the effect of foreign exchange gains or losses, changes arising for obtaining or losing control of subsidiaries, changes in fair value).
It is expected that the amendments, when initially applied, will not have a material impact on the financial statements of the group and bank.

Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses (Effective for annual periods beginning on or after 1 January 2017; to be applied prospectively. Earlier application is permitted.)
The amendments clarify how and when to account for deferred tax assets in certain situations and clarify how future taxable income should be determined for the purposes of assessing the recognition of deferred tax assets.
It is expected that the amendments, when initially applied, will not have a material impact on the presentation of the financial statements of the group and the bank because the group and the bank already measure future taxable profit in a manner consistent with the Amendments.

Amendments to IAS 40 Transfers of Investment Property (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively.)
The amendments reinforce the principle for transfers into, or out of, investment property in IAS 40 Investment Property to specify that such a transfer should only be made when there has been a change in use of the property. Based on the amendments a transfer is made when and only when there is an actual

change in use — i.e. an asset meets or ceases to meet the definition of investment property and there is evidence of the change in use. A change in management intention alone does not support a transfer.
The group /bank do not expect that the amendments will have a material impact on the financial statements because the group and the bank transfer a property asset to, or from, investment property only when there is an actual change in use.

IFRIC 22 Foreign Currency Transactions and Advance Consideration (Effective for annual periods beginning on or after 1 January 2018).
The Interpretation clarifies how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. In such circumstances, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.
The group /bank do not expect that the Interpretation, when initially applied, will have material impact on the financial statements as the group and the bank uses the exchange rate on the transaction date for the initial recognition of the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

Annual Improvements to IFRSs
Annual improvements to IFRSs 2014—2016 cycle were issued on 8 December 2016 and introduce two amendments to two standards and consequential amendments to other standards and interpretations that result in accounting changes for presentation, recognition or measurement purposes. The amendments on IFRS 12 Disclosure of Interest in Other Entities are effective for annual periods beginning on or after 1 January 2017 and amendments on IAS 28 Investments in Associates and Joint Ventures are effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively. Earlier application is permitted. None of these amendments are expected to have a significant impact on the financial statements of the group and bank.

The group/bank is currently assessing the impact of these standards to its financial situation and operations. The group/bank plans to implement these standards and interpretations on the effective date of their adoption by the EU.

Note 3

Interest income and expense

EUR '000

Interest income	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Total interest income of financial assets measured at fair value recognised in profit and loss	**37**	**403**	**37**	**-**
Interest income on available-for-sale securities				
on loans and advances to customers	36,530	34,904	36,447	34,579
on held-to-maturity securities	31,512	31,827	30,127	30,831
on available-for-sale securities	15,229	16,076	14,936	15,820
on balances due from credit institutions and central banks	2,711	2,338	2,661	2,317
Total interest income on available-for-sale financial assets at amortised cost	**85,982**	**85,145**	**84,171**	**83,547**
Total interest income	**86,019**	**85,548**	**84,208**	**83,547**
Interest expense				
on ordinary bonds issued	7,042	7,304	7,141	7,361
on subordinated liabilities	5,716	5,892	5,716	5,892
financial stability fee costs	3,566	425	3,566	425
Single Resolution Fund expense	2,019	1,337	2,019	1,337
on the deposit guarentee fund	1,606	4,690	1,606	4,690
on balances due to credit institutions and central banks	1,306	802	1,289	674
on deposits from non-bank customers	187	139	156	129
Total interest expense	**21,442**	**20,589**	**21,493**	**20,508**

The group's/bank's interest income on impaired assets totalled EUR 3.3 (2.4) million. Negative interest income has been included in interest expenses on balances due to credit institutions and central banks.

Note 4

Commission and fee income and expense

EUR '000

Commission and fee income	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
commission on payment transfer handling on behalf of customers	21,200	30,001	21,054	29,894
commission on account service	12,342	12,325	11,995	12,087
commission on handling of settlement cards	8,354	9,034	8,356	9,037
commission on brokerage operations	4,650	8,310	-	-
commission on assets management	3,301	2,363	407	628
commission on documentary operations	1,387	1,189	1,387	1,189
other commission and fee income	1,848	2,342	2,204	2,943
Total commission and fee income	**53,082**	**65,564**	**45,403**	**55,778**
Commission and fee income				
correspondent bank service charges	2,675	4,065	2,668	4,010
commission on payment cards	2,313	2,436	2,314	2,436
commission on customer attraction	1,571	2,385	8,584	9,036
commission on brokerage operations	1,297	1,409	-	-
other commission and fee expense	619	136	549	61
Total commission and fee expense	**8,475**	**10,431**	**14,115**	**15,543**

Note 5

Net gain on transactions with financial instruments and foreign exchange

EUR '000

Financial instruments at fair value through profit or loss	Group 01.01.2016 — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Gain/(loss) from revaluation of financial instruments at fair value through profit or loss	1,693	(699)	1,693	(654)
Derivatives	59	4	59	4
Securities	1,634	(703)	1,634	(658)
Gain/(loss) from trading with financial instruments at fair value through profit or loss	300	660	300	530
Derivatives	(87)	44	(87)	44
Securities	387	616	387	486
Net gain/(loss) from financial instruments at fair value through profit or loss	**1,993**	**(39)**	**1,993**	**(124)**
Available-for-sale financial instruments				
Gain from sale of available-for-sale securities	22,031	1,763	21,950	1,711
Net realised gain from available-for-sale financial instruments	**22,031**	**1,763**	**21,950**	**1,711**
Financial instruments at amortised cost				
(Loss) from sale of held-to-maturity investments	-	(52)	-	(52)
Net realised (loss) from sale of financial instruments	**-**	**(52)**	**-**	**(52)**
Net result from foreign exchange trading and revaluation	**21,373**	**19,827**	**21,247**	**19,769**
Net gain on transactions with financial instruments and foreign exchange	**45,397**	**21,499**	**45,190**	**21,304**

During reporting period a EUR 16.4 million gain was recognized from VISA Europe Ltd. Available-for-sale share buyback transaction. It included a EUR 13.1 million cash transfer, deferred payment of EUR 1.1 million and additionally, 4 750 class C preferred shares of Visa Inc. were allocated to the bank and were recognized in available-for-sale portfolio with fair value on receipt determined at EUR 2.2 million.

Note 6

Net result on transactions with repossessed real estate

EUR '000

	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.
Proceeds from disposal of repossessed real estate	12,079	16,498
Acquisition cost of disposed repossessed real estate	(11,068)	(15,992)
Cost of disposal of repossessed real estate	(66)	(28)
Net gain from sale	**945**	**478**
Proceeds from lease and management of repossessed real estate	330	425
Expense related to management of repossessed real estate	(486)	(576)
Impairment of repossessed real estate	(3,385)	(2,713)
Reversal of impairment of repossessed real estate	173	114
Net result on repossessed real estate	**(2,423)**	**(2,272)**

The net carrying amount of repossessed real estate properties disclosed as assets of the subsidiaries of Pillar Holding Company, KS amounts to EUR 41.3 (52.3) million, and the largest part of which 44.6% (34.8%) consists of land plots for private and commercial construction, and apartments comprise 29.2% (42.3%). Other repossessed real estate includes private houses, commercial sites and parking lots and other auxiliary facilities, which are mostly located within new apartment building projects.

The management of the group has carried out a valuation of these non-financial assets — repossessed real estate (paragraph p)). Following the assessment, changes in reversal of impairment have been identified. Based on the analysis, in 2016 and 2015 the group recognised impairment of these assets.
The gross carrying amount of repossessed real estate properties disclosed as assets of the subsidiaries of Pillar Holding Company, KS amounts to EUR 50.2 (59.1) million and the impairment recognised for these assets at the reporting date was EUR 8.9 (6.8) million.

During the reporting period, impairment charge of repossessed real estate properties increased resulting from revaluation of assets of the subsidiary of the group Pillar 3, SIA. As a precaution, additional impairment of all assets of Pillar 3, SIA was recognized in the reporting period, based on the company's actual sales data of previous periods, additional impairment adjustment factor (10%) was applied to the part of the assets, which was found to bear the marks of lower liquidity.The repossessed real estate recognised on the balance sheet of Pillar 3, SIA at the end of 2016 was EUR 15.9 (25.1) million, which comprised 38.5% (48.0%) of the total repossessed real estate of the group.

Note 7

Other operating income and expense

EUR '000

Other income	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
other income from sale of goods/services of related companies	2,518	5,979	-	-
income from financial consulting, legal, accounting and IT services	2,094	2,462	3,333	3,222
income from insurance	310	260	310	260
recognition of associates under the equity method	184	12	-	-
other operating income	755	868	435	164
Total other income	**5,861**	**9,581**	**4,078**	**3,646**
Other expense				
membership fees	1,441	1,363	1,223	1,154
other expense related to the sale of goods/services of related companies	1,126	4,983	-	-
losses of group due to loss of control	-	163	-	-
other expense	266	13	226	110
Total other expense	**2,833**	**6,522**	**1,449**	**1,264**

Decrease other operating income and expense during the reporting period is due to derecognition of other operating income and expenses of the holding company AmberStone Group, AS, by the group, because in June 2015 the group lost control over this holding company.

Note 8

Impairment allowance for loans

EUR '000

Category	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Loans — individual allowances	27	3,811	322	3,431
Loans — portfolio allowances	379	2,979	359	2,942
Increase/(decrease) in allowances for the reporting year	**406**	**6,790**	**681**	**6,373**
(Recovery) of write-offs/loss from asset write-off	(738)	(902)	(738)	(890)
Impairment allowances established during the reporting year, net	**(332)**	**5,888**	**(57)**	**5,483**

Changes in loan impairment allowances of the group in 2016:

EUR '000

	Mortgage	Business	Other	Consumer	Total
Allowances at the beginning of the year	**14,451**	**7,759**	**1,676**	**69**	**23,955**
Increase	3,027	3,243	720	42	7,032
(Decrease)	(4,033)	(1,831)	(762)	-	(6,626)
Total allowances for the year	**(1,006)**	**1,412**	**(42)**	**42**	**406**
(Decrease) in allowances for the year due to currency fluctations	16	86	-	-	102
(Elimination) of allowances for the year due to write-offs	(5,650)	(2,147)	(269)	(30)	(8,096)
Allowances at the end of the year	**7,811**	**7,110**	**1,365**	**81**	**16,367**
Individual allowances	281	4,490	-	-	4,771
Portfolio allowances	7,530	2,620	1,365	81	11,596
Total gross loans	**321,909**	**641,118**	**82,015**	**1,269**	**1,046,311**

As at 31 December 2016, the impairment allowances for loans represent 1.6% (2.7%) of the group's/bank's loan portfolio. The decrease in allowances for loans during the reporting period is mostly related to improvements in the quality of the mortgage loan portfolio and write-off of lost loans.

Changes in loan impairment allowances of the group in 2015:

EUR '000

	Mortgage	Business	Other	Consumer	Total
Allowances at the beginning of the year	**23,936**	**5,442**	**1,963**	**34**	**31,375**
Increase	7,131	7,097	486	440	15,154
(Decrease)	(5,778)	(1,899)	(285)	(402)	(8,364)
Total allowances for the year	**1,353**	**5,198**	**201**	**38**	**6,790**
(Decrease) in allowances for the year due to currency fluctations	46	(14)	-	-	32
(Elimination) of allowances for the year due to write-offs	(10,884)	(2,867)	(488)	(3)	(14,242)
Allowances at the end of the year	**14,451**	**7,759**	**1,676**	**69**	**23,955**
Individual allowances	234	6,164	-	-	6,398
Portfolio allowances	14,217	1,595	1,676	69	17,557
Total gross loans	**345,728**	**529,836**	**21,242**	**1,152**	**897,958**

Changes in loan impairment allowances of the bank in 2016:

EUR '000

	Mortgage	Business	Other	Consumer	Total
Allowances at the beginning of the year	**14,451**	**7,380**	**1,675**	**69**	**23,575**
Increase	3,012	3,237	734	34	7,017
(Decrease)	(4,018)	(1,543)	(775)	-	(6,336)
Total allowances for the year	**(1,006)**	**1,694**	**(41)**	**34**	**681**
(Decrease) in allowances for the year due to currency fluctations	16	93	-	-	109
(Elimination) of allowances for the year due to write-offs	(5,650)	(2,063)	(269)	(30)	(8,012)
Allowances at the end of the year	**7,811**	**7,104**	**1,365**	**73**	**16,353**
Individual allowances	281	4,490	-	-	4,771
Portfolio allowances	7,530	2,614	1,365	73	11,582
Total gross loans	**321,909**	**623,390**	**82,015**	**1,185**	**1,028,499**

Changes in loan impairment allowances of the bank in 2015:

EUR ’000

	Mortgage	Business	Other	Consumer	Total
Allowances at the beginning of the year	**23,936**	**5,446**	**1,963**	**32**	**31,377**
Increase	7,131	6,681	484	440	14,736
(Decrease)	(5,778)	(1,899)	(284)	(402)	(8,363)
Total allowances for the year	**1,353**	**4,782**	**200**	**38**	**6,373**
(Decrease) in allowances for the year due to currency fluctations	46	(15)	-	-	31
(Elimination) of allowances for the year due to write-offs	(10,884)	(2,833)	(488)	(1)	(14,206)
Allowances at the end of the year	**14,451**	**7,380**	**1,675**	**69**	**23,575**
Individual allowances	234	5,785	-	-	6,019
Portfolio allowances	14,217	1,595	1,675	69	17,556
Total gross loans	**345,728**	**528,953**	**21,241**	**1,152**	**897,074**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Note 9

Administrative expense

EUR '000

Category	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Remuneration to personnel, incl. Statutory Social Insurance Contributions	42,351	40,931	33,299	31,787
Remuneration to management, incl. Statutory Social Insurance Contributions	3,566	2,168	3,566	2,168
Total personnel expense	**45,917**	**43,099**	**36,865**	**33,955**
Consulting and professional services	4,016	3,337	2,991	2,462
Office maintenance	3,544	3,726	2,408	2,563
IT system maintenance and development	3,410	3,312	2,782	2,762
Penalty payment to State Treasury (see Note 37)	3,167	-	3,167	-
Advertising and marketing expenses	1,778	1,739	1,552	1,397
Communications and information resources	1,685	1,587	1,505	1,423
Other personnel expense	1,672	1,673	1,336	1,323
ML/TF inspection expenses (Navigant Consulting Inc.)	1,464	-	1,464	-
Non-deductible VAT	1,404	1,258	1,380	1,210
Donations	881	1,239	654	1,016
Other taxes	782	771	352	244
Sworn auditor statutory audit	138	165	70	57
Sworn auditor other audits	17	34	17	6
Sworn auditor tax consultation	-	15	-	6
Other administrative expense	397	96	229	192
Other administrative expense, total	**24,355**	**18,952**	**19,907**	**14,661**
Total administrative expense	**70,272**	**62,051**	**56,772**	**48,616**

In 2016 and 2015, the group employed an average of 809 (782) persons, whereas the bank employed an average of 655 (636) persons (full–time equivalent).

Number of employees of the group and the bank at the year end:

	Group 31.12.2016. number	Group 31.12.2015. number	Bank 31.12.2016. number	Bank 31.12.2015. number
Management	10	10	10	10
Heads of divisions and departments	152	142	105	102
Other personnel	665	645	550	542
Total at the end of the year	**827**	**797**	**665**	**654**

Note 10

Taxation

EUR '000

	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Corporate income tax	3,130	4,150	2,258	3,178
Deferred tax asset from temporary differences	(750)	2,035	267	2,153
Tax paid abroad	122	197	122	197
Prior year corporate income tax adjustments	(15)	(10)	(23)	(4)
Total corporate income tax expense	**2,487**	**6,372**	**2,624**	**5,524**

Effective corporate income tax calculation:

EUR '000

	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Profit before corporate income tax	81,303	68,246	81,961	74,563
Theoretical corporate income tax	**12,195**	**10,237**	**12,293**	**11,184**
Non-taxable portion for bonds which are publicly traded in the EU/EEA	(6,266)	(6,442)	(6,266)	(6,442)
Other permanent differences	(2,529)	1,605	(2,898)	(365)
Adjustments to prior-year corporate income tax	(15)	(10)	(23)	(4)
Adjustments to prior-year deferred tax	(152)	1,847	-	1,847
Unrecognized deferred tax asset	(73)	-	-	-
Minimum tax from operation	-	21	-	-
Tax rebate	(795)	(1,083)	(604)	(893)
Tax paid abroad	122	197	122	197
Total corporate income tax expense	**2,487**	**6,372**	**2,624**	**5,524**

Deferred tax movement of group:

EUR '000

	01.01.2016.				31.12.2016.		31.12.2016.
	Net balance	Recognized in profit or loss	Recognized in other compre-hensive income	Excluded after loss of control	Net balance	Deferred tax (assets)	Deferred tax liabilities
Temporary difference between tangible fixed asset carrying balance in financial accounting and for tax purposes	1,326	27	-	-	1,353	-	1,353
Fair value revaluation reserve	10	-	78	-	88	-	88
Revaluation of derivatives and securities	(29)	30	-	-	1		1
Revaluation of assets and reserve for unused vacation	(340)	212	-	-	(128)	(128)	-
Deferred tax asset from transactions within the group	(57)	-	-	-	(57)	(57)	-
Tax losses	(273)	(1,019)	-	-	(1,292)	(1,292)	-
Deferred tax (assets)/liabilities before off-set	**637**	**(750)**	**78**	**-**	**(35)**	**(1,477)**	**1,442**
Tax off-set						76	(76)
Net tax (assets)/liabilities						**(1,401)**	**1,366**

Deferred tax asset was not recognised with regard to tax losses of EUR 2.7 (2.2) million as it is not certain that future profits will be available to the group to use this asset.

Given the improved financial performance of the subsidiary ABLV Luxembourg, S.A., the deferred tax position was reviewed during the reporting period. The management recognised a deferred tax asset of EUR 1.1 million, based on the forecast operational results and the amount of projected taxable profit for the next three years disclosed in the strategic plan of ABLV Luxembourg, S.A.

EUR '000

	01.01.2015.				31.12.2015.		31.12.2015.
	Net balance	Recognized in profit or loss	Recognized in other compre-hensive income	Excluded after loss of control	Net balance	Deferred tax (assets)	Deferred tax liabilities
Temporary difference between tangible fixed asset carrying balance in financial accounting and for tax purposes	2,417	(1,091)	-	-	1,326	-	1,326
Fair value revaluation reserve	(294)	-	304	-	10	-	10
Revaluation of derivatives and securities	(265)	236	-	-	(29)	(29)	-
Revaluation of assets and reserve for unused vacations	(2,242)	1,828	-	74	(340)	(340)	-
Deferred tax asset from transactions within the group	(58)	1	-	-	(57)	(57)	-
Tax losses	(1,334)	1,061	-	-	(273)	(273)	-
Deferred tax (assets)/liabilities before off-set	**(1,776)**	**2,035**	**304**	**74**	**637**	**(699)**	**1,336**
Tax off-set						320	(320)
Net tax (assets)/liabilities						**(379)**	**1,016**

Deferred tax movement of bank:

EUR '000

	01.01.2016.				31.12.2016.	31.12.2016.
	Net balance	Recognized in profit or loss	Recognized in other compre-hensive income	Excluded after loss of control	Net balance	Deferred tax (assets)
Temporary difference between tangible fixed asset carrying balance in financial accounting and for tax purposes	1,232	25	-	1,257	-	1,257
Fair value revaluation reserve	10	-	78	88	-	88
Revaluation of derivatives and securities	(29)	30	-	1	-	1
Revaluation of assets and reserve for unused vacations	(212)	212	-	-	-	-
Deferred tax (assets)/liabilities before off-set	**1,001**	**267**	**78**	**1,346**	**-**	**1,346**
Tax off-set					-	-
Net tax (assets)/liabilities					**-**	**1,346**

EUR '000

	01.01.2015.			31.12.2015.		31.12.2015.
	Net balance	Recognized in profit or loss	Recognized in other compre-hensive income	Net balance	Deferred tax (assets))	Deferred tax liabilities
Temporary difference between tangible fixed asset carrying balance in financial accounting and for tax purposes	1,173	59	-	1,232	-	1,232
Fair value revaluation reserve	(294)	-	304	10	-	10
Revaluation of derivatives and securities	(265)	236	-	(29)	(29)	-
Revaluation of assets and reserve for unused vacations	(2,070)	1,858	-	(212)	(212)	-
Deferred tax (assets)/liabilities before off-set	**(1,456)**	**2,153**	**304**	**1,001**	**(241)**	**1,242**
Tax off-set					241	(241)
Net tax (assets)/liabilities					**-**	**1,001**

Taxes paid by the group and the bank:

EUR '000

Tax	Group 01.01.2016. — 31.12.2016.	Group 01.01.2015. — 31.12.2015.	Bank 01.01.2016. — 31.12.2016.	Bank 01.01.2015. — 31.12.2015.
Corporate income tax	2,987	3,609	1,612	3,111
Personal income tax	8,136	7,846	7,180	6,902
Statutory social insurance contributions	10,863	7,814	9,333	6,567
Value added tax	(746)	844	140	159
Real estate tax	751	652	367	244
Risk duty	3	4	3	3
Natural resource tax	2	3	1	-
Total	**21,996**	**20,772**	**18,636**	**16,986**

Note 11

Cash and deposits with central banks

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Demand deposits with the Bank of Latvia	398,719	438,528	398,719	438,528
Cash on hand	14,331	9,662	14,328	9,659
Demand deposits with Banque de Luxembourg	1,381	946	-	-
Total cash and deposits with central banks	**414,431**	**449,136**	**413,047**	**448,187**

As at 31 December 2016 and 2015, the bank had no overdue balances due from central banks.

Note 12

Balances due from credit institutions

As at 31 December 2016, the bank had established correspondent relationships with 32 (32) credit institutions registered in the EU and OECD area, 4 (4) credit institutions registered in Latvia, and 36 (38) credit institutions incorporated in other countries. The group's and bank's major balances due from credit institutions at the reporting date were as follows: Bank of China Limited (Singapore Branch), EUR 48.0 (46.1) million, Landesbank Baden-Wuerttemberg, EUR 45.5 (114.6) million, UBS Switzerland AG EUR 27.0 (18.5) million.

EUR '000

Demand deposits with credit institutions	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Correspondent account balances	178,833	363,058	175,484	359,850
Overnight deposits	3,734	-	16,067	5,000
Total demand deposits with credit institutions	**182,567**	**363,058**	**191,551**	**364,850**
Other balances due from credit institutions				
Term deposits	79,189	296,893	79,189	296,893
Other balances	10,764	10,029	10,764	10,029
Total other balances due from credit institutions	**89,953**	**306,922**	**89,953**	**306,922**
Total balances due from credit institutions	**272,520**	**669,980**	**281,504**	**671,772**

As at 31 December 2016, part of the group's and bank's balances due from credit institutions totalling EUR 24.8 (49.7) million and EUR 24.3 (49.2) million respectively were pledged to secure transactions with financial instruments other than cash equivalents. Cash equivalents do not include the group's and bank's term deposits of EUR 51.1 (5.3) million.

As at 31 December 2016 and 2015, the group's and bank's balances due from credit institutions were neither past due nor impaired. The maximum credit risk exposure of the balances due from credit institutions is equal to the carrying amount of these assets.

Note 13

Financial assets at fair value through profit or loss

EUR '000

Issuer	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Fixed-income debt securities				
Corporate companies	12,352	9,322	-	-
Credit institutions	6,647	1,479	4,671	-
Central governments and central banks	2,483	511	-	-
Financial auxillaries and other financial intermediaries	229	162	-	-
Municipalities	112	13	-	-
Total fixed-income debt securities	**21,823**	**11,487**	**4,671**	**-**
Equity shares				
Corporate companies	272	1,506	272	1,506
Credit institutions	-	1,100	-	1,100
Total investments in equity shares	**272**	**2,606**	**272**	**2,606**
Investments in funds	6,321	12,028	16,067	19,680
Total financial instruments at fair value	**28,416**	**26,121**	**21,010**	**22,286**

The maximum credit risk exposure of securities designated at fair value is equal to the carrying amount of these assets. As at 31 December 2016, the group's and the bank's investments at fair value of EUR 5.3 (11.1) million and EUR 15.0 (18.7) million respectively in open-ended investment funds registered in Latvia, which are redeemable at net asset value, were not listed on stock exchanges.

Ten largest exposures as at 31 December 2016 amounted to 42.6% (46.6%) of the total group's financial assets at fair value through profit or loss, whereas ten largest exposures of the total bank's financial assets at fair value through profit or loss, amounted to 99.9% (87.9%).

Note 14

Available-for-sale financial assets

EUR '000

Issuer	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Fixed-income debt securities				
Central governments	630,171	1,447,424	608,301	1,425,277
Credit institutions	237,546	238,795	214,832	223,449
International organisations	67,092	64,864	67,092	64,864
Corporate companies	64,766	33,008	41,776	31,094
Municipalities	22,760	19,510	17,013	16,590
Financial auxillaries and other financial intermediaries	6,974	6,651	4,806	6,651
Total fixed-income debt securities	**1,029,309**	**1,810,252**	**953,820**	**1,767,925**
Equity shares				
Financial auxillaries and other financial intermediaries	2,974	12,398	2,974	12,398
Corporate companies	300	231	300	231
Total investments in equity shares	**3,274**	**12,629**	**3,274**	**12,629**
Investments in funds	9,991	10,192	-	-
Total available-for-sale financial instruments	**1,042,574**	**1,833,073**	**957,094**	**1,780,554**

The maximum credit risk exposure of securities designated at fair value is equal to the carrying amount of these assets. During the reporting period, an impairment allowance was recognised for available-for-sale debt securities in the amount of EUR 0.3 (1.1) million.

Most of the debt securities' portfolio — 88.9% (90.9%) of assets - has been invested by the bank in investment-grade securities. At the end of the reporting year, the weighted average duration of the bank's securities portfolio was 2.5 (2.5) years.

Ten largest exposures as at 31 December 2016 amounted to 62.2% (78.1%) of the total group's available-for-sale financial assets, whereas ten largest exposures of the total bank's available-for-sale financial assets as at 31 December 2016 amounted to 66.5% (79.3%).

Note 15

Held-to-maturity financial instruments

EUR '000

Issuer	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Fixed-income debt securities				
Central governments and central banks	645,800	602,613	623,428	587,571
Corporate companies	185,403	164,235	159,001	147,119
Credit institutions	120,197	150,774	109,754	137,603
Municipalities	71,615	69,339	69,214	67,014
International organisations	30,322	30,136	28,667	28,512
Financial auxillaries and other financial intermediaries	1,982	516	978	-
Total held-to-maturity financial instruments, gross	**1,055,319**	**1,017,613**	**991,042**	**967,819**
Impairment allowance	(1,332)	(2,566)	(1,332)	(2,566)
Total held-to-maturity financial instruments, net	**1,053,987**	**1,015,047**	**989,710**	**965,253**

The maximum credit risk exposure of held-to-maturity portfolio securities is equal to their carrying amount.

The largest part of the group's portfolio of held-to-maturity securities, 84.9% (81.0%), is invested in investment grade securities. Whereas, the share of the portfolio of held-to-maturity securities that the bank has invested in investment grade securities is 84.1% (80.4%).

As at 31 December 2016, part of the held-to-maturity financial instruments totalling EUR 4.6 (9.4) million were pledged for securing transactions with financial instruments and held-to-maturity financial instruments totalling EUR 53.2 (143.4) million for securing targeted longer-term refinancing operations (TLTRO).

Ten largest exposures as at 31 December 2016 amounted to 59.6% (58.0%) of the total group's held-to-maturity financial instruments, whereas ten largest exposures of the total bank's held-to-maturity financial instruments as at 31 December 2016 amounted to 62.5% (60.1%).

EUR '000

	Group/bank 01.01.2016.—31.12.2016.	Group/bank 01.01.2015.—31.12.2015.
Impairment allowance at the beginning of the period	**2,566**	**1,963**
Increase	623	1,235
(Decrease)	(856)	(587)
(Decrease) due asset to write-offs	(1,017)	(89)
Changes in allowances for the year due to currency fluctations	16	44
Impairment allowance at the end of the period	**1,332**	**2,566**

Note 16

Derivatives

The table below presents the notional amounts and fair values of foreign currency exchange contracts and other derivative financial instruments. The notional amount of foreign currency exchange contracts is the amount receivable. The notional amount of other derivative financial instruments is the value of the underlying assets of these instruments.

EUR '000

	Group 31.12.2016.			Bank 31.12.2016.			Group/bank 31.12.2015.		
		Fair value			Fair value			Fair value	
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
Gold futures	405	59	-	405	59	-	405	4	-
Currency forwards	19,934	565	42	2,903	21	42	5,357	117	365
Total derivatives	**20,339**	**624**	**42**	3,308	80	42	**5,762**	**121**	**365**

The bank uses derivative foreign currency exchange instruments in order to manage currency positions. As at 31 December 2016 and 31 December 2015, payments related to derivatives were not past due.

Note 17

Loans and receivables

The breakdown of loans issued by the group and the bank by customer profile:

EUR '000

Customer profile	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Corporate companies	483,065	406,752	465,337	405,868
Private individuals	348,924	372,906	348,840	372,906
Financial auxiliaries and other financial intermediaries	204,382	118,300	204,382	118,300
Credit institutions	9,940	-	9,940	-
Total gross loans	**1,046,311**	**897,958**	**1,028,499**	**897,074**
Impairment allowance	(16,367)	(23,955)	(16,353)	(23,575)
Total net loans	**1,029,944**	**874,003**	**1,012,146**	**873,499**

At 31 December 2016, a part of liabilities of the group and the bank to other financial intermediaries in the amount of EUR 22.8 (35.1) million was pledged to secure transactions with financial instruments.

More detailed information about impairment allowances for loans is disclosed in Note 8.

The maximum credit risk exposure of loans issued to customers is equal to the carrying amount of these assets.

Ten largest exposures of the group as at 31 December 2016 amounted to 22.9% (23.1%) of the total group's net loan portfolio, however, those of the bank amounted to 23.3% (23.1%) of the total bank's net loan portfolio. No individual impairment allowances has been established for these loans.

The breakdown of loans issued by the group and the bank by category:

EUR '000

Category	Carrying amount 31.12.2016.	Off-balance sheet amount 31.12.2016.	Total exposure, gross 31.12.2016.	Carrying amount 31.12.2015.	Off-balance sheet amount 31.12.2015.	Total exposure, gross 31.12.2015.
Group						
Ordinary loans	851,391	27,517	878,908	772,641	33,768	806,409
Credit lines	109,505	61,672	171,177	99,448	17,205	116,653
Receivable from finance intermediaries	56,395	-	56,395	11,790	-	11,790
Security payments for financial transactions	13,994	-	13,994	7,733	-	7,733
Balances on current accounts	3,261	-	3,261	4,539	-	4,539
Balances on payment cards	1,548	13,187	14,735	1,807	15,708	17,515
Debt securities	10,217	-	10,217	-	-	-
Total gross loans	**1,046,311**	**102,376**	**1,148,687**	**897,958**	**66,681**	**964,639**
Impairment allowance	(16,367)	-	(16,367)	(23,955)	-	(23,955)
Total net loans	**1,029,944**	**102,376**	**1,132,320**	**874,003**	**66,681**	**940,684**
Bank						
Ordinary loans	833,603	27,517	861,120	771,757	33,768	805,525
Credit lines	109,506	61,672	171,178	99,448	17,205	116,653
Receivable from finance intermediaries	56,395	-	56,395	11,790	-	11,790
Security payments for financial transactions	13,994	-	13,994	7,733	-	7,733
Balances on current accounts	3,236	-	3,236	4,539	-	4,539
Balances on payment cards	1,548	13,257	14,805	1,807	15,775	17,582
Debt securities	10,217	-	10,217	-	-	-
Total gross loans	**1,028,499**	**102,446**	**1,130,945**	**897,074**	**66,748**	**963,822**
Impairment allowance	(16,353)	-	(16,353)	(23,575)	-	(23,575)
Total net loans	**1,012,146**	**102,446**	**1,114,592**	**873,499**	**66,748**	**940,247**

The maximum credit risk exposure of loans issued to customers is equal to the carrying amount of these assets.

The breakdown of allowances established by the group and the bank by loan category:

EUR '000

Category	31.12.2016.				31.12.2015.			
		Portfolio allowances				Portfolio allowances		
	Individual allowances	allowances for impaired loans	allowances for not impaired loans	Total	Individual allowances	allowances for impaired loans	allowances for not impaired loans	Total
Group								
Mortgage	281	6,780	750	7,811	234	13,241	976	14,451
Business	4,490	256	2,364	7,110	6,164	185	1,410	7,759
Other	-	1,365	-	1,365	-	1,676	-	1,676
Consumer	-	81	-	81	-	69	-	69
Total impairment allowances for loans	**4,771**	**8,482**	**3,114**	**16,367**	**6,398**	**15,171**	**2,386**	**23,955**
Bank								
Mortgage	281	6,781	749	7,811	234	13,241	976	14,451
Business	4,490	245	2,369	7,104	5,785	185	1,410	7,380
Other	-	1,365	-	1,365	-	1,675	-	1,675
Consumer	-	73	-	73	-	69	-	69
Total impairment allowances for loans	**4,771**	**8,464**	**3,118**	**16,353**	**6,019**	**15,170**	**2,386**	**23,575**

As loans, for which the impairment is recognised, are regarded loans, for which the group/bank has made allowances after the loss event has occurred. Taking into account that at the end of reporting year the group/bank is not aware of all loss events that have occurred, allowances are made for potential loss that have occurred, but are unknown.

The breakdown of loans issued by the group and the bank by industry profile:

EUR '000

Industry	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Mortgage loans to private individuals	307,772	324,731	307,772	324,731
Real estate management	272,525	255,112	277,265	255,112
Financial and insurance activities	213,969	118,086	213,970	118,087
Trading	58,872	47,951	49,530	47,951
Other loans to private individuals	30,914	30,646	30,837	30,646
Manufacturing	29,958	9,964	29,958	9,964
Transportation and logistics	28,099	9,912	28,099	9,912
Energy	3,831	5,148	3,831	5,148
Agriculture	3,781	4,751	3,781	4,751
Construction	13,372	60	278	60
Other industries	66,851	67,642	66,825	67,137
Total net loans	**1,029,944**	**874,003**	**1,012,146**	**873,499**

The breakdown of loans issued by the group and the bank by 5 largest countries of borrowers:

EUR '000

Country	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Latvia	721,342	639,138	726,057	638,634
Russian Federation	135,441	111,867	113,008	111,867
United States of America	51,366	11,611	51,366	11,611
Great Britain	30,832	19,285	30,831	19,285
Ukraine	17,961	18,001	17,961	18,001
Total other countries	73,002	74,101	72,923	74,101
Total net loans	**1,029,944**	**874,003**	**1,012,146**	**873,499**

Collateral analysis for the group’s loans:

EUR ’000

	Total gross loans	Deposit	Securities	Real estate	Other collateral	Fair value of collateral, total
Category						**31.12.2016.**
Mortgage	**321,909**	**197**	**-**	**355,429**	**376**	**356,002**
LTV up to 100%	123,990	197	-	224,076	376	224,649
LTV over 100%	197,919	-	-	131,353	-	131,353
Business	**641,118**	**46,008**	**351,877**	**607,085**	**260,567**	**1,265,537**
LTV up to 100%	604,239	46,008	351,877	590,695	260,458	1,249,038
LTV over 100%	36,879	-	-	16,390	109	16,499
Other	**82,015**	**-**	**-**	**-**	**1**	**1**
LTV up to 100%	-	-	-	-	-	-
LTV over 100%	82,015	-	-	-	1	1
Consumer	**1,269**	**1,895**	**18**	**-**	**-**	**1,913**
LTV up to 100%	405	1,895	18	-	-	1,913
LTV over 100%	864	-	-	-	-	-
Total gross loans	**1,046,311**	**48,100**	**351,895**	**962,514**	**260,944**	**1,623,453**
Impairment allowance	(16,367)					
Total net loans	**1,029,944**					
Category						**31.12.2015.**
Mortgage	**345,728**	**7**	**-**	**361,203**	**100**	**361,310**
LTV up to 100%	121,494	7	-	216,846	100	216,953
LTV over 100%	224,234	-	-	144,357	-	144,357
Business	**529,836**	**22,845**	**314,832**	**518,402**	**69,497**	**925,576**
LTV up to 100%	489,384	21,942	314,832	494,673	68,824	900,271
LTV over 100%	40,452	903	-	23,729	673	25,305
Other	**21,242**	**-**	**-**	**-**	**1**	**1**
LTV up to 100%	-	-	-	-	-	-
LTV over 100%	21,242	-	-	-	1	1
Consumer	**1,152**	**2,002**	**-**	**-**	**-**	**2,002**
LTV up to 100%	382	2,002	-	-	-	2,002
LTV over 100%	770	-	-	-	-	-
Total gross loans	**897,958**	**24,854**	**314,832**	**879,605**	**69,598**	**1,288,889**
Impairment allowance	(23,955)					
Total net loans	**874,003**					

LTV[5] above 100% does not generate significant risk as allowances are recognised both for existing losses and losses that have been incurred but are not yet known. The need for allowances is assessed by taking into account the unsecured portion of a mortgage and consumer loan and the statistics collected on loan movements to lower quality groups. Allowances for corporate loans are recognised if the primary source of repayment or cash flows from operating activities of the client and the secondary source of repayment, or potential income from the sale of collateral becomes insufficient for repayment of the loan. As concerns other loans, the most significant part is brokerage accounts and security deposits which are partially covered by customer funds.

5 LTV — loan carrying amounts to the fair value of collateral, where LTV < 100%, if the carrying amount of the loan is lower than fair value of collateral, but LTV > 100%, if the carrying amount of the loan is higher than the fair value of collateral or loans are unsecured.

Collateral analysis for the bank's loans:

EUR '000

	Total gross loans	Deposit	Securities	Real estate	Other collateral	Fair value of collateral, total
Category						**31.12.2016.**
Mortgage	**321,909**	**198**	**-**	**355,429**	**376**	**356,003**
LTV up to 100%	123,990	198	-	224,076	376	224,650
LTV over 100%	197,919	-	-	131,353	-	131,353
Business	**623,390**	**27,461**	**354,991**	**613,210**	**260,568**	**1,256,230**
LTV up to 100%	586,504	27,461	354,991	596,820	260,459	1,239,731
LTV over 100%	36,886	-	-	16,390	109	16,499
Other	**82,015**	**-**	**-**	**-**	**1**	**1**
LTV up to 100%	-	-	-	-	-	-
LTV over 100%	82,015	-	-	-	1	1
Consumer	**1,185**	**1,838**	**-**	**-**	**-**	**1,838**
LTV up to 100%	331	1,838	-	-	-	1,838
LTV over 100%	854	-	-	-	-	-
Total gross loans	**1,028,499**	**29,497**	**354,991**	**968,639**	**260,945**	**1,614,072**
Impairment allowance	(16,353)					
Total net loans	**1,012,146**					
Category						**31.12.2015.**
Mortgage	**345,728**	**7**	**-**	**361,203**	**100**	**361,310**
LTV up to 100%	121,494	7	-	216,846	100	216,953
LTV over 100%	224,234	-	-	144,357	-	144,357
Business	**528,953**	**22,845**	**314,832**	**512,802**	**67,257**	**917,736**
LTV up to 100%	488,501	21,942	314,832	489,073	66,584	892,431
LTV over 100%	40,452	903	-	23,729	673	25,305
Other	**21,241**	**-**	**-**	**-**	**1**	**1**
LTV up to 100%	-	-	-	-	-	-
LTV over 100%	21,241	-	-	-	1	1
Consumer	**1,152**	**2,002**	**-**	**-**	**-**	**2,002**
LTV up to 100%	382	2,002	-	-	-	2,002
LTV over 100%	770	-	-	-	-	-
Total gross loans	**897,074**	**24,854**	**314,832**	**874,005**	**67,358**	**1,281,049**
Impairment allowance	(23,575)					
Total net loans	**873,499**					

The principles for determining the fair value of collateral are described in Note 32. During the reporting year, the real estate with a total value of EUR 1.2 (8.6) million was taken over.

Note 18

Investments in subsidiaries and associates

The group's investments in associates:

EUR '000

		31.12.2016.				31.12.2015.			
Company	Country of incorporation	Share capital	Equity (non-audited)	Group's share of total share capital, %	Carrying amount by equity method	Share capital	Equity (non-audited)	Group's share of total share capital, %	Carrying amount by equity method
AmberStone Group, AS	LV	35,000	40,886	24.28	9,117	35,000	40,158	24.64	9,068
Total investments in associates		**35,000**	**40,886**	**x**	**9,117**	**35,000**	**40,158**	**x**	**9,068**

The bank's investments in associates:

EUR '000

Company	Country of incorporation	31.12.2016. Share capital	Equity (non-audited)	Group's share of total share capital, %	Carrying amount by cost method	31.12.2015. Share capital	Equity (non-audited)	Group's share of total share capital, %	Carrying amount by cost method
AmberStone Group, AS	LV	35,000	40,886	24.28	8,635	35,000	40,158	24.64	8,770
Total investments in associates		**35,000**	**40,886**	**x**	**8,635**	**35,000**	**40,158**	**x**	**8,770**

Movements in the investments in subsidiaries and associates:

EUR '000

	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Investments at the beginning of the year	**9,068**	**2**	**8,770**	**-**
Establishment/(disposal) of associates	(135)	(2)	(135)	-
Change in investments in associates under equity method	184	12	-	-
Increase in investments in associates as a result of loss of control over subsidiary	-	9,056	-	8,770
Investments at the end of the year	**9,117**	**9,068**	**8,635**	**8,770**

Consolidated operating results of associated company Amberstone Group, AS:

EUR '000

Position	31.12.2016. (non-audited)	31.12.2015. (audited)
Non-current assets	27,826	24,432
Current assets	25,888	29,277
Total assets	**53,714**	**53,709**
Non-current liabilities	8,597	8,294
Current liabilities	4,231	5,800
Total liabilities	**12,828**	**14,094**
Total equity	40,886	39,615
profit/(loss) for the reporting period	759	(5)
Total equity and liabilities	**53,714**	**53,709**

Changes in non-controlling interest:

EUR '000

	Group 01.01.2016.— 31.12.2016.	Group 01.01.2015.— 31.12.2015.
Non-controlling interest at the beginning of the year	**876**	**12,337**
Increase in non-controlling share investement	1,723	126
Part of profit related to the non-controlling share	222	597
Distributed dividends	(550)	(292)
Issue of personnel shares	-	36
(decrease) in non-controlling share as a result of losing control	-	(11,928)
Non-controlling share at the end of the year	**2,271**	**876**

Group entities:

No	Company	Country of incorporation	Registration number
1	ABLV Bank, AS	LV	50003149401
2	ABLV Bank Luxembourg, S.A.	LU	B 162048
3	ABLV Consulting Services, AS	LV	40003540368
4	ABLV Advisory Services, SIA	LV	40103964811
5	ABLV Corporate Services HoldingCompany, SIA	LV	40103799987
6	ABLV Corporate Services, SIA	LV	40103283479
7	ABLV Corporate Services, LTD	CY	HE273600
8	ABLV Capital Markets, IBAS	LV	40003814705
9	ABLV Asset Management, IPAS	LV	40003814724
10	PEM, SIA	LV	40103286757
11	PEM 1, SIA	LV	40103551353
12	ABLV Private Equity Fund 2010, KS	LV	40103307758
13	New Hanza Capital, AS	LV	50003831571
14	NHC 1, SIA	LV	50103247681
15	NHC 2, SIA	LV	40103963977
16	NHC 3, SIA	LV	50103994841
17	NHC 4, SIA	LV	40203032424
18	NHC 5, SIA	LV	50203032411
19	NHC 6, SIA	LV	40203032439
20	Pillar, SIA	LV	40103554468
21	Pillar Holding Company, KS	LV	40103260921
22	Pillar 3, SIA	LV	40103193067
23	Pillar 4 & 6, SIA	LV	40103210494
24	Pillar 7 & 8, SIA	LV	40103240484
25	Pillar 9, SIA	LV	40103241210
26	Pillar 11, SIA	LV	40103258310
27	Pillar 2, 12 & 14, SIA	LV	50103313991
28	Pillar 18, SIA	LV	40103492079
29	Pillar 19, SIA	LV	40103766952
30	Pillar 20, SIA	LV	40103903056
31	Pillar 21, SIA	LV	40103929286
32	Pillar 22, SIA	LV	50103966301
33	Pillar Management, SIA	LV	40103193211
34	Pillar RE Services, SIA	LV	40103731804
35	Pillar Contractor, SIA	LV	40103929498
36	Pillar Architekten, SIA	LV	40103437217
37	Pillar Development, SIA	LV	40103222826
38	Pillar Utilities, SIA	LV	40103693339
39	ABLV Building Complex, SIA	LV	40203037667

Business profile	31.12.2016. Share in the entity's capital (%)	31.12.2016. Share in the entity's capital with voting rights (%)	31.12.2015. Share in the entity's capital (%)	31.12.2015. Share in the entity's capital with voting rights (%)
Financial services	100	100	100	100
Financial services	100	100	100	100
Consulting services	100	100	100	100
Consulting services	100	100	-	-
Holding company	100	100	100	100
Consulting services	100	100	100	100
Consulting services	100	100	100	100
Financial services	90	100	90	100
Financial services	90	100	90	100
Investment project management	51	51	100	100
Wholesale trade services of other machinery and equipment	51	51	17.3	17.3
Investment activities	-	-	100	100
Holding company	88	88	91.6	91.6
Investments in real estate	88	88	100	100
Investments in real estate	88	88	-	-
Investments in real estate	88	88	-	-
Investments in real estate	88	88	-	-
Investments in real estate	88	88	-	-
Investments in real estate	88	88	-	-
Holding company	100	100	100	100
Holding company	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	100	100
Real estate transactions	100	100	-	-
Real estate management and administration	100	100	100	100
Parking management	100	100	100	100
Management and coordination of construction processes	100	100	100	100
Designing and designers supervision	100	100	100	100
Infrastructure maintenance	100	100	100	100
Infrastructure management	100	100	100	100
Investments in real estate	100	100	-	-

Open-ended mutual funds included in the group:

No	Open-end mutual fund	Country of registration	ISIN	Fund type	31.12.2016. Share in the entity's capital (%)	31.12.2015. Share in the entity's capital (%)
1	ABLV Multi-Asset Total Return USD Fund	LV	LV0000400919	Total return fund	70.6	76.0
2	ABLV High Yield CIS RUB Bond Fund	LV	LV0000400778	Corporate bond fund	69.3	69.3
3	ABLV Emerging Markets Corporate USD Bond Fund	LV	LV0000400935	Corporate bond fund	58.4	86.6
4	ABLV European Industry EUR Equity Fund	LV	LV0000400844	Equity fund	54.6	57.5

The bank’s investments in subsidiaries:

EUR ’000

		31.12.2016.				31.12.2015.			
Company	Country of incorporation	Share capital	Equity	Bank's share of total share capital, %	Carrying amount	Share capital	Equity	Bank's share of total share capital, %	Carrying amount
Pillar Holding Company, KS	LV	75,000	54,373	100	75,000	85,000	69,068	100	85,000
ABLV Bank Luxembourg, S.A.	LU	25,000	15,191	100	25,000	25,000	14,430	100	25,000
Pillar Development, SIA	LV	15,600	14,087	100	15,600	12,300	11,275	100	12,300
New Hanza Capital, AS	LV	15,000	14,904	88	13,200	-	-	-	-
ABLV Building Complex, SIA	LV	8,500	8,497	100	8,500	-	-	-	-
Pillar Management, SIA	LV	1,000	991	100	1,073	1,000	975	100	1,073
ABLV Capital Markets, IBAS	LV	1,000	4,173	90	900	1,000	6,423	90	900
ABLV Consulting services, AS	LV	711	907	100	711	711	802	100	711
ABLV Asset Management, IPAS	LV	650	830	90	585	650	1,032	90	585
PEM, SIA	LV	100	849	51	51	100	(256)	100	100
ABLV Corporate Services Holding Company, SIA	LV	100	211	100	100	100	141	100	100
Pillar, SIA	LV	3	(2)	100	6	3	2	100	6
ABLV Advisory Services, SIA	LV	3	26	100	3	-	-	-	-
ABLV Private Equity Fund 2010, KS	LV	-	-	-	-	50	2,492	100	50
Total bank's investments in subsidiaries, gross		**142,667**	**115,037**	**x**	**140,729**	**125,914**	**106,384**	**x**	**125,825**
Allowance for impairment					(20,784)				(14,559)
Total bank's investments in subsidiaries, net					**119,945**				**111,266**

Management believes that the investment in the Bank’s subsidiary ABLV Bank Luxembourg, S.A. is not impaired, as the present value of future cash flows exceeds the bank’s investment in the subsidiary and amounts to EUR 36.8 (46.8) million. As at 31 December 2015, the value of this investment was measured by the management of the bank using a different valuation method, therefore they are not directly comparable. The projected cash flow is discounted with a 12.2% (11.0%) discount rate. The estimates are based on the approved financial plan of ABLV Bank Luxembourg, S.A. for time period from 2017 to 2026, assuming that the profit of the subsidiary can be distributed in dividends, observing the minimum capital adequacy ratio determined by the Regulation. The first operating years of ABLV Bank Luxembourg, S.A. were planned with significant losses due to administrative expenses and low income. In further periods the expected income from client commissions and interest income increase significantly, thus exceeding the administrative costs and achieving profit. The compound annual growth rate from operating activities is forecast to be 16.7% (24.0%), compared to the actual data of 2016. Should the discount rate used in the calculations increase by 1 percentage point — to 13.2%, then the forecast present value of future cash flows would decrease by 10.3% to EUR 32.9 million. However, if profit from operating activities is forecast to grow at a slower pace — by 2 percentage points, then the forecast present value of future cash flows would decrease by 19.2% to EUR 29.6 million, which still exceeds the carrying amount of the bank's investment in ABLV Bank Luxembourg, S.A.

During the reporting period, the bank established a new subsidiary ABLV Building Complex, SIA with share capital of EUR 8.5 million. The new subsidiary will be the contracting authority for the construction of the head office building complex of the bank.
During the reporting period, according to prior plans the subsidiary ABLV Private Equity Fund 2010, KS was liquidated. This subsidiary was an investment fund, which was established to make investments in leading and prospective Latvian companies. During the operation of the fund, several investment projects were realised, which provided more than 20% annual profitability for invested capital. As all of the ABLV Private Equity Fund 2010, KS, investments were realised, the bank decided to liquidate the company.
Customer assets under trust management by ABLV Asset Management, IPAS and assets of the open investment funds managed by ABLV Asset Management, IPAS at the end of the reporting period amount to EUR 127.2 (131.2) million. Customer financial instruments of ABLV Capital Markets, IBAS at the end of the reporting period amount to EUR 1.27 (1.15) billion. The bank and ABLV Capital Markets, IBAS provide investments services to customers jointly: ABLV Capital Markets, IBAS accepts customer orders for transactions with financial instruments and the bank executes these orders and acts as the custodian of customer financial instruments.
Credit risk and other risks related to these assets are borne by the customer, who provided these assets the group and/or the bank for trust management.

Movements in the allowance for impairment of subsidiaries:

EUR '000

	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Allowance for impairement at the beginning of the period	**14,559**	**11,719**
Increase in allowance for impairement	6,225	2,840
Allowance for impairement at the end of the period	**20,784**	**14,559**

During the reporting period the bank recognised allowance impairment of its subsidiary Pillar Holding Company, KS amounting to EUR 6.2 (2.8) million. This allowance impairment is related to the decrease in estimated cash flow expected to be generated by subsidiary operations (see Note 6). The recoverable value of the investment was measured at value in use determined by discounting future cash flows from the sale of property owned by subsidiaries at the expected market value on the date of sale net of selling and maintenance costs of this property. If the cash flow discount rate of Pillar Holding Company, KS was increased by 1 percentage point to 4.0%, then the investment in subsidiaries would decrease by 1.3% or EUR 0.5 million.

Movements in the bank's investment in subsidiaries:

EUR '000

	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Investments at the beginning of period, gross	**125,825**	**126,818**
Established/(dispossessed) subsidiaries	21,703	1,073
(Decrease) in investments due to the loss of control	-	(5,725)
Increase in investments in subsidiaries	3,300	6,980
Decrease in investments in subsidiaries	(10,099)	(3,321)
Investments at the end of the period, gross	**140,729**	**125,825**
Allowance for impairment	(20,784)	(14,559)
Investments at the end of the period, net	**119,945**	**111,266**

Note 19

Investment properties

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Land	23,306	22,142	24,910	24,910
Buildings	11,384	834	148	159
Total investment properties	**34,690**	**22,976**	**25,058**	**25,069**

In 2016, the bank's lease and rent income from investments in real estate amounted to EUR 86.0 (29.8) thousand, maintenance expenses — EUR 290.1 (187.8) thousand, including maintenance expenses for non-performing real estate — EUR 209.3 (161.4) thousand.

However, the group's lease and rent income from investments in real estate amounted to EUR 571.9 (29.8) thousand, maintenance expense — EUR 472.7 (187.8) thousand, including maintenance expense for non-performing real estate — EUR 209.3 (161.4) thousand.

The fair value of investment properties is described in Note 32.

Movements in the group's and bank's investment properties in 2016:

EUR '000

	Group			Bank		
	Land	Buildings	Total, excl. prepayments	Land	Buildings	Total, excl. prepayments
Acquisition value as at 01.01.2016.	**22,142**	**1,000**	**23,142**	**24,910**	**225**	**25,084**
Additions	1,349	11,132	12,481	-	-	-
Reclassification to property and equipment	(185)	-	(185)	-	-	-
Disposals	-	(471)	(471)	-	-	-
Acquisition value as at 31.12.2016.	**23,306**	**11,661**	**34,967**	**24,910**	**225**	**25,084**
Accumulated depreciation as at 01.01.2016.	**-**	**166**	**166**	**-**	**66**	**66**
Depreciation charge	-	111	111	-	11	11
Accumulated depreciation as at 31.12.2016.	**-**	**277**	**277**	**-**	**77**	**77**
Net carrying amount as at 01.01.2016.	**22,142**	**834**	**22,976**	**24,910**	**159**	**25,069**
Net carrying amount as at 31.12.2016.	**23,306**	**11,384**	**34,690**	**24,910**	**148**	**25,058**

Movements in the group's and bank's investment properties in 2015:

EUR '000

	Group				Bank		
	Land	Construction in progress	Buildings	Total, excl. prepayments	Land	Buildings	Total, excl. prepayments
Acquisition value as at 01.01.2015	**22,094**	**7,073**	**947**	**30,114**	**24,859**	**225**	**25,084**
Additions	48	-	-	48	51	-	51
Reclassification	-	(7,073)	53	(7,020)	-	-	-
Acquisition value as at 31.12.2015	**22,142**	**-**	**1,000**	**23,142**	**24,910**	**225**	**25,135**
Accumulated depreciation as at 01.01.2015.	**-**	**-**	**118**	**118**	**-**	**55**	**55**
Depreciation charge	-	-	48	48	-	11	11
Accumulated depreciation as at 31.12.2015	**-**	**-**	**166**	**166**	**-**	**66**	**66**
Net carrying amount as at 01.01.2015.	**22,094**	**7,073**	**829**	**29,996**	**24,859**	**170**	**25,029**
Net carrying amount as at 31.12.2015.	**22,142**	**-**	**834**	**22,976**	**24,910**	**159**	**25,069**

Note 20

Intangible assets, property and equipment

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Intangible assets	5,600	6,133	5,366	5,811
Prepayments for intangible fixed assets	460	232	460	225
Total intangible assets	**6,060**	**6,365**	**5,826**	**6,036**
Buildings and property improvements	5,644	6,280	3,785	4,167
Construction in progress	11,186	8,162	-	-
Office equipment and IT hardware	3,542	3,375	3,019	2,616
Land	3,123	2,938	173	173
Vehicles	1,646	1,441	1,054	984
Art objects	942	866	942	866
Leasehold improvements	424	509	424	509
Prepayments for tangible fixed assets	760	296	64	214
Total property and equipment	**27,267**	**23,867**	**9,461**	**9,529**

As at 31 December 2016, the group had intangible assets, property and equipment with the carrying amount of 0, and amortised cost of EUR 6.2 (6.1) million, whereas the cost of the bank's intangible assets, property and equipment was EUR 6.1 (5.9) million.

Movements in the group's intangible assets, property and equipment in 2016:

	Goodwill	Intangible fixed assets	Land	Production equipment
Acquisition value as at 01.01.2016.	**-**	**12,582**	**2,938**	**-**
Additions	-	839	-	-
Reclassification	-	-	185	-
Disposals and written-offs	-	(1)	-	-
Acquisition value as at 31.12.2016.	**-**	**13,420**	**3,123**	**-**
Accumulated depreciation as at 01.01.2016.	**-**	**6,449**	**-**	**-**
Depreciation charge	-	1,372	-	-
Depreciation write-off	-	(1)	-	-
Accumulated depreciation as at 31.12.2016.	**-**	**7,820**	**-**	**-**
Net carrying amount as at 01.01.2016.	**-**	**6,133**	**2,938**	**-**
Net carrying amount as at 31.12.2016.	**-**	**5,600**	**3,123**	**-**

Movements in the group's intangible assets, property and equipment in 2015:

	Goodwill	Intangible fixed assets	Land	Production equipment
Acquisition value as at 01.01.2015.	**229**	**10,962**	**4,055**	**7,270**
Additions	-	2,158	-	-
Reclassification	-	(2)	-	-
Disposals	(229)	(5)	(1,117)	(7,270)
Disposals and written-offs	-	(531)	-	-
Acquisition value as at 31.12.2015.	**-**	**12,582**	**2,938**	**-**
Accumulated depreciation as at 31.12.2015.	**-**	**5,699**	**-**	**2,213**
Depreciation charge	-	1,264	-	-
Reclassification	-	9	-	-
Disposals due to loss of control	-	(2)	-	(2,213)
Depreciation write-off	-	(521)	-	-
Accumulated depreciation as at 31.12.2015.	**-**	**6,449**	**-**	**-**
Net carrying amount as at 01.01.2015.	**229**	**5,263**	**4,055**	**5,057**
Net carrying amount as at 31.12.2015.	**-**	**6,133**	**2,938**	**-**

EUR '000

Construction in progress and leasehold improvements	Buildings and property improvements	Vehicles	Office equipment and IT hardware and other fixed assets	Total, excl. prepayments
9,539	**11,195**	**2,058**	**14,016**	**52,328**
3,068	2	613	1,753	6,275
-	-	-	-	185
-	-	(275)	(1,642)	(1,918)
12,607	**11,197**	**2,396**	**14,127**	**56,870**
868	**4,915**	**617**	**9,775**	**22,624**
129	638	320	1,489	3,948
-	-	(187)	(1,621)	(1,809)
997	**5,553**	**750**	**9,643**	**24,763**
8,671	**6,280**	**1,441**	**4,241**	**29,704**
11,610	**5,644**	**1,646**	**4,484**	**32,107**

EUR '000

Construction in progress and leasehold improvements	Buildings and property improvements	Vehicles	Office equipment and IT hardware	Total, excl. prepayments
1,546	**26,822**	**2,273**	**13,965**	**67,122**
1,159	34	596	1,358	5,305
7,033	(8)	-	2	7,025
(199)	(15,653)	(531)	(686)	(25,690)
-	-	(280)	(623)	(1,434)
9,539	**11,195**	**2,058**	**14,016**	**52,328**
746	**6,153**	**703**	**8,867**	**24,381**
122	1,014	286	2,285	4,971
-	(2)	-	(9)	(2)
-	(2,250)	(191)	(758)	(5,414)
-	-	(181)	(610)	(1,312)
868	**4,915**	**617**	**9,775**	**22,624**
800	**20,669**	**1,570**	**5,098**	**42,741**
8,671	**6,280**	**1,441**	**4,241**	**29,704**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Movements in the bank's intangible assets, property and equipment in 2016:

EUR '000

	Intangible fixed assets	Land	Buildings and property improvements	Leasehold inprovements	Vehicles	Office equipment and IT hardware and other fixed assets	Total, excluding prepayments
Acquisition value as at 01.01.2016.	**11,691**	**173**	**7,921**	**1,120**	**1,396**	**12,308**	**34,609**
Additions	800	-	-	44	322	1,676	2,842
Disposals and written-offs	-	-	-	-	(110)	(1,584)	(1,694)
Acquisition value as at 31.12.2016.	**12,491**	**173**	**7,921**	**1,164**	**1,608**	**12,400**	**35,757**
Accumulated depreciation as at 01.01.2016.	**5,880**	**-**	**3,754**	**611**	**412**	**8,826**	**19,483**
Depreciation charge	1,245	-	382	129	196	1,179	3,131
Depreciation write-off	-	-	-	-	(54)	(1,566)	(1,620)
Accumulated depreciation as at 31.12.2016.	**7,125**	**-**	**4,136**	**740**	**554**	**8,439**	**20,994**
Net carrying amount as at 01.01.2016.	**5,811**	**173**	**4,167**	**509**	**984**	**3,482**	**15,126**
Net carrying amount as at 31.12.2016.	**5,366**	**173**	**3,785**	**424**	**1,054**	**3,961**	**14,763**

Movements in the bank's intangible assets, property and equipment in 2015:

EUR '000

	Intangible fixed assets	Land	Buildings and property improvements	Leasehold inprovements	Vehicles	Office equipment and IT hardware and other fixed assets	Total, excluding prepayments
Acquisition value as at 01.01.2015.	**10,127**	**173**	**7,890**	**1,091**	**1,150**	**11,783**	**32,214**
Additions	2,084	-	31	29	416	1,111	3,671
Reclassification	(2)	-	-	-	-	2	-
Disposals and written-offs	(518)	-	-	-	(170)	(588)	(1,276)
Acquisition value as at 31.12.2015.	**11,691**	**173**	**7,921**	**1,120**	**1,396**	**12,308**	**34,609**
Accumulated depreciation as at 01.01.2015.	**5,231**	**-**	**3,378**	**490**	**368**	**7,873**	**17,340**
Depreciation charge	1,151	-	376	121	175	1,543	3,366
Reclassification	9	-	-	-	-	(9)	-
Depreciation write-off	(511)	-	-	-	(131)	(581)	(1,223)
Accumulated depreciation as at 31.12.2015.	**5,880**	**-**	**3,754**	**611**	**412**	**8,826**	**19,483**
Net carrying amount as at 01.01.2015.	**4,896**	**173**	**4,512**	**601**	**782**	**3,910**	**14,874**
Net carrying amount as at 31.12.2015.	**5,811**	**173**	**4,167**	**509**	**984**	**3,482**	**15,126**

Information about contractual commitments on the purchase of intangible assets, property and equipment is disclosed in Note 28.

Note 21

Other assets

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Receivables	1,133	1,363	501	504
Payments for financial instruments	162	102	162	102
Total other financial assets	**1,295**	**1,465**	**663**	**606**
Due from state treasury	2,170	419	346	-
Deferred expenses and accrued income	2,138	1,928	1,636	1,239
Stock	994	995	-	-
Precious metals	451	401	451	401
Other assets	1,167	1,120	742	669
Total other non-financial assets	**6,920**	**4,863**	**3,175**	**2,309**
Impairment expense	(333)	(336)	(128)	(178)
Total other assets, net	**7,882**	**5,992**	**3,710**	**2,737**

Note 22

Due to Bank of Latvia and demand deposits from credit institutions

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Targeted longer term refinancing operation (TLTRO) liabilities	50,000	180,072	50,000	180,072
Total balances due to Bank of Latvia	**50,000**	**180,072**	**50,000**	**180,072**

In March 2016, ECB announced a new targeted longer-term refinancing operations actions (hereinafter — TLTRO) — TLTRO II with an even lower interest rate and a 4-year term, as well as announced the opportunity to cover previous liabilities before maturity.

Using this opportunity and assessing the current necessity for long-term resources, group/bank prematurely repaid EUR 180.0 million, which it had received previously within the program. Subsequently, within TLTRO II group/bank attracted funds in the amount of EUR 50.0 million, to increase the term of using resources and reduce the interest expenses.

Demand deposits from credit institutions:

EUR '000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Latvian credit institutions	12,138	40,346	12,138	40,346
Credit institutions from other countries	4,105	6,937	4,105	6,937
Credit institutions from EMU countries	220	1,871	4,132	16,011
Total demand deposits from credit institutions	**16,463**	**49,154**	**20,375**	**63,294**

As at 31 December 2016, the group had balances due to 5 (4) credit institutions, which exceeded 10% of the total balances due to credit institutions, which amounted to EUR 11.8 (35.2) million. The bank had balances due to 5 (4) credit institutions, which exceeded 10% of the total balances due to credit institutions, which amounted to EUR 13.7 (44.9) million.

Note 23

Deposits

EUR '000

Customer type	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Corporate companies				
current accounts	2,201,391	2,850,172	2,124,978	2,797,758
term deposits	73,929	37,516	52,206	37,465
Total corporate companies	**2,275,320**	**2,887,688**	**2,177,184**	**2,835,223**
Other financial intermediaries				
current accounts	210,779	330,460	221,356	338,620
term deposits	19,196	778	19,196	778
Total other financial intermediaries	**229,975**	**331,238**	**240,552**	**339,398**
Other customers				
current accounts	629	1,796	629	1,796
term deposits	-	-	-	-
Total other customers	**629**	**1,796**	**629**	**1,796**
Total deposits from corporate customers	**2,505,924**	**3,220,722**	**2,418,365**	**3,176,417**
Private individuals				
current accounts	500,331	639,554	466,820	601,596
term deposits	21,517	15,179	16,639	15,179
Total deposits from private individuals	**521,848**	**654,733**	**483,459**	**616,775**
Total deposits	**3,027,772**	**3,875,455**	**2,901,824**	**3,793,192**

The group's top 20 customers in terms of the deposit amount account 14.0% (14.4%) of the total deposits the banks 20 customers in terms of the deposit amount account for 14.3% (14.4%) of the total deposits.

Of the total deposits placed with the group and the bank, 85.9% (85.7%) are from customers whose beneficiaries are CIS residents.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Note 24

Issued securities

EUR '000

ISIN	Currency	Number of initially issued securities	Par value	Date of emmision	Date of maturity	Discount/ coupon rate, %	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Subordinated bonds										
LV0000800936	EUR	150,000	100	22.12.2011.	22.12.2021.	4.8	-	14,316	-	14,316
LV0000800977	EUR	50,000	100	25.06.2012.	25.06.2022.	4.5	4,883	4,669	4,883	4,669
LV0000800985	USD	200,000	100	27.06.2012.	27.06.2022.	4.5	18,983	18,380	18,983	18,380
LV0000801124	USD	200,000	100	18.03.2013.	18.03.2023.	4.5	17,792	16,474	17,792	16,474
LV0000801173	USD	200,000	100	27.06.2013.	27.06.2023.	4.3	17,815	16,537	17,815	16,537
LV0000801181	EUR	200,000	100	27.06.2013.	27.06.2023.	4.3	18,723	17,948	18,723	17,948
LV0000801223	USD	150,000	100	23.10.2013.	23.10.2023.	4.3	14,098	13,650	14,098	13,650
LV0000801520	EUR	200,000	100	27.10.2014.	27.10.2024.	4.1	17,592	16,844	17,592	16,844
LV0000801835	EUR	200,000	100	26.10.2015.	26.10.2025.	3.8	17,348	2,299	17,348	2,299
LV0000802189	EUR	200,000	100	31.10.2016.	31.10.2026.	3.8	2,685	-	2,685	-
Subordinated bonds, total							**129,919**	**121,117**	**129,919**	**121,117**
Ordinary bonds										
LV0000801298	USD	75,000	1,000	17.02.2014.	17.02.2016.	1.98	-	34,795	-	34,795
LV0000801306	EUR	20,000	1,000	17.02.2014.	17.02.2016.	1.98	-	12,811	-	14,322
LV0000801421	USD	75,000	1,000	08.07.2014.	08.07.2016.	2.00	-	60,734	-	60,734
LV0000801439	EUR	20,000	1,000	08.07.2014.	08.07.2016.	2.05	-	19,705	-	19,705
LV0000801504	USD	75,000	1,000	28.10.2014.	28.10.2016.	2.10	-	66,437	-	66,437
LV0000801512	EUR	20,000	1,000	28.10.2014.	28.10.2016.	1.90	-	17,143	-	18,147
LV0000801645	USD	75,000	1,000	23.02.2015.	23.02.2017.	2.20	62,671	68,031	62,671	68,031
LV0000801652	EUR	20,000	1,000	23.02.2015.	23.02.2017.	1.80	16,902	17,763	18,411	19,273
LV0000801751	USD	75,000	1,000	07.07.2015.	07.07.2017.	1.55	50,234	50,636	50,234	50,636
LV0000801769	EUR	20,000	1,000	07.07.2015.	07.07.2017.	0.80	11,291	17,768	12,797	19,274
LV0000801850	USD	75,000	1,000	26.10.2015.	26.10.2017.	1.65	42,498	57,579	42,498	57,579
LV0000801868	EUR	20,000	1,000	26.10.2015.	26.10.2017.	0.80	5,365	6,358	7,368	8,361
LV0000801991	USD	75,000	1,000	22.02.2016.	22.02.2018.	1.85	60,328	-	60,328	-
LV0000802007	EUR	20,000	1,000	22.02.2016.	22.02.2018.	0.70	6,273	-	8,278	-
LV0000802072	USD	75,000	1,000	11.07.2016.	11.07.2018.	1.85	57,310	-	57,310	-
LV0000802080	EUR	20,000	1,000	11.07.2016.	11.07.2018.	0.70	8,572	-	8,572	-
LV0000802163	USD	75,000	1,000	31.10.2016.	31.10.2018.	1.85	56,039	-	56,039	-
LV0000802171	EUR	20,000	1,000	31.10.2016.	31.10.2018.	0.70	13,879	-	13,879	-
Ordinary bonds, total							**391,362**	**429,760**	**398,385**	**437,294**
Issued securities, total							**521,281**	**550,877**	**528,304**	**558,411**

The group/bank retains the right to exercise early redemption of subordinated bonds according to the information provided on the base prospectus of the respective programmes.

As at 31 December 2016 76.0% (74.2%) of the group's/bank's issued security holders were legal entities and 24.0% (25.8%) were individuals. In turn, 93.0% (91.8%) of the bond holders were non-residents while 7.0% (8.2%) — residents.

Note 25

Subordinated liabilities

As at 31 December 2016, the group's and bank's subordinated liabilities of EUR 144.7 (136.4) million comprised subordinated bonds amounting to EUR 129.9 (121.1) million and subordinated deposits amounting to EUR 14.8 (15.3) million.

Subordinated deposits by currencies amount to USD 9.8 (9.9) million and EUR 5.5 (6.2) million.

Information on the subordinated bonds issued by the bank is disclosed in Note 24.

The analysis of subordinated deposits as at 31 December 2016:

Lenders	Loan amount, EUR '000	Accumulated interest, EUR '000	Total subordinated loans, EUR '000	Interest rate, %	Currency
non-residents	7,442	12	7,454	1.75—3.15	USD
non-residents	5,450	7	5,457	3.00—3.76	EUR
residents	1,898	1	1,899	1.99—3.15	USD
Total subordinated deposits	**14,790**	**20**	**14,810**		

The analysis of subordinated deposits as at 31 December 2015:

Lenders	Loan amount, EUR '000	Accumulated interest, EUR '000	Total subordinated loans, EUR '000	Interest rate, %	Currency
non-residents	9,043	12	9,055	1.75—3.15	USD
non-residents	6,195	11	6,206	3.00—3.90	EUR
Total subordinated deposits	**15,238**	**23**	**15,261**		

The proportionate share of lenders (for each individual lender) does not exceed 10% of the total amount of the subordinated liabilities.

The remaining weighted average maturity of subordinated deposits from lenders is 2.9 (3.4) years.

Subordinated loans are included in the second tier of equity calculation and are stated at amortised cost. According to the provisions of the subordinated loan agreements, the lenders have no right to demand premature repayment of the loans. The lenders have no right to capitalise the subordinated deposits or bonds into the bank's share capital. Discount/coupon rates and payment frequency are indicated in the final issue regulations, and no solvent issuers may annul coupon payments. If an issuer is dissolved, the payments are made in accordance with statutory requirements. More detailed information about the conditions of issues is available on the bank's website www.ablv.com and relevant final bond issue regulations.

Note 26

Paid-in share capital

As at 31 December 2016, the paid-in share capital of the bank amounted to EUR 38.3 million (35.3 million). The par value of each share is EUR 1.0 (1.0).

The bank's share capital consists of 34 470 000 (31 770 000) ordinary registered voting shares and 3 830 000 (3 530 000) registered non-voting shares (personnel shares).

As at 31 December 2016, the bank had 138 (135) voting shareholders.

The major shareholders of the bank and groups of related shareholders are as follows:

	31.12.2016.		31.12.2015.	
	Share of the bank's share capital, EUR '000	Share of the bank's voting capital, %	Share of the bank's share capital, EUR '000	Share of the bank's voting capital, %
Group of shareholders related to Ernests Bernis				
Ernests Bernis	1,701	4.93	1,568	4.93
Nika Berne	293	0.85	270	0.85
Cassandra Holding Company, SIA	12,924	37.49	11,864	37.34
Group of shareholders related to Ernests Bernis, total	**14,918**	**43.27**	**13,702**	**43.12**
Group of shareholders related to Oļegs Fiļs				
OF Holding, SIA	14,918	43.28	13,702	43.13
Group of shareholders related to Oļegs Fiļs, total	**14,918**	**43.28**	**13,702**	**43.13**
Other shareholders, total	4,634	13.45	4,366	13.75
Total voting shares	**34,470**	**100.00**	**31,770**	**100.00**
Non-voting shares (personnel shares)	3,830		3,530	
Total share capital	**38,300**		**35,300**	

In the reporting year, the bank issued 2 700 000 ordinary registered voting shares (based on the decisions of the ordinary shareholders' meeting of 7 April 2016. The par value of all the issued shares was EUR 1.0, while the emission price of each ordinary registered voting share was EUR 14.15, comprised of the par value of EUR 1.0 and the share premium of EUR 13.15. The issue was intended to ensure steady development of the group/bank in the future. During the reporting period, on account of the bank issued 300 000 personnel shares (from the previous years retained earnings) with nominal value EUR 1.0 (based on the decision of the Extraordinary Shareholders' Meeting of 29 December 2016).

After this issue, share capital of the bank consisted of 34 470 000 name shares with voting rights and 3 830 000 personnel shares. All name shares with voting rights rank equal with respect to dividends, liquidation quota and voting rights in the Shareholders meeting. All personnel shares grant equal rights to dividends. Personnel shares do not grant any right to vote or receive liquidation quotas. Most of the issued voting shares have been acquired by the existing shareholders of the bank — Cassandra Holding Company, SIA and OF Holding, SIA.

The registered non-voting shares (personnel shares) are as follows:

	31.12.2016.			31.12.2015.		
	Number of employees	Number of personnel shares	Share of the bank's share capital, EUR '000	Number of employees	Number of personnel shares	Share of the bank's share capital, EUR '000
Chairman of the council and council members	3	-	-	3	-	-
Chairman of the board	1	-	-	1	-	-
Board members	6	1,705,000	1,705	6	1,633,800	1,634
Heads and deputy heads of divisions	26	1,775,000	1,775	21	1,566,200	1,566
Department heads	1	50,000	50	-	-	-
Non-distributed	-	300,000	300	-	330,000	330
Registered non-viting shares (personnel shares), total	**x**	**3,830,000**	**3,830**	**x**	**3,530,000**	**3,530**

Dividends declared and paid:

EUR '000

	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Dividends declared	68,835	58,444
Dividends paid	(68,840)	(58,443)

EUR

	Bank 01.01.2016.— 31.12.2016.	Bank 01.01.2015.— 31.12.2015.
Bank's share par value	1.00	1.00
Dividends declared per bank's value	1.95	1.79
Dividends paid per bank's value	1.95	1.79

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Note 27

Other liabilities

EUR ‘000

	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Fund shares owned by third parties	6,541	4,088	-	-
Other liabilities	3,001	1,013	1,691	874
Payments in progress for transactions with financial instruments	1,355	23,568	235	23,568
Payments to subsidiaries	-	-	195	293
Payables to suppliers	1,118	1,326	158	29
Total other financial liabilities	**12,015**	**29,995**	**2,279**	**24,764**
Deferred expenses and accrued income	6,749	8,935	7,068	8,816
Accrual for employee vacation pay	3,787	2,351	1,670	1,417
Other liabilities	371	456	67	75
Total other non-financial liabilities	**10,907**	**11,742**	**8,805**	**10,308**
Total other liabilities	**22,922**	**41,737**	**11,083**	**35,072**

Note 28

Memorandum items

EUR ‘000

Contingent liabilities	Group 31.12.2016.	Group 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
Guaranties and indemnities	10,015	9,949	9,928	9,516
Total contingent liabilities	**10,015**	**9,949**	**9,928**	**9,516**
Other commitments to customers				
Unused credit lines	61,672	17,205	61,672	17,205
Loan commitments	27,517	33,768	27,517	33,768
Letters of credit	23,965	2,074	23,965	2,074
Undrawn credit facilities on settlement cards	13,187	15,708	13,257	15,775
Contractual commitments on purchase of non-financial assets	6,064	6,855	221	85
Other commitments to customers, total	**132,405**	**75,610**	**126,632**	**68,907**
Total contingent liabilities and commitments to customers	**142,420**	**85,559**	**136,560**	**78,423**

Note 29

Funds under trust management

As at 31 December 2016, funds under trust management by the group amounted to EUR 279.8 (226.3) million, while funds under trust management by the bank amounted to EUR 25.4 (39.7) million.

The bank’s funds under trust management comprise loans issued from the funds specifically assigned by customers to the bank. Meanwhile, the group’s funds under trust management also include funds of the customers of ABLV Asset Management, IPAS managed by the said company based on the customers’ authorisation and the funds under trust management of ABLV Bank Luxembourg, S.A.
More detailed information on the funds of the customers of ABLV Asset Management, IPAS is disclosed in Note 18.

The related credit risk and other risks remain fully with the customer, which provided these funds to the group and/or the bank.

Note 30

Related party disclosures

Group's transactions with related parties:

					31.12.2016.
Assets	Share-holders	Management	Related companies	Associated companies	Other related individuals
Loans	1,438	1,873	9,252	8,726	29
Liabilities					
Deposits	5,698	2,037	7,036	8,306	940
Subordinated deposits	380	-	-	-	-
Ordinary bonds	-	15	-	6,665	33
Subordinated bonds	49	6,919	865	2,453	849
Memorandum items					
Undrawn credit facilities and payment card limits	-	167	78	703	20
Guarantees	-	125	-		-
Income/expense					01.01.2016.— 31.12.2016.
Interest income	104	42	196	345	-
Interest expense	(2)	(228)	(61)	(300)	(28)
Commission and fee income	36	19	40	44	5
Net results form sales of repossessed real estate	-	-	-	-	77

Bank's transactions with related parties:

					31.12.2016.
Assets	Sharehol-ders	Management	Related companies	Subsidiaries	Other related individuals
Due from credit institutions	-	-	-	12,333	-
Loans	1,438	1,873	9,252	13,445	29
Liabilities					
Due to credit institutions	-	-	-	3,913	-
Deposits	5,698	1,974	7,036	35,186	940
Subordinated deposits	380	-	-	-	-
Ordinary bonds	-	15	-	13,689	33
Subordinated bonds	49	6,919	865	2,453	849
Memorandum items					
Undrawn credit facilities and payment card limits	-	167	78	773	20
Guarantees	-	125	-	168	-
Income/expense					01.01.2016.— 31.12.2016.
Interest income	104	42	196	401	-
Interest expense	(2)	(228)	(61)	(419)	(28)
Income from dividends	-	-	-	6,104	-
Commission and fee income	1	16	7	728	4
Commission and fee expense	-	-	-	(7,013)	-
Other operating income	-	-	-	3,333	-
Recognised impairment, net	-	-	-	(6,225)	-

EUR ’000

				31.12.2015.
Share-holders	Management	Related companies	Associated companies	Other related individuals
29	2,318	9,263	9,838	109
3,111	2,255	9,988	7,737	1,884
-	-	-	-	-
150	45	1,139	14,063	28
-	5,081	1,096	1,748	820
-	150	198	937	29
-	125	-	-	-
				01.01.2015.— 31.12.2015.
20	65	173	298	2
(2)	(167)	(71)	(127)	(28)
1	16	268	4	3
-	-	-	72	-

Related parties of the group and the bank are defined as shareholders who have a qualifying holding in the bank, and chairman and members of the bank’s council and board, staff of the Internal Audit Department, key management personnel of the group and the bank that are authorised to plan, manage and control group’s/bank’s operations and are responsible for these functions, and spouses, children of the individuals referred to previously, bank’s subsidiaries and companies in which the group/bank has an interest, companies in which these individuals have a qualifying holding as well as other legal entities.

EUR ’000

				31.12.2015.
Share-holders	Management	Related companies	Subsidiaries	Other related individuals
-	-	-	5,000	-
29	2,318	9,263	9,838	109
-	-	-	14,663	-
3,111	2,245	9,988	26,317	1,884
-	-	-	-	-
150	45	1,139	21,596	28
-	5,081	1,096	1,748	820
-	150	198	1,004	29
-	125	-	8	-
				01.01.2015.— 31.12.2015.
20	65	173	521	2
(2)	(167)	(71)	(207)	(28)
-	-	-	9,201	-
1	16	268	853	3
-	-	-	(6,651)	-
-	-	-	3,222	-
-	-	-	(2,840)	-

Information on registered non-voting shares (personnel shares) is presented in Note 26, information on remuneration to management of the group and the bank is presented in Note 9. Meanwhile, information on changes in investments in subsidiaries and associates is disclosed in Note 18.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Note 31

Segment information

The management of the group and the bank believe that the group's operations can be organised into four segments based on the core business activities as follows: banking services, advisory services, investment management services, and real estate development (previously - management of repossessed properties and investments in real estate).

The group defines its operating segments based on its organisational structure. The bank views its operations as one single segment, without making any separate disclosures, while at the group level the bank and all its subsidiaries are attributed to the group's operating segments as follows:

- banking services: ABLV Bank, AS, ABLV Bank Luxembourg, S.A.;
- advisory services: ABLV Consulting Services, AS, ABLV Corporate Services Holding Company, SIA, ABLV Corporate Services, SIA, ABLV Corporate Services, LTD, ABLV Advisory Services, SIA;
- investment management services: ABLV Asset Management, IPAS, ABLV Capital Markets, IBAS, PEM SIA, PEM 1, SIA, New Hanza Capital, AS, NHC 1, SIA, NHC 2, SIA, NHC 3, SIA, NHC 4, SIA, NHC 5, SIA, NHC 6, SIA, investment funds included in the group (see Note 18);
- real estate development: ABLV Building Complex, SIA, Pillar Holding Company, KS, Pillar, SIA, Pillar 3, SIA, Pillar 4 & 6, SIA, Pillar 7 & 8, SIA, Pillar 9, SIA, Pillar 11, SIA, Pillar 2, 12 & 14 SIA, Pillar 18, SIA, Pillar 19, SIA, Pillar 20, SIA, Pillar 21, SIA, Pillar 22, SIA, Pillar Development, SIA, Pillar Utilities, SIA, Pillar Management, SIA, Pillar RE Services, SIA, Pillar Contractor, SIA, Pillar Architekten, SIA.

Operating segment information is prepared on the basis of internal reports.

Analysis of the operating segments of the group:

EUR '000

	01.01.2016. — 31.12.2016.					
	Banking	Investment management	Consultation services	Real estate development*	Eliminated or corrected on consolidation	Group, total
Net interest income	64,452	(35)	-	134	26	64,577
incl. external transactions	64,495	82	-	-		
incl. internal transactions	(43)	(117)	-	134		
Net commission income	33,258	7,468	(18)	(8)	3,907	44,607
incl. external transactions	39,763	4,853	(9)	-		
incl. internal transactions	(6,505)	2,615	(9)	(8)		
Net result of transactions with securities and foreign exchange	51,684	(5)	402	57	(6,572)	45,566
incl. external transactions	45,546	(3)	23	-		
incl. internal transactions	6,138	(2)	379	57		
Net other income/expenses	2,485	2,640	6,973	(1,772)	(9,721)	605
incl. external transactions	(407)	1,472	2,118	(2,578)		
incl. internal transactions	2,892	1,168	4,855	806		
Personnel and other administrative expenses	(60,608)	(3,860)	(6,545)	(3,676)	4,417	(70,272)
Depreciation	(3,368)	(162)	(144)	(385)	-	(4,059)
Impairment allowance and other provisions	(6,243)	32	-	-	6,490	279
Corporate income tax	(1,566)	(672)	(81)	(168)	-	(2,487)
Total segment profit/(loss)	**80,094**	**5,406**	**587**	**(5,818)**	**(1,453)**	**78,816**
Additions of property and equipment, intangible assets and investment property	2,868	12,576	81	4,024	(793)	18,756
						31.12.2016.
Total segment assets	**4,032,562**	**58,542**	**3,011**	**141,810**	**(262,602)**	**3,973,323**
Total segment liabilities	**3,695,568**	**32,834**	**1,459**	**10,228**	**(85,099)**	**3,654,990**

* For more details on Real estate development segment operating results see Note 6 and Note 18

EUR '000

	01.01.2015. — 31.12.2015.						
	Banking	Investment management	Investement management excluded due to loss of control	Consultation services	Management of reposessed properties and investments in real estate	Eliminated or corrected on consolidation	Group, total
Net interest income	64,217	849	(46)	5	83	(149)	64,959
incl. external transactions	63,840	955	-	-	-		
incl. internal transactions	377	(106)	(46)	5	83		
Net commission income	41,228	10,230	(7)	(20)	(8)	3,710	55,133
incl. external transactions	47,213	7,929	-	(9)	-		
incl. internal transactions	(5,985)	2,301	(7)	(11)	(8)		
Net result of transactions with securities and foreign exchange	30,841	(175)	(1)	202	(15)	(9,094)	21,758
incl. external transactions	21,776	(166)	-	(38)	-		
incl. internal transactions	9,065	(9)	(1)	240	(15)		
Net other income/expenses	2,155	(262)	1,777	6,437	(1,398)	(7,922)	787
incl. external transactions	(848)	581	1,777	2,036	(2,759)		
incl. internal transactions	3,003	(843)	-	4,401	1,361		
Personnel expense and other administrative expenses	(52,457)	(3,659)	(437)	(5,932)	(3,908)	4,342	(62,051)
Depreciation	(3,606)	(52)	(860)	(101)	(400)	-	(5,019)
Impairment allownace and other provisions	(12,782)	(296)	-	-	-	5,757	(7,321)
Corporate income tax	(5,547)	(841)	(19)	(50)	85	-	(6,372)
Total segment profit/(loss)	**64,049**	**5,794**	**407**	**541**	**(5,561)**	**(3,356)**	**61,874**
Additions of property and equipment, intangible assets and investment property	5,381	64	-	273	1,354	(3)	7,069
							31.12.2015.
Total segment assets	**5,047,508**	**22,253**	**-**	**2,961**	**152,743**	**(233,877)**	**4,991,588**
Total segment liabilities	**4,754,624**	**10,240**	**-**	**1,562**	**5,742**	**(57,909)**	**4,714,259**

Note 32

Fair values

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The group and the bank disclose the fair values of assets and liabilities in such a manner so as to be able to compare the fair values with the carrying amounts.

Fair value of financial instruments, such as available-for-sale financial assets, financial assets at fair value through profit or loss and held-to-maturity investments, is mostly defined based on quoted prices in an active market. Where no price is observable for some of these financial instruments, fair value is determined based on observable prices in a market, where no active trading is done — this is applicable to several debt securities and open-ended investment funds.

Finally, other valuation techniques are used for some financial assets which are not quoted in the market and for which no quoted prices for similar financial assets in active markets are available. Fair value of such financial instruments is estimated based on valuation models which are based on the assumptions and estimates regarding the potential future financials of the investment property, and the industry and geographical area risks in which the respective investment property operates. Fair value of derivatives is calculated based on the net present value method, where all inputs in the valuation model are observable, while exchanged traded derivatives, such as futures, as valued based on quoted prices.

The management of the bank and the group believe that the most credible market value of real estate was identified based on the evaluations presented by both external real estate appraisers and bank's real estate experts. Investment properties are valued on the basis of discounted cash flows. According to this approach, fair value is calculated based on assumptions regarding expected future cash flows from income and expense resulting from the holding of real estate during its life cycle, including the value of the property at the date of sale. These cash flows are discounted at a discount rate, which is equal to the market return from similar assets, to arrive at the present value. The selling value of the investment properties may differ from the market value as defined, if the market of such kind of properties is not properly developed in Latvia.

As regards other assets and liabilities for which fair value is disclosed and which have a short maturity (less than three months), except for loans and receivables, the group and the bank assume that the fair value approximates to their carrying amount. This assumption also applies to demand deposits and savings accounts. The fair value of loans and advances to customers is estimated by discounting the expected cash flows at a discount rate calculated according to the money market rates at the end of the reporting period and loan interest margins.

The fair value of term deposits is estimated by discounting the expected cash flows at the average market interest rates prevailing at the end of the reporting period.

The carrying amounts and fair values of the group's assets and liabilities are as follows:

EUR '000

	31.12.2016.		31.12.2015.	
Assets at fair value	Carrying amount	Fair value	Carrying amount	Fair value
Derivatives	624	624	121	121
At fair value through profit or loss				
Financial assets at fair value through profit or loss	28,416	28,416	26,121	26,121
Available-for-sale				
Available-for-sale financial assets	1,042,574	1,042,574	1,833,073	1,833,073
Total assets at fair value	**1,071,614**	**1,071,614**	**1,859,315**	**1,859,315**
Assets at amortised cost				
Cash and deposits with central banks	414,431	414,431	449,136	449,136
Balances due from credit institutions	272,520	272,520	669,980	669,980
Loans	1,029,944	1,029,081	874,003	873,744
Held-to-maturity investments	1,053,987	1,084,140	1,015,047	1,029,737
Investment properties	34,690	43,040	22,976	22,976
Other financial assets	1,295	1,295	1,465	1,465
Total assets at amortised cost	**2,806,867**	**2,844,507**	**3,032,607**	**3,047,038**
Liabilities at fair value				
Derivatives	42	42	365	365
Group's consolidated fund shares owned by 3rd parties	**6,541**	**6,541**	**4,088**	**4,088**
Total liabilities at fair value	**6,583**	**6,583**	**4,453**	**4,088**
Liabilities at amortised cost				
Financial liabilities at amortised cost	**3,635,800**	**3,631,082**	**4,696,726**	**4,692,596**
Total liabilities at amortised cost	**3,635,800**	**3,631,082**	**4,696,726**	**4,692,596**

The carrying amounts and fair values of the bank's assets and liabilities are as follows:

EUR '000

	31.12.2016.		31.12.2015.	
Assets at fair value	Carrying amount	Fair value	Carrying amount	Fair value
Derivatives	80	80	121	121
At fair value through profit or loss				
Financial assets at fair value through profit or loss	21,010	21,010	22,286	22,286
Available-for-sale				
Available-for-sale financial assets	957,094	957,094	1,780,554	1,780,554
Total assets at fair value	**978,184**	**978,184**	**1,802,961**	**1,802,961**
Assets at amortised cost				
Cash and deposits with central banks	413,047	413,047	448,187	448,187
Balances due from credit institutions	281,504	281,504	671,772	671,772
Loans	1,012,146	1,011,445	873,499	873,240
Held-to-maturity investments	989,710	1,020,884	965,253	980,771
Investment properties	25,058	34,306	25,069	25,069
Other financial assets	663	663	606	606
Total assets at amortised cost	**2,722,128**	**2,761,849**	**2,984,386**	**2,999,645**
Liabilities at fair value				
Derivatives	42	42	365	365
Total liabilities at fair value	**42**	**42**	**365**	**365**
Liabilities at amortised cost				
Financial liabilities at amortised cost	3,517,592	3,512,838	4,634,994	4,630,798
Total liabilities at amortised cost	**3,517,592**	**3,512,838**	**4,634,994**	**4,630,798**

Hierarchy of input data for determining the fair value of assets and liabilities

The group and the bank use the following hierarchy of three levels of input data for determining and disclosing the fair value of assets and liabilities:
Level 1: Quoted prices in active markets;
Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable;
Level 3: Other techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

Level 1 instruments may contain liquid securities and exchange traded derivatives. Level 2 instruments may contain securities that do not have an active market, standardised OTC derivatives and foreign exchange transactions as well as certain open-ended investment funds. Level 3 instruments contain certificates of venture capital funds, investment properties, term deposits and loans. For valuation methods and assumptions, please see the description above.

The group's assets and liabilities according to the hierarchy of input data for determining the fair value:

EUR '000

				31.12.2016.				31.12.2015.
Assets at fair value	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivatives	59	565	-	624	4	117	-	121
Financial assets at fair value through profit or loss	21,519	6,897	-	28,416	19,504	6,617	-	26,121
Available-for-sale financial assets	989,277	49,955	3,342	1,042,574	1,760,689	59,687	12,697	1,833,073
Total assets at fair value	**1,010,855**	**57,417**	**3,342**	**1,071,614**	**1,780,197**	**66,421**	**12,697**	**1,859,315**
Assets at amortised cost								
Loans	-	-	1,029,944	1,029,944	-	-	874,003	874,003
Held-to-maturity investments	1,035,724	17,905	358	1,053,987	996,477	18,240	330	1,015,047
Investment properties	-	-	34,690	34,690	-	-	22,976	22,976
Total asets at amortised cost	**1,035,724**	**17,905**	**1,064,992**	**2,118,621**	**996,477**	**18,240**	**897,309**	**1,912,026**
Liabilities at fair value								
Derivatives	-	42	-	42	-	365	-	365
Group's consolidated fund shares owned by 3rd parties	-	6,541	-	6,541	-	4,088	-	4,088
Total liabilities at fair value	**-**	**6,583**	**-**	**6,583**	**-**	**4,453**	**-**	**4,453**
Liabilities at amortised cost								
Financial liabilities at amortised cost	-	603,941	96,792	700,733	-	741,687	57,996	799,683
Total liabilities at amortised cost	**-**	**603,941**	**96,792**	**700,733**	**-**	**741,687**	**57,996**	**799,683**

The bank's assets and liabilities according to the hierarchy of input data for determining the fair value:

EUR '000

				31.12.2016.				31.12.2015.
Assets at fair value	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivatives	59	21	-	80	4	117	-	121
Financial assets at fair value through profit or loss	1,117	19,893	-	21,010	3,545	18,741	-	22,286
Available for sale financial assets	919,764	33,988	3,342	957,094	1,718,362	49,495	12,697	1,780,554
Total assets at fair value	**920,940**	**53,902**	**3,342**	**978,184**	**1,721,911**	**68,353**	**12,697**	**1,802,961**
Assets at amortised cost								
Loans	-	-	1,012,146	1,012,146	-	-	873,499	873,499
Held to maturity investments	971,447	17,905	358	989,710	946,683	18,240	330	965,253
Investment properties	-	-	25,058	25,058	-	-	25,069	25,069
Total assets at amortised cost	**971,447**	**17,905**	**1,037,562**	**2,026,914**	**946,683**	**18,240**	**898,898**	**1,863,821**
Liabilities at fair value								
Derivatives	-	42	-	42	-	365	-	365
Total liabilities at fair value	**-**	**42**	**-**	**42**	**-**	**365**	**-**	**365**
Liabilities at amortised cost								
Financial liabilities at amortised cost	-	610,964	70,191	681,155	-	749,221	57,945	807,166
Total liabilities at amortised cost	**-**	**610,964**	**70,191**	**681,155**	**-**	**749,221**	**57,945**	**807,166**

The analysis of fair value measurement's hierarchy of assets does not include cash on hands, deposits with central banks, balances due from credit institutions and other financial assets, due to the fact that these assets have not differences between the carrying amount and fair value in terms of short residual maturity. The analysis of fair value measurement's hierarchy of liabilities, which are not recognized at fair value, does not include demand deposits amounted to 2.95 (3.91) billion EUR in the group and demand deposits amounted to 2.85 (3.84) billion EUR in the bank, as these liabilities do not have differences between carrying amount and fair value.

Reclassification of financial instruments between level 1 and 2 of the hierarchy of sources of determining the fair value made in the reporting period and previous reporting period was insignificant, except the following: in 2015, debt securities of one central government, amounting to EUR 66.0 million, were reclassified from the second level of the hierarchy of sources of determining the fair value to the first one.

Analysis of changes in the group's/bank's financial instruments of Level 3:

EUR '000

Assets at fair value	31.12.2016.	Redemption	Recognition	Impairment	31.12.2015.
Available-for-sale financial assets	3,342	(12,274)	2,401	518	12,697
Total assets at fair value	**3,342**	**(12,274)**	**2,401**	**518**	**12,697**

During the reporting period group and bank concluded a share buyback transaction for EUR 12.3 million involving VISA Europe Limited shares classified as Level 3 financial instruments. There were no reclassifications to/from Level 3 during the reporting period.

Level 3 available-for-sale security discounted value as at 31 December 2016 amounted to 0.32% (0.69%) from total available-for-sale portfolio, which insignificant, therefore group/bank did not conduct a sensitivity analysis.

EUR '000

Assets at fair value	31.12.2015.	Redemption	Impairment	Revaluation	Reclassification	Effect of foreign exchange	31.12.2014.
Available-for-sale financial assets	12,697	(16)	(1,053)	12,274	284	86	1,122
Total assets at fair value	**12,697**	**(16)**	**(1,053)**	**12,274**	**284**	**86**	**1,122**

During 2015 a reclassification from Level 2 to Level 3 was performed for the following securities:
- one central government debt security for EUR 136.5 thousand;
- one credit institution debt security for EUR 147.4 thousand.

Note 33

Capital management and capital adequacy

The primary objective of the group's and bank's capital management is to ensure that the group and the bank comply with externally imposed capital requirements and maintain healthy capital ratios in order to support their business and maximise the shareholders' value. Capital adequacy refers to the sufficiency of the group's and bank's capital resources to cover credit risk, operational risk, and market risks.

The goals of the group's and bank's capital management in 2016 are consistent with those of the previous years. According to the Regulation, the group/bank use the Standardised Approach for credit risk and market risk capital requirements, the Basic Indicator Approach for operational risk capital requirement, and the Standardised Approach to calculate the capital requirement for credit valuation adjustment (CVA) risk of OTC derivatives.
It is specified in the Regulation that Tier 1 common capital (CET1) ratio should be 4.5%, Tier 1 capital should be 6.0% and the total capital ratio should be at least 8.0%. According to the Regulation, the total capital of the group/bank should be equal to the sum of credit risk, market risk and operational risk capital requirements, including capital reserves and potential Pillar II capital increases.

According to the Law on Credit Institutions, the group and the bank maintains a capital conservation buffer in the amount of 2.5% of total exposures, which restricts dividend payment and redemption of certain Tier 1 equity instruments, which effectively sets a target of 8.5% for Tier 1 capital and 10.5% for the total capital adequacy ratio.
In addition to the above, on 1 January 2016 the requirements of the FCMC for countercyclical capital buffer come into effect, which are based on risk distribution by geography. The group/bank provides that the common equity tier 1 capital (CET1) is sufficient to cover the capital conservation and countercyclical capital buffer.
In 2016, Commission Delegated Regulation (EU) 2016/101 entered into effect which sets out the principles of calculation of additional valuation adjustment (AVA). The bank and the group applies the simplified approach for determination of additional valuation adjustment. According to this approach, the additional valuation adjustment is calculated as 0.1% of the asset and liability absolute value sum in fair.
The group and the bank have observed the requirements of the Regulation and during the reporting period the CET1 ratio of the group was 12.31%, the total capital ratio was 18.81%, thus the capitalisation of the group is maintained at a level exceeding the capital requirements according to the Regulation.

At the end of 2015, the FCMC made the decision to list the bank as other systemically significant institution and specified that from 30 June 2017 the group/bank was required to maintain a capital reserve of other systemically significant institutions of 1.0% of total exposures and from 30 June 2018 a reserve of 2.0%.

Apart from the calculation of the minimum capital adequacy ratio, the bank documents and assesses internal capital adequacy. The internal capital adequacy assessment (ICAAP) procedure performed by the bank comprises both quantitative capital adequacy assessment and qualitative aspects, including long-term business planning and formulation of the development strategy, identification of material risks, determination of acceptable risk exposure, development and improvement of risk management systems, as well as identification and control of risks inherent in the bank's business (risk profile) on an ongoing basis.
The methods employed for the ICAAP purposes and the calculation procedure are detailed in the Statement on Information Disclosure published on the bank's website www.ablv.com.

Own funds and capital requirements:

EUR '000

Tier 1	Group* 31.12.2016.	Group* 31.12.2015.	Bank 31.12.2016.	Bank 31.12.2015.
paid-in share capital	38,300	35,300	38,000	35,300
share premium	132,423	96,918	132,423	96,918
reserve capital and other reserves	2,134	2,134	2,134	2,134
retained earnings	62,805	72,188	68,770	68,565
curent year's profit	6,000	-	6,000	-
intangible assets	(6,029)	(6,333)	(5,827)	(6,036)
revaluation reserve of available-for-sale financial assets	676	3,784	683	3,799
non-controlling interests	1,010	558	-	-
additional value adjustment for assets measured at fair value	(647)	-	(595)	-
Total Tier 1	**236,672**	**204,549**	**241,588**	**200,680**
Common equity Tier 1 capital (CET1)	**236,672**	**204,549**	**241,588**	**200,680**
Additional Tier 1 capital	**-**	**-**	**-**	**-**
Tier 2				
subordinated capital	125,063	120,323	125,063	120,323
Total Tier 2 capital	**125,063**	**120,323**	**125,063**	**120,323**
Total own funds	**361,735**	**324,872**	**366,651**	**321,003**
Capital requirement				
Capital requirement for credit risk	126,178	125,680	124,879	125,612
Total capital requirement for market risks	7,353	7,240	7,289	7,240
capital requirement for foreign currency risk	1,671	496	1,686	496
capital requirement for position risk	5,682	6,744	5,603	6,744
Capital requirement for counterparty credit risk	63	11	5	11
CVA	12	3	1	3
Capital requirement for operational risk	20,229	20,907	17,601	15,867
Total capital requirement for market risks	**153,835**	**153,841**	**149,775**	**148,733**
Common equity Tier 1 capital ratio (CET1) (%)	**12.31**	**10.64**	**12.90**	**10.79**
Total capital ratio (%)	**18.81**	**16.89**	**19.58**	**17.27**

* The group is compliant with the requirements of the Regulation, differences from the IFRS requirements are indicated in the disclosure of information on the bank's website www.ablv.com.

Note 34

Risk management

Risks are inherent in the group’s and bank’s business and risk management is one of the group’s and bank’s strategic values, which is based on the confidence that efficient risk management is critical for the success of the group and the bank. Managing risks permits keeping the group’s and bank’s exposure at a level meeting their willingness and ability to undertake risks.

In the ordinary course of business, the group and the bank are exposed to various risks, the most significant of them being credit risk, market risk, liquidity risk, operational risk, AML/CTF risk and other unquantifiable risks (reputation risk, compliance risk, strategy and business risk, commission fee income and expenses volatility risk).

Risk management stands for identification, assessment and control of potential risks; it is a structured, coordinated and ongoing process across all levels of the entity aimed at identifying and assessing potential threats and making decisions on the prevention of such threats, maintaining the appropriate balance between risks and profits and minimising potential adverse effects of risks on the entity’s financial position and operations.

The risk management process includes the following:

- identification, assessment and measurement of the significant risks;
- setting restrictions and limits defining the maximum permissible exposure;
- regular monitoring of the compliance with the risk management policies and procedures and with any limits set;
- defining the risk assessment procedures and limits before commencing new transactions;
- within capital adequacy assessment process carrying out comprehensive risk assessment and creation of capital adequacy statements, that are based on the group's and the bank's risk profile;
- stress testing aimed at the following:
  - identification of situations which are likely to produce a considerable impact on the group’s and/or bank’s operations;
  - assessment of the group’s and/or bank’s ability to withstand any significant deterioration in external and internal conditions;
  - determination of ways to minimise certain risks;
  - formulation of contingency plans;
- regular revision and enhancement of the policies and instructions following the market changes.

For the purposes of risk management, a risk strategy has been articulated. This strategy defines risks assumed by the bank both individually and at the group level in carrying on its operations and providing services, the level of risk tolerance and actions to ensure compliance with this level. The risk strategy, which has been approved by the council of the bank, is based on the Operational Strategy of the ABLV Group 2016—2018. Apart from the risk strategy, risk management policies have been developed and approved by the council of the bank. The introduction and effectiveness of these policies are controlled by the board and the Chief Risk Officer (CRO), while the practical implementation is provided by the respective structural units, including the Risk Management Division whose functions are strictly segregated from the business functions.

To create a highly disciplined, conservative and constructive risk management and control environment, training seminars are organised for the staff.

The goal of the risk management policies is to ensure efficient risk management, identify and analyse the risks inherent in the group’s and bank’s business, set relevant limits, introduce reliable control procedures, as well as control risk and exposure compliance with the applicable limits using administrative and IT resources. The risk management system has been constantly improved following the group’s and bank’s operational and financial market development. The improvement process is controlled by the Internal Audit Department on a regular basis.

Note 35

Credit risk

Credit risk is exposure to potential loss in case the group's or bank's counterparty or debtor will be unable to fulfil the contractual obligations to the group or the bank or pledged assets will not cover the group's or bank's requirements.

Credit risk management framework

Credit risk is managed according to the Credit Risk Management Policy, which stipulates the provisions and key principles of credit risk management for the sake of timely identification, analysis, assessment, and prevention of possible credit risks. The group and the bank believe that their exposure to credit risk arises mainly from loans, investments in fixed income securities, and balances due from credit institutions.

The credit risk management process comprises the following:
- placing and monitoring of credit risk and concentration risk limits;
- setting and monitoring of criteria for granting of loans;
- evaluation of customer's solvency and collateral;
- monitoring of credit quality, both individually and collectively;
- determination of the recoverable amount of loans and other assets;
- measurement and assessment of credit risk;
- revision of regulations concerning credit risk and concentration risk management.

The following is employed for the purposes of credit risk management:
- limits system:
  - loan portfolio limits for individual loan programs, lines, exposures to customers or groups of related customers, which is determined according to the financial plan, EU Regulation No. 575/2013;
  - loan portfolio concentration limits, diversifying the loan portfolio by industries, collateral of the same type and currencies;
  - limits for credit institutions and financial companies;
  - limits for investments in securities;
  - limits for financial instruments and goods holders;
  - limits for country risk and credit rating groups;
  - limits for high risk transactions.
- asset quality monitoring.

In order to measure credit risk, the group and the bank perform the following:
- regular loan portfolio quality analysis — at least once per quarter;
- regular analysis of compliance with the limits set for the loan portfolio, securities portfolio, and claims on credit institutions — at least once per quarter;
- regular concentration analysis of the loan portfolio, claims on credit institutions, and debt securities — at least once per year;
- regular asset quality assessment, which is performed at least once per quarter for the loan portfolio and securities portfolio and at least once per year — for other assets;
- regular country risk analysis — at least once per half a year;
- regular analysis of credit institutions, financial companies, and financial instrument and commodity custodians — at least once per year;
- regular credit risk stress testing — at least once per half a year;
- regular capital adequacy assessment — at least once per half a year;
- regular credit risk and concentration risk assessment under the risk management report — at least once per quarter;
- regular assessment of strategic indicators — at least once per quarter.

Before entering into any cooperation with customers, the group and the bank perform a comprehensive review of the customer's solvency and collateral.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

In analysing any potential cooperation with financial institutions, the bank assesses each potential counterparty, by analysing both its financial performance and other criteria, and further reviews these indicators on a regular basis. Meanwhile, to assess solvency of private individuals, the bank has developed an internal rating system whereby customers are divided in categories on the basis of their income level and quality of their credit histories. After initiating cooperation with a customer, the bank monitors loan payment delays and changes in collateral value, as well as evaluates on a sample basis sufficiency of the customer's income. The group and the bank assess creditworthiness of corporate customers by conducting the financial due diligence for each new customer; subsequently, the borrower's financial position is reviewed on a regular basis. Corporate customers are also granted monitoring/risk factors, and any instances of non-compliance with these factors indicate that credit risk might have increased before the financial position of such customer is reviewed.

Collateral is appraised by an independent appraiser accepted by the group and the bank. The bank may adjust (reduce) the value defined by the independent appraiser if, in the bank's opinion, the appraiser has not considered certain risk factors. For the purposes of loan collateral, the bank considers such reduced value. As collateral, the bank may accept real estate, new and used vehicles, commercial vehicles, goods held at customs or customer's warehouse, securities, technological equipment and machinery, receivables as the aggregation of property, etc. Based on the collateral type and liquidity, the group and the bank apply the maximum acceptable proportion of the loan to be issued.

The Credit Policy, the Lending Regulation and other regulations provide for the main criteria and types of acceptable collateral, the basic principles and frequency of collateral evaluations. Depending on the type of collateral and risk exposure, the bank's employees perform monitoring of the collateral value 1—4 times per year. On certain occasions, an independent appraiser may be involved. With regard to exposures in excess of EUR 3 million or 5% of the bank's equity, independent appraisals are conducted once every three years.

For effective credit risk management, the bank has set up the permanent Assets Evaluation Committee which performs a regular analysis of assets and memorandum items, i.e., their recoverability. Depending on the results of such analysis, the amount of the allowance for credit losses (impairment) is determined. For the purposes of such analysis, both specific and collective (portfolio) risks are considered. The bank analyses the quality of its loan portfolio on a regular basis to identify loss events. If a loss event is identified, the loan is assessed for impairment. The age of past due loans is used as one of the quality criteria. The criteria applied to corporate loans also include the borrower's business performance and prospects, its existing and forecast cash flows to meet the liabilities, compliance with the monitoring/risk factors set, collateral value, etc. Past due loans are loans with delayed contractual interest and/or principal payments. Different loan groups (mortgage loans, corporate loans, consumer loans, etc.) have different aging criteria (8 to 90 days) which are determined by assessing and considering risks inherent in the relevant loan group. Information on delayed credit payments is disclosed starting from the first day of delay. Impaired loans are loans for which the bank has recognised impairment allowances as a result of a loss event.

Non-performing loans are loans with payments overdue by more than 90 days or impaired loans, or loans that are planned to be forwarded for collection by way of forced disposal of collateral, and loans with disposed collaterals. If a non-performing loan is restructured (provisions of the agreement are changed) it remains classified as a non-performing loan for at least 12 months after the date of change of provisions.

Loss events are the following:
- significant financial difficulties of the borrower;
- non-compliance with the agreement;
- benefits granted to the borrower for economic or legal reasons associated with the financial difficulties of the borrower, which would not be otherwise granted by the group/bank;
- relatively high likelihood of bankruptcy proceedings or other financial reorganisation initiated by the borrower;
- absence of pre-requisites for the implementation of funded projects;
- default on obligations by a party related to the borrower, which affects the borrower's ability to settle its obligations to the bank;
- decrease in the value of collateral if repayment of the loan is directly dependent on the collateral value;
- other events leading to the elevation of credit risk.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Credit quality analysis for the group:

EUR '000

	Mortgage	Business	Other	Consumer	Total gross loans	Fair value of collateral
						31.12.2016.
Neither past due nor impaired loans	269,227	622,659	80,607	1,055	973,548	1,557,791
Past due but not impaired loans, incl.:	30,607	7,254	-	124	37,985	41,868
less than 30 days	24,852	3,571	-	54	28,477	30,872
31 to 59 days	4,472	3,403	-	26	7,901	9,106
60 to 89 days	505	6	-	23	534	416
more than 90 days	778	274	-	21	1,073	1,474
Impaired loans	22,075	11,205	1,408	90	34,778	23,794
Total gross loans	**321,909**	**641,118**	**82,015**	**1,269**	**1,046,311**	**1,623,453**
Impairment allowance	(7,811)	(7,110)	(1,365)	(81)	(16,367)	
Total net loans	**314,098**	**634,008**	**80,650**	**1,188**	**1,029,944**	
						31.12.2015.
Neither past due nor impaired loans	280,325	510,619	19,523	912	811,379	1,221,800
Past due but not impaired loans, incl.:	30,948	4,445	-	126	35,519	33,667
less than 30 days	26,448	697	-	76	27,221	24,454
31 to 59 days	3,107	1,325	-	26	4,458	4,731
60 to 89 days	414	1,159	-	12	1,585	1,866
more than 90 days	979	1,264	-	12	2,255	2,616
Impaired loans	34,455	14,772	1,719	114	51,060	33,422
Total gross loans	**345,728**	**529,836**	**21,242**	**1,152**	**897,958**	**1,288,889**
Impairment allowance	(14,451)	(7,759)	(1,676)	(69)	(23,955)	
Total net loans	**331,277**	**522,077**	**19,566**	**1,083**	**874,003**	

Credit quality analysis for the bank:

EUR '000

	Mortgage	Business	Other	Consumer	Total gross loans	Fair value of collateral
						31.12.2016.
Neither past due nor impaired loans	269,227	604,945	80,607	982	955,761	1,548,410
Past due but not impaired loans, incl.:	30,607	7,255	-	123	37,985	41,868
less than 30 days	24,852	3,571	-	53	28,476	30,872
31 to 59 days	4,472	3,404	-	26	7,902	9,106
60 to 89 days	505	6	-	23	534	416
more than 90 days	778	274	-	21	1,073	1,474
Impaired loans	22,075	11,190	1,408	80	34,753	23,794
Total gross loans	**321,909**	**623,390**	**82,015**	**1,185**	**1,028,499**	**1,614,072**
Impairment allowance	(7,811)	(7,104)	(1,365)	(73)	(16,353)	
Total net loans	**314,098**	**616,286**	**80,650**	**1,112**	**1,012,146**	
						31.12.2015.
Neither past due nor impaired loans	280,325	510,620	19,523	912	811,380	1,213,960
Past due but not impaired loans, incl.:	30,948	4,445	-	126	35,519	33,667
less than 30 days	26,448	697	-	76	27,221	24,454
31 to 59 days	3,107	1,325	-	26	4,458	4,731
60 to 89 days	414	1,159	-	12	1,585	1,866
more than 90 days	979	1,264	-	12	2,255	2,616
Impaired loans	34,455	13,888	1,718	114	50,175	33,422
Total gross loans	**345,728**	**528,953**	**21,241**	**1,152**	**897,074**	**1,281,049**
Impairment allowance	(14,451)	(7,380)	(1,675)	(69)	(23,575)	
Total net loans	**331,277**	**521,573**	**19,566**	**1,083**	**873,499**	

Regular stress tests of the group's/bank's loan portfolio, balances due from credit institutions as well as securities portfolio are performed to assess the credit risk exposure and identify potential critical situations. The maximum exposure to credit risk is assessed without taking into account collateral and other credit enhancements, while the minimum exposure is assessed taking into account the fair value of the collateral at the reporting date. If the loan is secured against a financial instrument, its fair value is determined according to the market value of the respective financial instrument; if the loan is secured against a bank deposit, the fair value of the collateral is the nominal value of the respective deposit; if the loan is secured against real estate, its fair value is determined according to the valuation provided by independent experts and adjusted (reduced) based on the group's/bank's experience. The fair value of other collateral is their purchase value or carrying amount taking into consideration the valuation provided by independent experts and the group.

As at 31 December 2016, the gross amount of loans having the maturity date for principal or interest changed totalled EUR 80.8 (82.6) million. These changes were made on the basis of the agreements between the group or the bank and customers amending respective loan conditions, as otherwise the loans might be past due. A loan is considered to be restructured from the date of the above mutual agreement to the date when at least two years have passed without delays of contractual payments by more than 30 days or any of the loss events has taken place.

The group and the bank manage the credit quality of their financial assets by applying internal ratings. Loans to customers are assigned internal ratings where higher-rating assets are standard assets with a sound credit standing, while lower-rating assets are those assets which have doubtful credit quality and require close monitoring by the group and the bank. Meanwhile, balances due from credit institutions and securities are granted credit ratings assigned by rating agencies. Higher-rating assets represent investment-grade assets, i.e., assets having a rating of no lower than BBB-, while lower-rating assets represent assets rated below investment grade.

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Financial assets of the group by risk rating:

EUR '000

	Assets not overdue without recognised impairment		Portfolio allowance		Individually assessed		
	Higher rating	Lower rating	Assets overdue without recognised impairment	Assets with recognised impairment	Assets without recognised impairment	Assets with recognised impairment	**Gross financial assets**
Financial assets							31.12.2016.
Cash and deposits with central banks	414,431	-	-	-	-	-	414,431
Balances due from credit institutions	226,241	46,279	-	-	-	-	272,520
Derivatives	624	-	-	-	-	-	624
Financial assets at fair value through profit or loss	11,815	16,601	-	-	-	-	28,416
Available-for-sale financial assets	1,001,455	41,119	-	-	-		1,042,574
Held-to-maturity investments	894,397	159,342	-	-	-	1,580	1,055,319
Loans and receivables	907,476	66,072	37,804	23,524	181	11,254	1,046,311
Mortgage	268,570	657	30,607	21,754	-	321	321,909
Business	557,244	65,415	7,170	272	84	10,933	641,118
Other	80,607	-	-	1,408	-	-	82,015
Consumer	1,055	-	27	90	97	-	1,269
Other financial assets	-	1,295	-	-	-	-	1,295
Total financial assets, gross	**3,456,439**	**330,708**	**37,804**	**23,524**	**181**	**12,834**	**3,861,490**
							31.12.2015.
Cash and deposits with central banks	449,136	-	-	-	-	-	449,136
Balances due from credit institutions	580,075	89,905	-	-	-	-	669,980
Derivatives	121	-	-	-	-	-	121
Financial assets at fair value through profit or loss	19,601	6,520	-	-	-	-	26,121
Available-for-sale financial assets	1,794,532	38,541	-	-	-	99	1,833,172
Held-to-maturity investments	823,777	189,391	-	-	-	4,445	1,017,613
Loans and receivables	742,358	69,022	34,720	36,093	798	14,967	897,958
Mortgage	279,288	1,037	30,800	34,066	148	389	345,728
Business	442,634	67,985	3,892	194	553	14,578	529,836
Other	19,523	-	-	1,719	-	-	21,242
Consumer	913	-	28	114	97	-	1,152
Other financial assets	-	1,465	-	-	-	-	1,465
Total financial assets, gross	**4,409,600**	**394,844**	**34,720**	**36,093**	**798**	**19,511**	**4,895,566**

Financial assets of the bank by risk rating:

EUR '000

	Assets not overdue without recognised impairment		Portfolio allowance		Individually assessed		
	Higher rating	Lower rating	Assets overdue without recognised impairment	Assets with recognised impairment	Assets without recognised impairment	Assets with recognised impairment	**Gross finanacial assets**
Financial assets							31.12.2016.
Cash and deposits with central banks	413,047	-	-	-	-	-	413,047
Balances due from credit institutions	225,118	56,386	-	-			281,504
Derivatives	80	-	-	-	-	-	80
Financial assets at fair value through profit or loss	-	21,010	-	-	-	-	21,010
Available-for-sale financial assets	925,966	31,128	-	-	-	-	957,094
Held-to-maturity investments	832,528	156,934	-	-	-	1,580	991,042
Loans and receivables	889,689	66,072	37,804	23,499	181	11,254	1,028,499
Mortgage	268,570	657	30,607	21,754	-	321	321,909
Business	539,531	65,415	7,170	257	84	10,933	623,390
Other	80,607	-	-	1,408	-	-	82,015
Consumer	981	-	27	80	97	-	1,185
Other financial assets	-	663	-	-	-	-	663
Total financial assets, gross	**3,286,428**	**332,193**	**37,804**	**23,499**	**181**	**12,834**	**3,692,939**
							31.12.2015.
Cash and deposits with central banks	448,187	-	-	-	-	-	448,187
Balances due from credit institutions	585,203	86,569	-	-	-	-	671,772
Derivatives	121	-	-	-	-	-	121
Financial assets at fair value through profit or loss	20,708	1,578	-	-	-	-	22,286
Available-for-sale financial assets	1,742,013	38,541	-	-	-	99	1,780,653
Held-to-maturity investments	775,870	187,504	-	-	4,445	-	967,819
Loans and receivables	742,358	69,022	34,720	36,093	798	14,083	897,074
Mortgage	279,288	1,037	30,800	34,066	148	389	345,728
Business	442,635	67,985	3,892	194	553	13,694	528,953
Other	19,522	-	-	1,719	-	-	21,241
Consumer	913	-	28	114	97	-	1,152
Other financial assets	-	606	-	-	-	-	606
Total financial assets, gross	**4,314,460**	**383,820**	**34,720**	**36,093**	**5,243**	**14,182**	**4,788,518**

Credit risk concentration

To mitigate concentration risk, the group and the bank apply diversification and a system of limits. The group and the bank place limits on the amount of risk for individual borrowers (groups of connected clients), and for geographical and industry concentrations as well as exposures having one type of collateral, etc.

With a view to limiting credit risk and concentration risk, the target levels and limits of the loan portfolio are defined as a percentage of eligible capital, considering risks associated with the lending product and the location and liquidity of collateral.

Concentration limits for individual industry sectors are determined on the basis of credit quality ratios in the relevant sector and industry trends both in Latvia and abroad.

Concentration limits for geographical regions are based on the possibilities of registering and recovering collateral, as well as the political and economic situation in the relevant country.

Concentration limits for a certain type of collateral are defined, considering the liquidity of collateral.

In the event that any group of loans is affected by economic factors deteriorating the condition of all loans belonging to this group, it is decided to place certain restrictions on lending in the specific industry, and potential credit losses are identified.

The exposure to any single borrower, including banks and brokers, is further restricted by sub-limits. The credit risk concentration is analysed also by estimating the credit exposure ratio to eligible capital. According to the Regulation, the group and the bank treat credit exposure as a high risk transaction if it exceeds 10% of the eligible capital.

For the purposes of the credit risk concentration analysis, the issuers incorporated in a country only for the attraction of funds are disclosed as attributable to the country or region where the guarantors of the issue are located.

The credit risk inherent in the group's and bank's securities portfolios is reflected by the credit rating granted to respective securities and issuers. The group's and bank's securities portfolios are well-diversified and portfolio diversification is based on issues, credit rating classes, issuers and maturities.

Apart from the effective management of credit risk concentration, the bank has set limits for credit institutions and financial companies in order to restrict balances held with one institution and group of related institutions as well as defined the limit control regulations specifying the independent procedure for controlling compliance with the limits.

To enhance the effectiveness of credit risk management, which is associated with the assessment of existing and potential counterparties, the bank has designed an internal model for the assessment of credit institutions. With the model, the group determines the maximum recommended co-operation limits, which are used for decision-making when assigning cooperation limits for credit institutions. Accordingly the internal rules provide execution control in accordance to stated limits.

Analysis of concentration of the group's financial assets and liabilities by geographical area as at 31 December 2016:

EUR '000

Assets	Latvia	EMU countries	Other EU member states	Other OECD countries	International organisations	CIS countries	Other countries	Total
Cash and deposits with central banks	413,047	1,384	-	-	-	-	-	414,431
Balances due from credit institutions	2	99,120	8,457	44,676	-	50,769	69,496	272,520
Derivatives	-	-	15	59	-	-	550	624
Financial assets at fair value through profit or loss	5,529	2,368	1,668	7,054	-	4,006	7,791	28,416
Available-for-sale financial assets	39,311	369,907	147,332	369,177	67,092	32,826	16,929	1,042,574
Loans	721,342	41,653	30,855	57,867	-	156,176	22,051	1,029,944
Held-to-maturity investments	209,493	186,521	55,767	319,961	29,616	207,377	45,252	1,053,987
Other financial assets	1,277	18	-	-	-	-	-	1,295
Total financial assets	**1,390,001**	**700,971**	**244,094**	**798,794**	**96,708**	**451,154**	**162,069**	**3,843,791**
Liabilities								
Derivatives	-	-	18	-	-	-	24	42
Financial liabilities at amortised cost	277,024	349,130	609,062	126,053	-	536,686	1,732,371	3,630,326
Other financial liabilities	4,221	1,497	538	1,707		3	4,049	12,015
Total financial liabilities	**281,245**	**350,627**	**609,618**	**127,760**	**-**	**536,689**	**1,736,444**	**3,642,383**
Memorandum items	**44,619**	**29,128**	**6,158**	**40,138**	**-**	**13,092**	**9,285**	**142,420**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Analysis of concentration of the group's financial assets and liabilities by geographical area as at 31 December 2015:

EUR '000

Assets	Latvia	EMU countries	Other EU member states	Other OECD countries	International organisations	CIS countries	Other countries	Total
Cash and deposits with central banks	448,187	949	-	-	-	-	-	449,136
Balances due from credit institutions	4,568	247,719	34,125	267,271	-	45,383	70,914	669,980
Derivatives	-	-	99	19	-	-	3	121
Financial assets at fair value through profit or loss	5,793	3,263	1,901	6,706	-	3,840	4,618	26,121
Available-for-sale financial assets	53,330	409,938	200,664	1,054,614	64,864	37,966	11,697	1,833,073
Loans	639,138	23,008	19,299	33,794	-	132,934	25,830	874,003
Held-to-maturity investments	203,714	191,200	77,837	287,535	29,428	203,190	22,143	1,015,047
Other financial assets	1,363	102	-	-	-	-	-	1,465
Total financial assets	**1,356,093**	**876,179**	**333,925**	**1,649,939**	**94,292**	**423,313**	**135,205**	**4,868,946**
Liabilities								
Derivatives	1	187	114	59	-	-	4	365
Financial liabilities at amortised cost	458,178	321,858	1,000,321	1,211,759	-	703,712	974,991	4,670,819
Other financial liabilities	4,048	23,653	799	611		277	607	29,995
Total financial liabilities	**462,227**	**345,698**	**1,001,234**	**1,212,429**	**-**	**703,989**	**975,602**	**4,701,179**
Memorandum items	**45,398**	**11,792**	**6,864**	**8,589**	**-**	**7,126**	**5,790**	**85,559**

Analysis of concentration of the bank's financial assets and liabilities by geographical area as at 31 December 2016:

EUR '000

Assets	Latvia	EMU countries	Other EU member states	Other OECD countries	International organisations	CIS countries	Other countries	Total
Cash and deposits with central banks	413,047	-	-	-	-	-	-	413,047
Balances due from credit institutions	1	108,193	8,456	44,633		50,725	69,496	281,504
Derivatives	-	-	15	59	-	-	6	80
Financial assets at fair value through profit or loss	19,892	-	-	1,021	-	97	-	21,010
Available-for-sale financial assets	34,288	340,848	136,357	332,603	67,092	32,826	13,080	957,094
Loans	726,056	41,578	30,854	57,867	-	133,742	22,049	1,012,146
Held-to-maturity investments	205,558	172,612	47,710	295,201	28,667	204,515	35,447	989,710
Other financial assets	645	18	-	-	-	-	-	663
Total financial assets	**1,399,487**	**663,249**	**223,392**	**731,384**	**95,759**	**421,905**	**140,078**	**3,675,254**
Liabilities								
Derivatives	-	-	18	-	-	-	24	42
Financial liabilities at amortised cost	296,550	346,063	582,356	122,941	-	511,970	1,655,433	3,515,313
Other financial liabilities	1,611	200	38	192		3	235	2,279
Total financial liabilities	**298,161**	**346,263**	**582,412**	**123,133**	**-**	**511,973**	**1,655,692**	**3,517,634**
Memorandum items	**38,759**	**29,128**	**6,158**	**40,138**	**-**	**13,092**	**9,285**	**136,560**

Analysis of concentration of the bank's financial assets and liabilities by geographical area as at 31 December 2015:

EUR '000

Assets	Latvia	EMU countries	Other EU member states	Other OECD countries	International organisations	CIS countries	Other countries	Total
Cash and deposits with central banks	448,187	-	-	-	-	-	-	448,187
Balances due from credit institutions	4,566	249,583	34,125	267,271	-	45,314	70,913	671,772
Derivatives	-	-	99	19	-	-	3	121
Financial assets at fair value through profit or loss	18,950	191	-	1,567	-	1,578	-	22,286
Available-for-sale financial assets	53,330	389,891	197,273	1,026,452	64,864	37,966	10,778	1,780,554
Loans	638,634	23,008	19,299	33,794	-	132,934	25,830	873,499
Held-to-maturity investments	199,770	179,369	68,207	269,598	28,512	200,425	19,372	965,253
Other financial assets	504	102	-	-	-	-	-	606
Total financial assets	**1,363,941**	**842,144**	**319,003**	**1,598,701**	**93,376**	**418,217**	**126,896**	**4,762,278**
Liabilities								
Derivatives	1	187	114	59	-	-	4	365
Financial liabilities at amortised cost	484,239	333,939	985,551	1,175,846	-	667,384	963,271	4,610,230
Other financial liabilities	1,196	23,568	-	-		-	-	24,764
Total financial liabilities	**485,436**	**357,694**	**985,665**	**1,175,905**	**-**	**667,384**	**963,275**	**4,635,359**
Memorandum items	**38,262**	**11,792**	**6,864**	**8,589**	**-**	**7,126**	**5,790**	**78,423**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Note 36

Other financial risks

Liquidity risk

Liquidity is the group's and bank's ability to maintain or ensure sufficient cash and cash equivalents to meet the expected (everyday) or sudden (critical) legally justified claims of its creditors. This means the group's and bank's ability to turn their assets into cash with minimal loss or ensure reasonably priced credit facilities.

The Chief Risk Officer (CRO) is responsible for liquidity risk management. The Risk Management Division is responsible for liquidity risk assessment and control. The Chief Financial Officer (CFO) is responsible for liquidity management and the Financial Market Division is responsible for ensuring the required liquidity level and compliance with the set limits according to the policies and instructions adopted.

The key principles and procedures to identify, analyse and control liquidity risk on a timely basis are laid down in the Liquidity Management Policy.

For ordinary liquidity risk management purposes, the bank applies the following indicators having certain limits and restrictions set:

- deposit coverage ratio;
- net liquidity positions by all currencies in total and by each separate currency;
- liquidity ratios for up to 30 days;
- large deposits on demand to liquid assets on demand;
- sum of term deposits of one customer (group of related customers)
- liquidity coverage ratio (LCR);
- net stable funding ratio (NSFR).

To identify the potential deterioration in the liquidity position on a timely basis, an early warning indicators system has been designed:

- substantial daily reduction of the amounts to be claimed under savings accounts and term deposits with the remaining maturities of "Less than 30 days";
- simultaneous decrease in the weighted average duration and the total balance of term deposits;
- substantial growth of deposits claimed before their contractual maturity;
- decrease in the proportion of liquid assets in the total assets of the bank;
- negative information reported in the mass media about the bank or its related parties that may harm the bank's reputation.

As at 31 December 2016, the bank's liquidity ratio was 78.40% (82.68%).

As at 31 December 2016, the liquidity coverage ratio (LCR) of the group and the bank was 398.0% (448.0%) and 375.0% (437.0%). According to the Regulation, as at 31 December 2016, the group and the bank were required to maintain an LCR of at least 70%. The bank manages funding liquidity risk and controls the funding structure by assessing the following:

- the funding structure in order to define the bank's dependence on certain types of resources;
- diversification of funding maturities;
- potential funding sources and the bank's access to such sources.

The bank regularly evaluates and controls its liquid assets and collateral positions (assets, which can be used by the bank as collateral for funding). The bank diversifies these assets, taking into account potential restrictions (legal, regulatory, operating, etc.) as to funding (transactions), price fluctuations, discounts (the difference between the amount of funding and the fair value of related collateral), additional collateral requirements in critical situations, etc.

Contingency liquidity risk

Contingency liquidity risk relates to the organisation and planning for liquidity management in times of stress. Within the bank a specific crisis team is responsible for the liquidity manage-

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

ment in times of crisis. This crisis team consists of the CEO, CRO, CFO, the Financial Market Division and the Risk Management Division. The group and the bank have defined principles to identify liquidity crisis stages and actions to overcome crisis situations. The main objective of group's contingency plans is to enable senior management to act effectively and efficiently at times of crisis. The contingency plans are established for addressing temporary and long-term liquidity disruptions caused by a general event in the market or a bank specific event. These plans ensure that all roles and responsibilities are clearly defined and the necessary management information is in place.

According to the internal classification of the group and the bank, several liquidity crisis stages are distinguished: potential liquidity crisis, short-term and long-term liquidity crisis. Each stage has quantitative and qualitative indicators fixed, which, if observed, also require certain actions to enhance liquidity.
The bank performs regular liquidity stress tests to identify the sources of potential liquidity problems, determine when the mandatory ratios may be breached or the crisis indicators listed in the Liquidity Crisis Manual may emerge as well as establish whether the bank's liquidity management documents need to be revised. The capital requirement for liquidity risk is determined by the group and the bank based on the results of liquidity stress tests.

Liquidity gap analysis
The group and the bank have prepared these consolidated financial statements on a going concern basis. The group's and bank's management closely monitor and manage the group's and bank's liquidity position on a daily basis in accordance with the liquidity risk management framework.

Assets and liabilities are distributed into maturity bands in the following liquidity gap analysis tables according to the signed agreements, except as stated below.

Securities in the bank's portfolio are included in the maturity range in which they can be sold without loss, i.e. at the market value, except for held-to-maturity investments. Securities of the held-to-maturity portfolio are disclosed in the maturity range based on the ability to perform repo transactions with these securities in exchange for a secured loan. The share of the securities qualifying for repo transactions is presented in the "on demand and up to 1 month" maturity range, while the share of the securities not qualifying for repo transactions is disclosed according to the maturity date.

According to the bank's experience, current accounts and other similar deposits constitute a sound source of financing. Current accounts and conceptually similar deposit types due "on demand" are classified in line with the bank's experience regarding the life cycle of these deposits with the bank, although customers may receive demand deposits from the bank at any time and without any penalties applied. The breakdown of demand deposits by maturity does not exceed 5 years and complies with the bank's historical experience regarding the length of the period and the extent of the outflow of demand deposits from the bank. This principle is not applied to demand deposits placed by large customers as the bank considers them less stable and these deposits are included in the maturity band of "on demand and up to 1 month".
Term deposits are disclosed according to contractual terms; however, customers may claim term deposits from the bank before the maturity date, subject to the deduction of a certain amount from the respective term deposit.
Impaired assets are stated net of allowances.

Liquidity gap analysis for the group's assets, liabilities and memorandum items as at 31 December 2016

EUR '000

Assets	On demand and up to 1 month	1—3 months	3—12 months	1—5 years	More than 5 years and termless	Total
Cash and deposits with central banks	414,431	-	-	-	-	414,431
Balances due from credit institutions	245,629	2,562	-	-	24,329	272,520
Derivatives	20	60	365	179	-	624
Financial assets at fair value through profit or loss	23,569	-	4,847	-	-	28,416
Available-for-sale financial assets	945,876	10,233	27,112	55,805	3,548	1,042,574
Loans	142,606	26,882	139,818	482,851	237,787	1,029,944
Held-to-maturity investments	727,925	15,320	53,597	124,673	132,472	1,053,987
Other assets	5,624	-	6,225	-	118,978	130,827
Total assets	**2,505,680**	**55,057**	**231,964**	**663,508**	**517,114**	**3,973,323**
Liabilities						
Derivatives	23	19	-	-	-	42
Financial liabilities at amortised cost	753,772	200,966	575,567	1,968,895	131,126	3,630,326
Other liabilities	24,622	-	-	-	-	24,622
Total liabilities	**778,417**	**200,985**	**575,567**	**1,968,895**	**131,126**	**3,654,990**
Shareholders' equity	-	-	-	-	318,333	318,333
Total liabilities and shareholders' equity	**778,417**	**200,985**	**575,567**	**1,968,895**	**449,459**	**3,973,323**
Total memorandum items	32,478	11,199	66,943	15,910	15,890	142,420
Net liquidity position	1,694,785	(157,127)	(410,546)	(1,321,297)	51,765	x
Total liquidity position	1,694,785	1,537,658	1,127,112	(194,185)	(142,420)	x

Liquidity gap analysis for the group's assets, liabilities and memorandum items as at 31 December 2015:

EUR '000

Assets	On demand and up to 1 month	1—3 months	3—12 months	1—5 years	More than 5 years and termless	Total
Cash and deposits with central banks	449,136	-	-	-	-	449,136
Balances due from credit institutions	631,612	7,350	7,805	-	23,213	669,980
Derivatives	53	68	-	-	-	121
Financial assets at fair value through profit or loss	6,369	19,543	209	-	-	26,121
Available-for-sale financial assets	1,690,252	71,037	31,099	33,616	7,069	1,833,073
Loans	98,911	24,841	69,314	475,839	205,098	874,003
Held-to-maturity investments	588,257	11,897	58,984	237,393	118,516	1,015,047
Other assets	5,767	228	3,524	-	114,588	124,107
Total assets	**3,470,357**	**134,964**	**170,935**	**746,848**	**468,484**	**4,991,588**
Liabilities						
Derivatives	150	215	-	-	-	365
Financial liabilities at amortised cost	902,149	199,120	693,950	2,752,584	123,016	4,670,819
Other liabilities	43,075	-	-	-	-	43,075
Total liabilities	**945,374**	**199,335**	**693,950**	**2,752,584**	**123,016**	**4,714,259**
Shareholders' equity	-	-	-	-	277,329	277,329
Total liabilities and shareholders' equity	**945,374**	**199,335**	**693,950**	**2,752,584**	**400,345**	**4,991,588**
Total memorandum items	35,450	3,763	5,511	16,038	24,797	85,559
Net liquidity position	2,489,533	(68,134)	(528,526)	(2,021,774)	43,342	x
Total liquidity position	2,489,533	2,421,399	1,892,873	(128,901)	(85,559)	x

Liquidity gap analysis for the bank's assets, liabilities and memorandum items as at 31 December 2016:

EUR '000

Assets	On demand and up to 1 month	1—3 months	3—12 months	1—5 years	More than 5 years and termless	Total
Cash and deposits with central banks	413,047	-	-	-	-	413,047
Balances due from credit institutions	254,613	2,562	-	-	24,329	281,504
Derivatives	20	60	-	-	-	80
Financial assets at fair value through profit or loss	16,163	-	4,847	-	-	21,010
Available-for-sale financial assets	944,919	6,181	5,423	-	571	957,094
Loans	142,523	26,882	121,573	483,381	237,787	1,012,146
Held-to-maturity investments	727,401	14,603	51,912	89,399	106,395	989,710
Other assets	4,040	-	2,456	-	168,499	174,995
Total assets	**2,502,726**	**50,288**	**186,211**	**572,780**	**537,581**	**3,849,586**
Liabilities						
Derivatives	23	19	-	-	-	42
Financial liabilities at amortised cost	725,047	198,975	544,957	1,915,209	131,125	3,515,313
Other liabilities	12,429	-	-	-	-	12,429
Total liabilities	**737,499**	**198,994**	**544,957**	**1,915,209**	**131,125**	**3,527,784**
Shareholders' equity	-	-	-	-	321,802	321,802
Total liabilities and shareholders' equity	**737,499**	**198,994**	**544,957**	**1,915,209**	**452,927**	**3,849,586**
Total memorandum items	26,618	11,199	66,943	15,910	15,890	136,560
Net liquidity position	1,738,609	(159,905)	(425,689)	(1,358,339)	68,764	x
Total liquidity position	1,738,609	1,578,704	1,153,015	(205,324)	(136,560)	x

Liquidity gap analysis for the bank's assets, liabilities and memorandum items as at 31 December 2015:

EUR '000

Assets	On demand and up to 1 month	1—3 months	3—12 months	1—5 years	More than 5 years and termless	Total
Cash and deposits with central banks	448,187	-	-	-	-	448,187
Balances due from credit institutions	633,842	7,350	7,805	-	22,775	671,772
Derivatives	53	68	-	-	-	121
Financial assets at fair value through profit or loss	3,336	18,741	209	-	-	22,286
Available-for-sale financial assets	1,693,215	60,845	26,340		154	1,780,554
Loans	98,911	24,841	69,314	475,839	204,594	873,499
Held-to-maturity investments	588,258	10,654	55,992	214,210	96,139	965,253
Other assets	3,131	228	3,039	-	160,051	166,449
Total assets	**3,468,933**	**122,727**	**162,699**	**690,049**	**483,713**	**4,928,121**
Liabilities						
Derivatives	150	215	-	-	-	365
Financial liabilities at amortised cost	893,983	198,226	690,113	2,704,892	123,016	4,610,230
Other liabilities	36,073	-	-	-	-	36,073
Total liabilities	**930,206**	**198,441**	**690,113**	**2,704,892**	**123,016**	**4,646,668**
Shareholders' equity	-	-	-	-	281,453	281,453
Total liabilities and shareholders' equity	**930,206**	**198,441**	**690,113**	**2,704,892**	**404,469**	**4,928,121**
Total memorandum items	28,314	3,763	5,511	16,038	24,797	78,423
Net liquidity position	2,510,413	(79,477)	(532,925)	(2,030,881)	54,447	x
Total liquidity position	2,510,413	2,430,936	1,898,011	(132,870)	(78,423)	x

Financial liabilities and memorandum items of the group as at 31 December 2016, which are expected in the future:

EUR '000

Financial liabilities	Carrying amount	Up to 1 month	1—12 months	1—5 years	More than 5 years	Total
Demand deposits from credit institutions	16,463	16,463	-	-	-	16,463
Derivative inflow amount	42	(1,695)	(1,189)	-	-	(2,884)
Derivative outflow amount	-	1,694	1,155	-	-	2,849
Financial liabilities at amortised cost	3,613,863	3,032,637	242,539	222,609	131,882	3,629,667
Other financial liabilities	12,015	12,015	-	-	-	12,015
Total financial liabilities	**3,630,368**	**3,049,099**	**242,505**	**222,609**	**131,882**	**3,646,095**
Memorandum items	142,420	32,477	78,143	15,910	15,890	142,420
Total financial liabilities and memorandum items	**3,772,788**	**3,081,576**	**320,648**	**238,519**	**147,772**	**3,788,515**

In estimating the amount of expected financial liabilities, the group and the bank have included in the maturity gap analysis also interest payable on financial liabilities and memorandum items effective as at 31 December 2016 and 2015 which is expected in the future but has not been assessed at the reporting date.

Financial liabilities and memorandum items of the group as at 31 December 2015, which are expected in the future:

EUR '000

Financial liabilities	Carrying amount	Up to 1 month	1—12 months	1—5 years	More than 5 years	Total
Demand deposits from credit institutions	49,154	49,154	-	-	-	49,154
Derivative inflow amount	365	(2,804)	(2,641)	-	-	(5,445)
Derivative outflow amount	-	2,899	2,712	-	-	5,611
Financial liabilities at amortised cost	4,621,665	3,835,839	264,020	415,857	123,664	4,639,380
Other financial liabilities	29,995	29,995	-	-	-	29,995
Total financial liabilities	**4,671,184**	**3,885,088**	**264,091**	**415,857**	**123,664**	**4,688,700**
Memorandum items	85,559	35,450	9,274	16,038	24,797	85,559
Total financial liabilities and memorandum items	**4,756,743**	**3,920,538**	**273,365**	**431,895**	**148,461**	**4,774,259**

Financial liabilities and memorandum items of the bank as at 31 December 2016, which are expected in the future:

EUR '000

Financial liabilities	Carrying amount	Up to 1 month	1—12 months	1—5 years	More than 5 years	Total
Demand deposits from credit institutions	20,375	20,375	-	-	-	20,375
Derivative inflow amount	42	(1,695)	(1,189)	-	-	(2,884)
Derivative outflow amount	-	1,694	1,155	-	-	2,849
Financial liabilities at amortised cost	3,494,938	2,932,824	224,721	221,314	131,882	3,510,741
Other financial liabilities	2,279	2,279	-	-	-	2,279
Total financial liabilities	**3,515,355**	**2,953,198**	**224,687**	**221,314**	**131,882**	**3,531,081**
Memorandum items	136,560	26,618	78,142	15,910	15,890	136,560
Total financial liabilities and memorandum items	**3,651,915**	**2,979,816**	**302,829**	**237,224**	**147,772**	**3,667,641**

Financial liabilities and memorandum items of the bank as at 31 December 2015, which are expected in the future:

EUR '000

Financial liabilities	Carrying amount	Up to 1 month	1—12 months	1—5 years	More than 5 years	Total
Demand deposits from credit institutions	63,294	63,294	-	-	-	63,294
Derivative inflow amount	365	(2,804)	(2,641)	-	-	(5,445)
Derivative outflow amount	-	2,899	2,712	-	-	5,611
Financial liabilities at amortised cost	4,546,936	3,753,521	266,568	420,966	123,664	4,564,719
Other financial liabilities	24,764	24,764	-	-	-	24,764
Total financial liabilities	**4,610,595**	**3,816,910**	**266,639**	**420,966**	**123,664**	**4,628,179**
Memorandum items	78,423	28,314	9,274	16,038	24,797	78,423
Total financial liabilities and memorandum items	**4,689,018**	**3,845,224**	**275,913**	**437,004**	**148,461**	**4,706,602**

Market risks

Market risk is exposure to potential losses due to the revaluation of assets and liabilities and memorandum items caused by changes in the market prices of financial instruments resulting from the fluctuations of currency exchange rates, interest rates and other factors. Market risk identification, assessment and management of the group and the bank are laid down in Market Risk Management Policy.

The group and the bank distinguish the following components of market risk:

- securities price risk — the risk of loss due to the revaluation of debt or equity securities positions caused by changes in the price of relevant securities;
- interest rate risk — potential adverse effects of interest rate fluctuations on the group's and bank's income and the economic value of their capital;
- currency risk — the risk of loss due to the revaluation of assets and liabilities and memorandum items denominated in foreign currencies caused by changes in foreign exchange rates, with gold treated as a foreign currency;
- commodity risk — the risk of loss due to the revaluation of commodity positions caused by changes in the price of the relevant commodity. Commodity hereunder is a tangible item which is or may be marketed on the secondary market, such as agricultural products, oil, precious metals (except for gold);

In 2016, the bank and group were not engaged in any securitizations.

Price risk

The "loss" indicator is used by the group and bank as one of the tools to manage price risk in order to identify any reductions in the securities prices below the mandatory level in a timely fashion. Based on the above, the heads of responsible structural units may decide whether the affected securities should be sold or kept in the portfolio.

Non-fixed income financial instruments are held in the bank's trading portfolio.

The exposure to equity securities not held in the group's trading portfolio as at the reporting date amounts to EUR 12.9 (12.6) million, and for bank — EUR 2.9 (12.6) million.

The level of risk related to changes in securities prices is limited by the bank and the group by setting internal limits that are controlled on a regular basis using an internal value-at-risk model.

As part of liquidity stress testing, the bank and the group regularly evaluate the risk of changes in security prices.

The capital requirement for the security price risk for the securities in the trading portfolio and available-for-sale portfolio is determined by the bank and group using the Value at Risk (VaR) and Stressed Value at Risk (SVaR) internal models.

Currency risk

The group and the bank are exposed to negative effects of fluctuations in foreign currency exchange rates on their financial position and cash flows. The exposure to currency risk is calculated for each separate currency and includes assets and liabilities denominated in foreign currencies, as well as cash flows arising from derivatives.

The Risk Management Division is responsible for currency risk control and assessment. The Financial Market Division is responsible for maintaining currency risk within specified limits.

According to the bank's policy, the bank may use derivatives to limit its exposure to currency risk. Any transactions involving derivatives with aim to earn profits are prohibited.

The bank has major open positions in EUR and USD (US dollars). The bank's open currency position in USD is rather small as it is hedged by using currency forwards/futures. As at 31 December 2016, the bank's open currency position in USD was 3.6% (0.7%) of the bank's qualifying capital and, therefore, the effect of changes in the USD exchange rate is insignificant, and the group/bank conducts Value at Risk (VaR) calculation, which is also used for determining the amount of capital needed for covering currency risk. This risk is also controlled by limits set by Limits policy. As at 31 December 2016, all the above limits were met.

The group's Limits Policy defines major principles for limits application and control; limits for open foreign currency positions stipulate restrictions for each separate currency open position and total open position that are controlled on a daily basis. According to Credit Institution Law of Latvia open positions in each foreign currency may not exceed 10% of the bank's eligible capital and that the total foreign currency open position may not exceed 20% of eligible capital. As at 31 December 2016 the bank was in compliance with this requirement.

Group's currency position as at 31 December 2016:

EUR '000

Assets	EUR	USD	RUB	Other currencies	Total
Cash and deposits with central banks	410,719	3,476	35	201	414,431
Balances due from credit institutions	28,940	178,353	5,970	59,257	272,520
Derivatives	624	-	-	-	624
Financial assets at fair value through profit or loss	7,914	18,897	1,605	-	28,416
Available-for-sale financial assets	105,747	929,574	2,364	4,889	1,042,574
Loans	750,291	275,332	2,132	2,189	1,029,944
Held-to-maturity investments	204,516	842,483	6,514	474	1,053,987
Other assets	130,290	84	-	453	130,827
Total assets	**1,639,041**	**2,248,199**	**18,620**	**67,463**	**3,973,323**
Liabilities					
Derivatives	42	-	-	-	42
Financial liabilities at amortised cost	1,318,121	2,227,988	20,696	63,521	3,630,326
Other liabilities	16,654	7,420	514	34	24,622
Total liabilities	**1,334,817**	**2,235,408**	**21,210**	**63,555**	**3,654,990**
Net long/(short) balance sheet position	**-**	**12,791**	**(2,590)**	**3,908**	**x**
Net off-balance sheet position from FX transactions	-	(363)	1,361	4,204	x
Net open long/(short) currency position	**-**	**12,428**	**(1,229)**	**8,112**	**x**
Sensitivity gap if exchange rate against the national currency drops by 15%	**-**	**(1,864)**	**184**	**(1,217)**	**x**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Group's currency position as at 31 December 2015:

EUR '000

Assets	EUR	USD	RUB	Other currencies	Total
Cash and deposits with central banks	445,704	3,311	-	121	449,136
Balances due from credit institutions	28,495	546,590	15,003	79,892	669,980
Derivatives	121	-	-	-	121
Financial assets at fair value through profit or loss	5,234	19,731	1,156	-	26,121
Available-for-sale financial assets	153,320	1,670,194	3,284	6,275	1,833,073
Loans	648,958	211,790	2,308	10,947	874,003
Held-to-maturity investments	205,074	802,372	7,130	471	1,015,047
Other assets	123,040	500	1	566	124,107
Total assets	**1,609,946**	**3,254,488**	**28,882**	**98,272**	**4,991,588**
Liabilities					
Derivatives	365	-	-	-	365
Financial liabilities at amortised cost	1,341,174	3,203,711	30,440	95,494	4,670,819
Other liabilities	21,754	21,289	17	15	43,075
Total liabilities	**1,363,293**	**3,225,000**	**30,457**	**95,509**	**4,714,259**
Net long/(short) balance sheet position	**-**	**29,488**	**(1,575)**	**2,763**	**x**
Net off-balance sheet position from FX transactions	-	(20,675)	2,461	171	x
Net open long/(short) currency position	**-**	**8,813**	**886**	**2,934**	**x**
Sensitivity gap if exchange rate against the national currency drops by 15%	**-**	**(1,322)**	**(133)**	**(440)**	**x**

Bank's currency position as at 31 December 2016:

EUR '000

Assets	EUR	USD	RUB	Other currencies	Total
Cash and deposits with central banks	409,335	3,476	35	201	413,047
Balances due from credit institutions	27,038	189,409	5,964	59,093	281,504
Derivatives	80	-	-	-	80
Financial assets at fair value through profit or loss	7,011	12,887	1,112	-	21,010
Available-for-sale financial assets	55,493	894,348	2,364	4,889	957,094
Loans	754,925	252,900	2,132	2,189	1,012,146
Held-to-maturity investments	195,434	787,288	6,514	474	989,710
Other assets	174,504	38	-	453	174,995
Total assets	**1,623,820**	**2,140,346**	**18,121**	**67,299**	**3,849,586**
Liabilities					
Derivatives	42	-	-	-	42
Financial liabilities at amortised cost	1,287,713	2,143,665	20,708	63,227	3,515,313
Other liabilities	11,735	638	22	34	12,429
Total liabilities	**1,299,490**	**2,144,303**	**20,730**	**63,261**	**3,527,784**
Net long/(short) balance sheet position	**-**	**(3,957)**	**(2,609)**	**4,038**	**x**
Net off-balance sheet position from FX transactions	-	16,668	1,361	4,204	x
Net open long/(short) currency position	**-**	**12,711**	**(1,248)**	**8,242**	**x**
Sensitivity gap if exchange rate against the national currency drops by 15%	**-**	**(1,907)**	**187**	**(1,236)**	**x**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Bank's currency position as at 31 December 2015:

EUR '000

Assets	EUR	USD	RUB	Other currencies	Total
Cash and deposits with central banks	444,755	3,311	-	121	448,187
Balances due from credit institutions	31,354	545,987	15,015	79,416	671,772
Derivatives	121	-	-	-	121
Financial assets at fair value through profit or loss	4,069	17,414	803	-	22,286
Available-for-sale financial assets	124,167	1,646,828	3,284	6,275	1,780,554
Loans	648,454	211,790	2,308	10,947	873,499
Held-to-maturity investments	191,507	766,146	7,129	471	965,253
Other assets	165,358	524	1	566	166,449
Total assets	**1,609,785**	**3,192,000**	**28,540**	**97,796**	**4,928,121**
Liabilities					
Derivatives	365	-	-	-	365
Financial liabilities at amortised cost	1,341,145	3,143,424	30,441	95,220	4,610,230
Other liabilities	12,366	23,675	17	15	36,073
Total liabilities	**1,353,876**	**3,167,099**	**30,458**	**95,235**	**4,646,668**
Net long/(short) balance sheet position	**-**	**24,901**	**(1,918)**	**2,561**	**x**
Net off-balance sheet position from FX transactions	-	(20,675)	2,461	171	x
Net open long/(short) currency position	**-**	**4,226**	**543**	**2,732**	**x**
Sensitivity gap if exchange rate against the national currency drops by 15%	**-**	**(634)**	**(81)**	**(410)**	**x**

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

Interest rate risk
Interest rate risk represents the adverse effect of market interest rate fluctuations on the bank's financial position. The Risk Management Division ensures interest rate risk assessment and management for both trading and non-trading portfolios. The Financial Market Division is responsible for maintaining interest rate risk within specified limits.

Interest rate risk is assessed on a regular basis both from the profitability perspective and the economic value perspective. The term 'economic value' denotes the economic value of equity, which is the difference between the economic value of claims and that of liabilities. Based on the results of analysis, it is evaluated whether an interest rate stress test is required and if so potential scenarios are developed for the stress test modelling potential adverse changes in interest rates. The aim of stress testing is to assess the impact of adverse changes in interest rates on net interest income and the economic value under difficult market conditions.

The amount of capital required to cover interest rate risk in the non-trading portfolio for the group and the bank is determined using the internal duration method.

In order to mitigate interest rate risk certain thresholds have been set for an acceptation decrease in the economic value and for the modified duration of the portfolio of open-ended investments. According to the bank's financial instrument policy, hedging derivatives may be used to hedge interest rate risk.

Assets, liabilities and contingent liabilities are distributed into maturity bands according to the following conditions:
- shorter of the remaining repayment/performance/maturity term — for financial instruments with fixed interest rates;
- term until the next interest rate change date or the interest rate repricing date — for financial instruments with floating interest rates;
- demand deposits are distributed into maturity bands by reference to the historical stability of demand deposits and the historical life cycle based on the decay rate. Maturity bands are assigned to the part of demand deposits that corresponds to the core part under the assumption concerning the shock scenario of interest rate by 200 basis points.

Derivatives are disclosed simultaneously as long and short off-balance-sheet positions. The impact of interest rate risk on the economic value of equity is calculated based on the duration method — a parallel increase in interest rates by 1 per cent (or 100 basis points) while the impact on profit is analysed using GAP analysis, i.e. analysis of the term structure of interest rate sensitive assets and liabilities and summing up the impact (profit or loss) calculated in each term interval up to one year.

In determining the impact of interest rate risk on equity the analysis is conducted by taking into consideration potential changes in the market value of debt securities in the available-for-sale portfolio upon changes in market interest rates. The impact on profit is comprised of changes in interest income resulting from changes in market interest rates taking into consideration all assets and liabilities exposed to interest rate risk.

The table below reflects the group's and the bank's sensitivity to changes in interest rates and the impact of these changes on profit and equity:

EUR '000

		Group		Group		Bank		Bank	
		01.01.2016.—31.12.2016.		01.01.2015.—31.12.2015.		01.01.2016.—31.12.2016.		01.01.2015.—31.12.2015.	
		+100 bps	-100 bps	+100 bps	-100 bps	+100 bps	-100 bps	+100 bps	-100 bps
Total for all currencies	Effect of changes on equity	(11,885)	11,885	(30,492)	30,492	(11,207)	11,207	(29,907)	29,907
	Effect of changes on profit	6,231	(6,231)	5,842	(5,842)	6,331	(6,331)	6,197	(6,197)
USD	Effect of changes on equity	(10,574)	10,574	(28,666)	28,666	(10,259)	10,259	(28,149)	28,149
	Effect of changes on profit	2,177	(2,177)	2,348	(2,348)	2,275	(2,275)	2,603	(2,603)
EUR	Effect of changes on equity	(1,311)	1,311	(1,826)	1,826	(948)	948	(1,758)	1,758
	Effect of changes on profit	4,054	(4,054)	3,494	(3,494)	4,056	(4,056)	3,594	(3,594)

Commodity risk
Precious metals represent the category of commodities exposing the group and the bank to commodity risk. The group's and bank's regulations set position limits and lay down the procedure for calculating the minimum capital requirement for commodity risk in respect of precious metals (except for gold), which are recognised on the group's and bank's statement of financial position at the date of the calculation.

Settlement risk
Settlement risk is the risk to which the group and the bank are exposed in unfinished transactions with foreign currency, securities or commodities, except for repo transactions, securities or commodity lending or borrowing transactions. Settlement risk comprises the risk of payments/delivery and the risk of free deliveries, and the capital requirement for settlement risk represents the total of capital requirements for these two risks. To limit the exposure to the risk of payments/delivery, holders of financial instruments are regularly assessed, the group and the bank place limits for the holders of their financial instruments. Where the group and the bank assume the risk of payments/delivery in customer transactions with financial instruments, the regulations set out actions to be taken by the group and the bank in the event of overdue payments and lay down the procedure for calculating the minimum capital requirement for settlement risk. The group and the bank have established the payment procedure for their counterparties in financial trading, thereby limiting their exposure to the risk of free deliveries.

Counterparty credit risk
Counterparty credit risk is the risk that the counterparty to a transaction could default on its obligations to the group or the bank before the final settlement of the transaction's cash flows. The group and the bank is exposed to counterparty credit risk in derivatives deals. To limit counterparty credit risk, internal rules developed by the group and the bank specify limits for counterparties, define positions to be included in these limits, set out the procedure and frequency for monitoring compliance with the limits and the procedure to attract the collateral. Sufficiency of collateral is controlled on a daily basis. The group and the bank use Mark-to-Market Method for calculating the minimum capital requirement for counterparty credit risk.

Note 37

Non-financial risks

During the course of their operations, the group and the bank encounter also non-financial risks (including operational risk, reputational risk, etc.) with exposure to sudden loss. The cause of such risks may be, for instance, clerical errors or fraud, break-downs in information systems, insufficient internal control and procedures, etc. The bank makes every effort to maintain the lowest possible risk level, meanwhile striving at not exceeding a reasonable level of expense. Internal control within the bank's structural units and the control exercised by the Risk Management Division are one of the measures taken to prevent the potential loss.

Operational risk

Operational risk is a risk of direct or indirect loss caused by non-complying or incomplete internal processes, human error or systems failure, as well as external factors. Operational risk comprises legal risk but excludes strategic and reputational risk.

Operational risk is inherent in all products, activities, processes, and systems of the group and the bank.

The Operational Risk Management Policy is approved by the council of the bank. The board of the bank is responsible for considering the risk analysis results and setting limits and other qualitative and quantitative indicators based on such results, so defining the level of operational risk acceptable for the group and the bank. The Chief Risk Officer (CRO) is responsible for monitoring the operational risk management process and making related final decisions within the limits fixed in the policy. The Risk Management Division is responsible for the centralisation and coordination of the operational risk management.

Given that businesses and processes for which operational risk is being assessed are different and specific, each risk event management is a responsibility of the head of a respective structural unit, according to the relevant internal regulations.

The key principles allowing efficient operational risk management are as follows:
- setting up an adequate operational risk management system;
- employing an adequate method to identify and assess operational risk;
- monitoring operational risk on a regular basis;
- controlling and/or mitigating operational risk adequately;
- ensuring business continuity.

The following risk mitigation techniques are employed for the purposes of operational risk management:
- process automation – investments in data processing and information security technologies to automate processes;
- outsourcing – partial elimination of causes of operational risk by making use of the experience and possibilities of outsourcing service providers;
- a system of limits – setting of limits for certain transactions, employees/structural units and group's and bank's business activities;
- prudent organisation of group's and bank's business processes, applying the following principles: segregation of functions, independent performance evaluation, authorisation of transactions;
- insurance – it is used to minimise operational risk loss caused by low-probability events having significant potential losses, and it is also recommended when the process is not fully or partially automated.

To manage the group's and bank's exposure to operational risk, an operational risk event database has been established. The key objectives of the database are as follows:
- collection of data about operational risk events and losses of the group and the bank;
- analysis of operational risk events and losses;
- assessment of the frequency of operational risk events and significance of operational risk losses;
- prevention of potential losses, based on the event assessment;
- definition of the major tendencies and making forecasts of future operational risk losses.

Information is registered and categorised in the database following the good practice principles defined by the Operational Riskdata eXchange Association (ORX). In addition to events resulting in actual losses, information about events for which no actual losses have been registered is also aggregated in the database, which enables the bank to identify potential losses and take all required measures to prevent such losses.

Operational risk testing is performed on a regular basis in order to assess potential losses related to operational risk. The results of operational risk testing are used in the assessment of the minimum capital requirement for operational risk.

During the reporting year, 949 (990) operational risk events were registered in the database, of which only 67 (61) events were those which resulted in actual losses amounting to EUR 126.4 (95.5) thousand. The considerable number of the identified and registered events and, at the same time, rather a small amount of loss testify to the active involvement of the group's and bank's employees in the operational risk management and to the effectiveness of the control environment.

Money laundering and terrorism financing risk

The risk of money laundering and terrorism financing (hereinafter referred to as "ML/TF risk") is the impact and likelihood that the credit institution may be used in the laundering of proceeds derived from criminal activity or in terrorism financing in relation to the financial services it provides, its customer base, the geographic operational profile of its customers, and the supply channels of products and services.

Management and control of ML/TF risk is the responsibility of Chief Compliance Officer. ML/TF risk is managed by the employees of the Compliance Department who develop risk prevention measures and ensure that approved ML/TF laws, regulations and standards are complied with and preclude the bank and the group companies from being involved in the laundering of proceeds derived from criminal activity and terrorism financing.

To ensure effective customer monitoring and ML/TF risk management, the bank has set up a permanent Customer Control Committee whose functions include approval of procedures and instructions related to customer identification, acceptance and due diligence, consideration of the results of investigating suspicious transactions and adoption of relevant decisions, analysis of KYC (due diligence) results within the limits of its competence and decision-making on abstaining from/termination or continuation of business relationships with a certain customer, as well as presentation to the board of recommendations for improvement of the ML/TF risk prevention system.

To increase the operational efficiency of the ML/FT area, the bank has also established a Customer Monitoring Committee whose primary task is to review reports prepared as a result of monitoring customer activities and make decisions thereon. The Committee supervises matters related to further service provision to customers and restrictions on services, and is also reviewing the results of due diligence procedures performed on certain customers.

The Customer Policy defines the principles of customer attraction and servicing based on the bank's and group's operational strategy that are implemented according to the local statutory requirements as well as good banking practice.

The ML/FT and sanctions policy details the control principles and the procedure for the Bank and its subsidiaries to manage money laundering and terrorism financing risks, to comply with economic/financial sanctions and Latvian, EU and international laws on ML/FT and sanctions. It is laid down in this policy how to identify and manage ML/FT risk, including measurement, assessment, control and reporting of this risk to the management of the bank.

To mitigate ML/TF risk, the bank has formulated and documented an internal ML/TF risk management and prevention system encompassing activities and measures aimed at ensuring compliance with the requirements of the Anti-Money Laundering and Counter-Terrorism Financing Law, Cabinet Regulations, FCMC Regulations and other applicable regulations. All the group's employees and authorised representatives involved in customer servicing and KYC processes are subject to the procedure prescribed by the aforementioned documents and relevant internal regulations. Bank's ML/TF risk management regulations lay down the following:

- criteria to commence cooperation with customers and counterparties;
- potential customers;
- procedure for commencing business relationships;
- procedure for customer identification and establishing actual beneficiaries;
- indicators of unusual and suspicious transactions, the procedure for establishing and investigating such indicators;
- procedure for abstaining from and reporting suspicious transactions to the Financial Intelligence Unit;
- customer risk identification;
- KYC procedures;
- customer transactions monitoring and customer due diligence;
- the procedure for ensuring processing of check sheets.

The amount of capital required to cover ML/FT risk is determined according an internal model based on the simplified method.

At the end of 2015, an administrative case was initiated by the FCMC and on 26 May 2016 the FCMC and ABLV Bank, AS signed an administrative agreement under which the parties reached settlement to close the case.

As part of the administrative agreement the bank was imposed a fine and an official warning was expressed to the board member in charge.
In determining the amount of the fine, the FCMC took into account that the bank was in compliance with all regulatory requirements and was in the process of improving internal controls, which resulted in reducing the fine to EUR 3.17 million, which is 2.5% of total annual revenue of the bank. Under the Credit Institution Law, the FCMC has the right to impose a fine of up to 10% of total net revenue of a bank for the previous financial year.

In the administrative agreement, the parties agreed on future measures which the bank committed to complete by the set deadline to improve its internal control system and raise the efficiency of its operations. The FCMC continues supervising whether the bank is fulfilling its commitments under the agreement according to the deadlines and the scope set therein.

The bank continues working on the responsibilities under the administrative agreement and improvement of its internal control system in compliance with the deadlines set out in the agreement. Following the initiative of the FCMC, Latvian banks that mostly render services to foreign clients, including ABLV Bank, underwent independent audit performed by the US advisory firms regarding the compliance with the US regulatory requirements; the audit was started in April 2016 and was intended for strengthening the internal control systems and processes in the banks. In our bank, the audit was performed by Navigant Consulting, Inc. This was one of the largest projects in our bank lately, which required considerable efforts and financial investments. In general, we are satisfied with the audit results: the bank's strengths were evaluated, and the recommendations given can be implemented without substantial investments in technologies and process modifications. During the audit, we acquired new experience in terms of differing compliance requirements in the European Union and the US.

Other risks
Other unquantifiable risks include:
- reputational risk;
- compliance risk;
- strategic and business risk;
- commission fee income and expenses volatility risk.

Given the difficulty to quantify certain risks the bank and the group have set up a high quality and efficient environment for the management of such risks.
The amount of capital required to cover other risks is determined using the simplified method by an additional assessment of suitability of this method for the bank's operations.

Reputational risk
Reputation risk is the risk of potential harm to reputation which may lead to adverse publicity, revenue decrease, costly litigation, reduction in the customer base or departure of key employees.

Reputational risk is a non-quantifiable risk and the consequences and losses that may be caused by this risk can hardly be determined. Reputational risk management by the bank (measurement, applicable methods, control) is governed by the Reputational Risk Management Policy.

Management and control of reputational risk is the responsibility of Chief Operations Officer (COO).

Reputation risk is managed by the following methods:
- risk identification and assessment;
- risk monitoring;
- risk control and prevention;
- set up of a risk communication and action plan.

Certain risk assessment criteria and indicators signalling changes in the level of risk have been introduced to support the assessment of reputation risk.

Reputation risk is assessed using the expert method and the appointed experts are Deputy Chief Executive Officer, Chief Risk Officer, Chief Operations Officer, Head of Public Relations and an employee of the Risk Analysis Department.
Monitoring measures are carried out in order to learn in due time and take immediate action in response to information on group companies or related parties published in the mass media that may impact the level of reputation risk.
Monitoring and management reporting upon discovering information that may have an adverse impact on reputation is ensured by the Head of Public Relations.

The group and the bank have documented rules in place for communication in reputation crisis, which aim to ensure that all structural units act in a prompt and consistent manner and there is optimum communication to prevent the crisis to the extent possible and to mitigate the harm to the bank's operations, reputation and image.

Reputation risk is mitigated by:
- control over compliance with legal requirements;
- analysis of reputation risk factors, impact on financial indicators and data;
- ensuring and controlling that settlements with customers and cooperation partners are made in due time;
- control of reliability of accounting data and reports;
- raising staff qualifications.

Compliance risk
Compliance risk is the risk that the bank or its subsidiary may incur losses or legal obligations, be subject to sanctions or suffer impairment of reputation as a result of a failure to comply or a breach of compliance laws, regulations and standards.

Compliance risk is unquantifiable and its consequences and losses are difficult to determine. Compliance risk is managed according to the Compliance risk management policy.

Management and control of compliance risk is the responsibility of Chief Compliance Officer (CCO).

The core elements of compliance risk management are:
• identification of compliance laws, regulations and standards and problems and critical areas;
• analysis of compliance risk and its impact;
• determination and implementation of measures to prevent (mitigate) compliance risk;
• monitoring of compliance risk.

Data required for the assessment of compliance risk are gathered and summarised by way of surveys and interviews conducted by a compliance expert.

Interviews are conducted with heads of the bank's structural units and subsidiaries and, where required, with other employees (specialists, subject matter experts) who have knowledge and experience that may help in the risk assessment.

In addition, the following is used: case studies, information from the litigation register, risk events registered in the risk event and loss data base, findings from regulator reviews and other sources of information.

Compliance risk is assessed using expert valuations.
The assigned level of risk indicates the type of reaction that needs to be taken, i.e. the level of detail of the preventive and corrective measures for the respective risk, what level of employees need to be assigned responsibility for the prevention of risk, and in what timeframe and manner one should react when the risk has materialised.

Compliance risk is monitored in order to be able to learn about and take immediate action in response to changes in compliance laws, regulations and standards.
Change monitoring is carried out by the Compliance Expert Unit. Observance of compliance laws, standards and rules in day to day operations of a structural unit is provided by the manager of each structural unit.

Compliance risk is mitigated by the following measures:
• constant control over compliance with laws, regulations and standards;
• analysis of compliance risk factors, their impact on financial indicators and data of the bank and its subsidiaries;
• raising staff qualifications and staff training.

Strategic and business risk
Strategic and business risk is the risk of adverse impact on the group's and bank's profit, capital and liquidity caused by changes in the business environment and the group's and bank's inability to react to these changes in due time or choosing an inappropriate or wrong development strategy, or the group's and bank's inability to secure resources required to implement the strategy.

Strategic and business risk is managed and mitigated at the bank using a strategic planning system.
The strategic planning is a process aimed at focussing resources and securing that the actions of all structural units are directed towards the same objectives and helping determine what decisions and action plans need to be in place for a successful implementation of the operational strategy.

The group and the bank have a documented Strategic Planning Regulation which specifies that strategic planning involves the following:
• operational strategy;
• financial plan for one year;
• budget for one year;

The accompanying notes on pages 122 to 221 form an integral part of these financial statements.

- preliminary financial plan for three years;
- worst-case scenario/factors analysis for a two year period.

Control over implementation of the strategy is carried out at the bank's and group's level by regular oversight and assessment of progress in the implementation versus planned results. Where digressions are identified from planned results, a financial analysis is conducted and, if applicable, the management makes a decision on risk mitigation measures.

Commission fee income and expenses volatility risk
Commission fee income and expenses volatility risk is the risk that the group and the bank may fail to receive the planned net commission income.

Commission fee income and expenses represent a significant part of operating income and changes in the types of operations or services that generate such income may have a significant impact on the operational result and capital of the group and the bank.

Commission fee income and expenses volatility risk is managed as part of strategy and business risk.

Information system risk
The bank has formulated the Information Technology Security Policy, the Information System Risk Analysis Regulations, the Security Requirements for Information Systems Being Designed, and other regulations dealing with information system risk management. Information system risk is included in operational risk based on the Operational Risk Management Policy adopted by the bank and, therefore, for capital adequacy purposes it was resolved not to segregate it from the capital requirement for operational risk. The bank analyses the data of the operational risk event and loss database to identify whether it is possible and necessary to establish a separate capital requirement for information system risk.

The bank conducts risk analysis on the basis of a documented methodology, which enables the effective planning of risk management measures. According to the risk analysis results, the bank chooses appropriate risk management (security) tools. Risk management measures are determined by the bank based on the relationship between security costs and potential loss. The bank specifically focuses and makes every effort to prevent risks associated with unauthorised access to the bank's information by third parties or leakage of confidential information via global networks (Internet, etc.), e-mail, modems, optical discs, USB flash and other information media.
When commencing new projects for the designing, acquisition and alteration (modification) of information systems, the bank conducts risk analysis pertaining to these changes and takes measures to minimise the risk exposure.

Note 38

Litigation and claims
In the ordinary course of business, the bank has been involved in a number of legal proceedings to recover outstanding credit balances and maintain collateral, as well as other proceedings related to specific transactions. The management believes that any legal proceedings pending as at 31 December 2016 will not result in material losses for the bank and/or the group.

Note 39

Events after the reporting date
As of the last day of the reporting year until the date of signing of these consolidated and separate financial statements there have been no events requiring adjustment of or disclosure in these consolidated and separate financial statements or notes thereto, excepted below mentioned.
The board of the bank will recommend to the shareholders to pay dividends of EUR 73.2 million and issue new ordinary shares in April 2017 to increase equity of the bank by EUR 50.7 million.

Independent Auditors' Report

To the shareholders of ABLV Bank, AS

Our Opinion on the Consolidated and Separate Financial Statements

We have audited the accompanying separate financial statements of ABLV Bank, AS ("the Bank") and accompanying consolidated financial statements of the Bank and its subsidiaries ("the Group") set out on pages 115 to 221 of the accompanying Consolidated and Separate Annual Report, which comprise:

- the consolidated and separate statements of financial position as at 31 December 2016,
- the consolidated and separate statements of comprehensive income for the year then ended,
- the consolidated and separate statements of changes in shareholders' equity for the year then ended,
- the consolidated and separate cash flow statements for the year then ended, and
- the notes to the consolidated and separate financial statements, which include a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying consolidated and separate financial statements give a true and fair view of the consolidated and separate financial position of the Group and the Bank as at 31 December 2016, and of their respective consolidated and separate financial performance and their respective consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for Opinion

In accordance with the "Law on Audit Services" of the Republic of Latvia we conducted our audit in accordance with International Standards on Auditing adopted in the Republic of Latvia (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated and Separate Financial Statements section of our report.

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated and separate financial statements of the current period. These matters were addressed in the context of our audit of the consolidated and separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our report.

Impairment of loans and receivables (Consolidated and separate financial statements)

Key audit matter

The carrying amount of loans and receivables in the consolidated financial statements as at 31 December 2016: EUR 1 029.9 million; impairment reversal recognised in 2016: EUR 0.3 million; total impairment loss allowance as at 31 December 2016: EUR 16.4 million. The carrying amounts of loans in the separate financial statements at 31 December 2016: EUR 1 012.1 million; impairment reversal recognised in 2016: EUR 0.1 million; total impairment loss allowance as at 31 December 2016: EUR 16.4 million.

We refer to the financial statements: Note 2 (j) and 2 (o) (Information on principal accounting policies), Notes 8, 17 and 35 (financial disclosures).

The Bank and other entities within the Group offer a variety of loan products to corporate clients and individuals. Relative significance of the loans and receivables to the total assets has increased during 2016. The Group and Bank have an exposure to borrowers in foreign jurisdictions, including those in the CIS countries which have a recent history of depressed economic activity amounting to EUR 156.2 million or 15.2% of the total net loans and receivables in the consolidated financial statements and EUR 133.7 million or 13.2% of the total net loans and receivables in the separate financial statements.

We identified this area as a significant risk during our audit because recognition of allowances for loan impairment is associated with significant estimation uncertainty as it requires the management to exercise judgment and develop complex and subjective assumptions about both the timing of recognition and the amounts of such impairment.

Individual impairment allowances recognized by the Bank and other entities within the Group mostly relate to large, individually monitored, corporate exposures. The assessment is therefore based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Collective allowances are predominantly related to mortgage-type loan exposures and reflect both already existing credit losses and also losses that have been incurred but are not yet identifiable on an individual exposure level. Collective impairment is estimated mainly based on historical pattern of losses and changes in loan risk characteristics based on qualitative indicators.

Our response
Our audit procedures included, among others:

- testing of controls over the approval, recording and monitoring of loans, including, but not limited to, those over loan risk grade assignments, identification of loss events, determination of loan collateral fair values and the calculation of the impairment allowances.

For corporate loans:

- for a sample of loans with higher risk characteristics, such as individually significant exposures to related borrower groups, watchlist, restructured or CIS-based exposures, critically assessing, by reference to the underlying loan files, and through discussion with loan officers and loan analysis department personnel, the existence of any impairment triggers;
- where impairment triggers had been identified, discussing with loan analysis department employees the forecasts of future cash flows used by Asset Evaluation Committee in the assessment of loan impairment and evaluating key assumptions applied, such as discount rates, collateral values (using our own valuation specialists), forecasted business performance as well as, where applicable, collateral sales costs and sales periods.

For loans to individuals and other exposures assessed for collective impairment:

- testing the underlying collective impairment models, including back-testing and the assessment of the completeness and accuracy of underlying data, and assessing the key parameters such as the probability of default, loss given default and time period required for collateral repossession and realization.
- critically assessing the rationale for the changes to model parameters and outputs in 2016, by reference to our understanding of the business, current economic trends and market practices;
- assessing the loan population that had not been subject to any impairment allowances as at 31 December 2016 by reference to our understanding of the exposures and the related risks.

Impairment of held-to-maturity investments (Consolidated and separate financial statements)

Key audit matter
The carrying amount of held-to-maturity (hereinafter "HTM") investments in the consolidated financial statements as at 31 December 2016: EUR 1 054.0 million; impairment reversal recognised in 2016: EUR 0.2 million; total impairment loss allowance as at 31 December 2016: EUR 1.3 million. The carrying amount of HTM investments in the separate financial statements as at 31 December 2016: EUR 989.7 million; impairment reversal recognised in 2016: EUR 0.2 million; total impairment loss allowance as at 31 December 2016: EUR 1.3 million.

We refer to the financial statements: Note 2 (j) and 2 (o) (Information on principal accounting policies), Note 15 and 35 (financial disclosures).

HTM investments, comprised of fixed income debt securities, and measured at amortized cost subsequent to initial recognition, are subject to a significant impairment risk, as both the Bank's and other Group entities' HTM investment portfolios include exposure to non-investment grade securities amounting to a gross balance of EUR 159.3 million or 15.1% of the total gross HTM portfolio in the consolidated financial statements and EUR 156.9 million or 15.8% of the total gross HTM portfolio in the separate financial statements. Assessment of whether any impairment should be recognized in light of existing impairment indicators, most notably fair value decrease of the investments, and the determination of the amounts of such impairment, if any, are subject to significant management judgment and estimates.

Our response

Our audit procedures included, among others:

- testing that HTM financial assets fair values have been based on observable data from relevant public information platforms and assessing the data to determine the fair value of these assets;
- comparing the estimated fair value of HTM investments to their current amortized cost as well as inspecting publicly available information and credit ratings of bond issuers to assess the need to perform an impairment assessment;
- for the investments with identified loss events, challenging the forecasts of future cash flows approved by the Bank's Asset Evaluation Committee and evaluating key assumptions applied;
- assessing collective impairment recognition for non-investment grade part of the HTM portfolio where impairment indicators have not been identified at a single exposure level.

Impairment of repossessed real estate (Consolidated and separate financial statements)

Key audit matter

The carrying amount of repossessed real estate in the consolidated financial statements as at 31 December 2016: EUR 41.3 million; impairment loss recognised in 2016: EUR 3.4 million; total impairment loss allowance as at 31 December 2016: EUR 8.9 million. The total amount of sales of repossessed real estate is equal to 12.1 million EUR.

We refer to the financial statements: Note 2 (k) and 2 (p) (Information on principal accounting policies), Note 6 (financial disclosures).

Significant judgement is required from the management to identify and measure impairment of repossessed real estate, measured at cost, particularly due to the wide range of property types and locations in question.
Due to the complexity of the estimates involved, mainly as concerns comparable sales prices and discount rates, and the fact that significant impairment losses were recognized in the past in relation to such assets that also affected the impairment amounts recognized in the Bank's separate financial statements in respect of its investment in Pillar Holding Company, KS (see Key Audit Matter "Investments in subsidiaries"), we have assessed the area to be a significant risk for the Group audit.

Our response

Our procedures included, among others:

- updating our understanding of Group's approach to the assessment of the recoverable amounts of repossessed real estate;
- challenging the estimates of the recoverable amounts of the repossessed real estate population used by Asset Evaluation Committee and discussing them with loan analysis department personnel, with a particular focus on properties with higher risk characteristics, such as those with high carrying amounts, offered

sales prices close to the carrying amount and/or in locations where actual recent market transactions have occurred with losses, including key assumptions made such as comparable sales prices and discount rates, by reference to our understanding of the real estate market and benchmarking against observable market transactions with comparable properties where available.

Impairment of investments in subsidiaries (Separate financial statements)

Key audit matter

The carrying amount of investments in subsidiaries in the separate financial statements as at 31 December 2016: EUR 119.9 million; impairment loss recognised in 2016: EUR 6.2 million; total impairment loss allowance as at 31 December 2016: EUR 20.8 million.

We refer to the financial statements: Note 2 (c) and 2 (p) (Information on principal accounting policies), Note 18 (financial disclosures).

The determination of the recoverable amounts of investments in subsidiaries is a complex process and requires the management to make subjective judgements, including those in respect of future operating cash flows, growth rates and discount rates. Accordingly, we have identified this area as a significant risk in our audit.

The above estimation uncertainty was particularly high in respect of the following two subsidiaries with recent history of operating losses:

- Pillar Holding Company, KS — managing the Group's repossessed real estate, with recoverability dependent on the uncertain realisation of repossessed collateral, as discussed further in the Key Audit Matter "Impairment of repossessed real estate".
- ABLV Bank Luxembourg, S.A — a development-stage subsidiary bank with recoverability dependent on future growth.

Our response

Our procedures included, among others:

- evaluating the reasonableness of management's judgments as to the existence of impairment indicators, and consequently, the requirement to perform related impairment tests. This included, but was not limited to, discussing the subsidiaries' performance with the Bank's Board members, and assessing their strategies and historical growth rates against past forecasts;
- assessing the Bank's models and estimates applied to determine impairment losses recognised, where applicable using our internal valuations specialists, and challenging reports on valuations prepared by external experts engaged by the Bank, whose competence and independence we also assessed. This included, among other things, challenging the valuation of repossessed real estate at Pillar Holding Company, KS and its subsidiaries, and forecasted growth rates and discount rates for ABLV Bank Luxembourg, S.A.; performing analysis of the sensitivity of the impairment tests' results to changes in assumptions and evaluating adequacy of impairment related disclosures.

Regulatory proceedings regarding Anti-Money Laundering practices (Consolidated and separate financial statements

Key audit matter

We refer to the financial statements: Note 37 (non-financial risks).

Since December 2015, the Bank had been involved in an administrative proceeding initiated by the Latvian financial services regulator, the Financial Capital and Market Commission (hereinafter "FCMC"), in relation to Anti-Money Laundering requirements embedded in Latvian law.

During 2016, the Bank entered into an administrative agreement with FCMC which concluded the administrative proceeding and resulted in a EUR 3.2 million fine imposed on the Bank as well as the requirement for the Bank to strengthen its internal control system in the area.

Compliance with the terms set out in the administrative agreement is a key prerequisite for Bank's successful operations in the future. Given the matter's importance to the Bank's reputational risk and the ability to continue as a going concern, we have assessed that the evaluation of the Bank's Anti-Money Laundering practices is a key audit matter for the Bank and the Group audit.

Our response

Our audit procedures included, among others:

- reading minutes of the meetings of the Management Board and the Council of the Bank, and inspecting correspondence with FCMC;
- updating our understanding of the matter through inquiries with the Bank's representatives responsible for compliance and, using our own internal forensic specialists, inspecting the regulator's findings and terms and conditions included in the administrative agreement;
- testing the Bank's Anti-Money Laundering practices by involving our forensic specialists on a sample of clients and their transactions that were selected based on high risk-criteria to assess whether further issues might arise in the areas which were identified as critical by the FCMC.
- evaluating the Bank's action plan for improving its internal control system as indicated by the FCMC, by inspecting the plan, reports and correspondence with the regulator, and considering the findings of an external advisor engaged by the Bank to perform an assessment of the Bank's Anti-Money Laundering control framework;
- assessing adequacy of disclosures in respect of significant legal and regulatory proceedings.

Reporting on Other Information
Reporting on Other Information
The Bank management is responsible for the other information. The other information comprises:

- the Bank's Management Report, as set out on pages 105 to 112 of the accompanying Annual Report,
- the Bank's Council and the Board, as set out on page 113 of the accompanying Annual Report,
- the Statement of Management's Responsibility, as set out on page 114 of the accompanying Annual Report, and
- the Statement of Corporate Governance, as set out in a separate statement prepared by management available on Bank's website www.ablv.com.

Our opinion on the financial statements does not cover the other information included in the Annual Report, and we do not express any form of assurance conclusion thereon, except as described in the Other reporting responsibilities in accordance with the legislation of the Republic of Latvia section of our report.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed and in light of the knowledge and understanding of the Bank, Group and its environment obtained, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Other reporting responsibilities in accordance with the legislation of the Republic of Latvia
In addition, in accordance with the "Law on Audit Services" of the Republic of Latvia with respect to the Management Report, our responsibility is to consider whether the Management Report is prepared in accordance with the requirements of the Financial and Capital Market Commission of the Republic of Latvia — regulation No. 46 "Regulations on the Preparation of Annual Reports and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies". Based solely on the work required to be undertaken in the course of our audit, in our opinion:

- the information given in the Management Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Management Report has been prepared in accordance with the Financial and Capital Market Commission of the Republic of Latvia requirements — regulation No. 46 "Regulations on the Preparation of Annual Reports and Annual Consolidated Accounts for Banks, Investment Brokerage Firms and Investment Management Companies".

In accordance with the Law on Audit Services of the Republic of Latvia with respect to the Statement of Corporate Governance, our responsibility is to consider whether the Statement of Corporate Governance includes the information required in section 56.[2], third paragraph, clause 1 of the "Financial Instruments Market Law" of the Republic of Latvia.

In our opinion, the Statement of Corporate Governance includes the information required in section 56.[2], third paragraph, clause 1 of the "Financial Instruments Market Law" of the Republic of Latvia.

Responsibilities of Management and Those Charged with Governance for the Financial Statements
Management is responsible for the preparation of the consolidated and separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the consolidated and separate financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Auditors' Responsibility for the Audit of the consolidated and separate Financial Statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrep-

resentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated and separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves a fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and objectivity, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The responsible certified auditor on the audit resulting in this independent auditors' report is Armine Movsisjana.

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

16 March 2017

KPMG Baltics SIA
Licence No 55