

## BANKING OPERATION

### GENERAL PROVISIONS

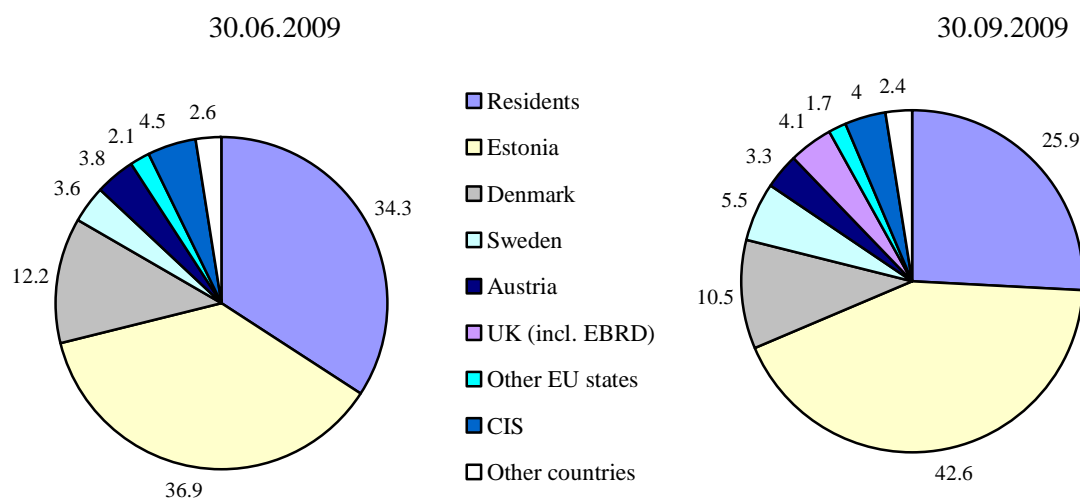
Though the branch of the joint stock company *SNORAS* was registered with the Commercial Register of the Republic of Latvia in the third quarter 2009, the branch, however, did not yet commence its financial activities in the accounting quarter, and there were still 21 banks and six branches of foreign banks operating in the Republic of Latvia on 30 September 2009.

During the reporting quarter, the banks continued strengthening their capital base, increasing both their share capital (*JSC Baltic International Bank*, *JSC Latvijas Krājbanka*, *JSC SEB banka* and *Swedbank JSC*), and subordinated capital (*JSC Latvijas Krājbanka* and *JSC SEB banka*), as well as reserves capital (*JSC DnB NORD Banka*). Total bank paid-up share capital during 3Q 2009 grew by 15.7% and at end-September totalled 1,274.8 million lats, incl. the share of foreign capital amounting to 74.1% (compared to 65.7% on 30 June 2009) (see Figure 1).

Figure 1

#### BANK PAID-UP SHARE CAPITAL BROKEN BY COUNTRIES

(at end-period; percentage)



In early September 2009, the European Bank for Reconstruction and Development (EBRD) acquired 25% plus one share in the *JSC Parex banka* share capital from the state-owned *JSC "Privatizācijas aģentūra"* (Latvian Privatization Agency), consequently the state-owned share in total paid-up banking share capital decreased and on 30 September 2009 made up 17.4% (compared to 25.8% on 30 June 2009).

By end-3Q 2009, 10 banks were subsidiaries of Member State banks and foreign banks, and the market share of these banks in total banking assets on 30 September was 54.3%, incl. five subsidiary banks of the EU banks, 51.5%, but five subsidiary banks of CIS<sup>1</sup> banks, 2.8% (compared to 54.3%, 51.3% and 3%, respectively, on 30 June 2009). By end of September, the

<sup>1</sup> CIS Commonwealth of Independent States.

market share of six branches of foreign banks in total assets accounted for 12.2% (compared to 12.4% on 30 June 2009).

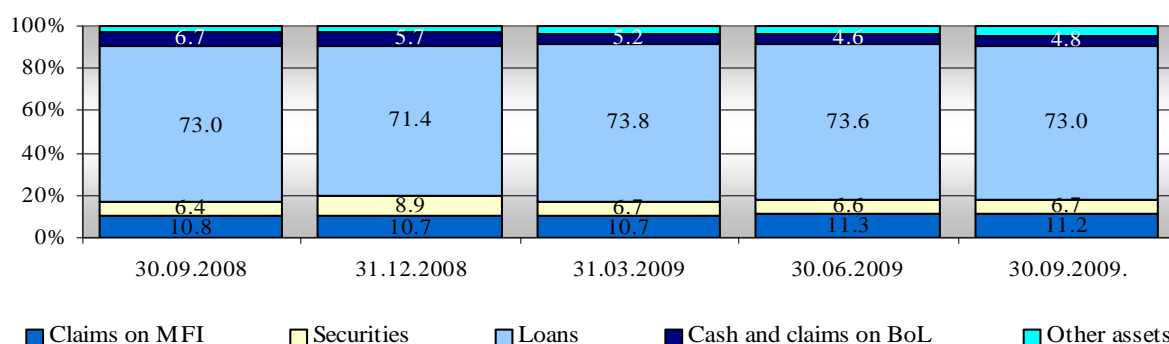
## STRUCTURE OF ASSETS AND LIABILITIES

In 3Q 2009, following a decrease in the total volume of bank liabilities to MFI<sup>2</sup> in 2Q 2009 (because of repayment of syndicated loans by several banks, as well as repayment of funding attracted from parent banks according to loan repayment schedule), as well as upon a decrease in the amount of attracted deposits (mainly resident deposits), the total amount of banking sector assets in the third quarter 2009 contracted by 163.4 million lats, or 0.8% (compared to a decrease in 2Q 2009 by 461.9 million lats or 2.1%), and their volume at end-September made up 21.6 billion lats. Loans constituted the largest share in the structure of banking assets, 73%, while bank claims on MFI, 11.2%, and investments in securities, 6.7% (compared to 73.6%, 11.3% and 6.6% on 30 June 2009) (see Figure 2).

Figure 2

### STRUCTURE OF ASSETS

(as a percentage)

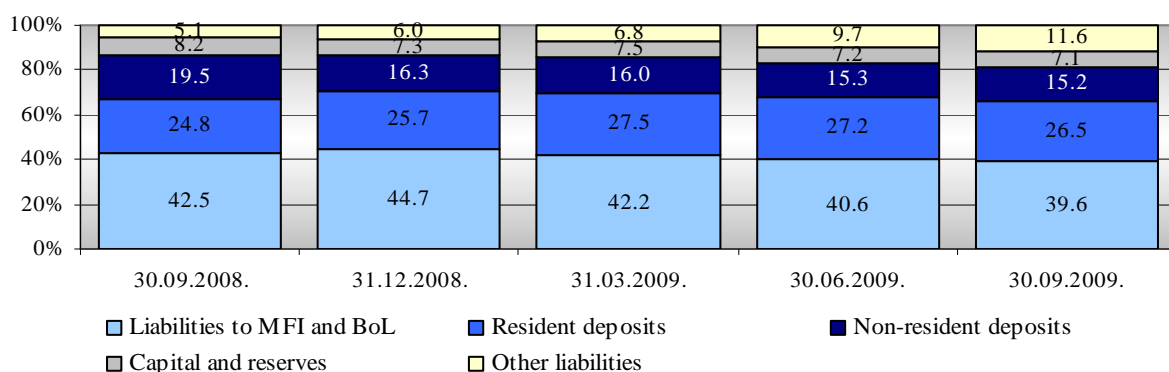


At the end of the reporting quarter, the share of resident deposits in the banking liabilities structure constituted 26.5%, non-resident deposits - 15.2%, while the banking liabilities to MFI and the Bank of Latvia, 39.6% (compared to 27.2%, 15.3% and 40.6% on 30 June 2009) (see Figure 3).

Figure 3

### STRUCTURE OF LIABILITIES

(as a percentage)



<sup>2</sup> Monetary financial institutions (MFI) – credit institutions and money market funds.

Total financing of foreign banks to their subsidiaries and branches in Latvia during 3Q 2009 shrank by 188.4 million lats, or 2.9% (compared to a decrease of 218 million lats, or 3.3%, in 2Q 2009) and at end-September still constituted 75.2% of total bank liabilities to MFI.

## LOANS

In 3Q 2009, upon the continuous economic downturn and uncertainty in economic development, total banking loan portfolio balance was still on decline, in the reporting quarter it shrank by more 230 million lats, or 1.4%, and at end-September amounted to 15.8 billion lats (in comparison with a decrease in 2Q 2009 by 400 million lats, or 2.4%).

### Loan portfolio broken down by national economy sector

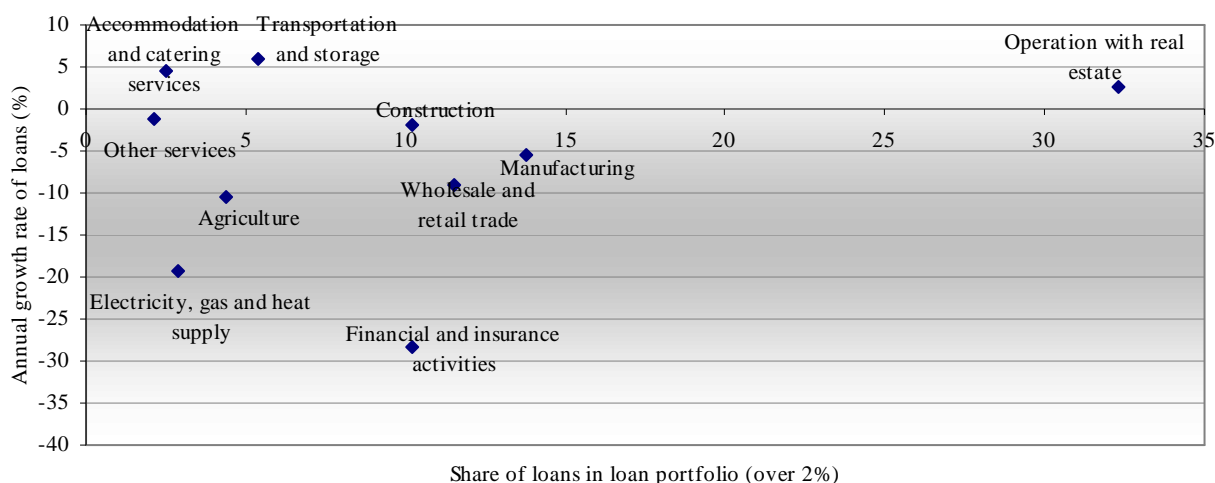
The amount of loans issued to the development of the Latvian national economy in the reporting quarter decreased by 124.4 million lats, or 1.6%, and at end-September totalled 7.7 billion lats (as compared with 2Q 2009 when a decrease was by 218.3 million lats, or 2.7%). In the reporting quarter, the most dramatic decline in loan balance was observed in such sectors as trade (by 43 million lats, or 4.6%), manufacturing industry (by 38 million lats, or 3.4%) and real estate transactions (by 23 million lats, or 0.9%). Though the total amount of loans issued to the economic development declined in 3Q 2009, loan balance in a number of sectors (with total share of 5.5% in loan portfolio) grew: professional, scientific and technical services – by 12.5 million lats, or 50.7%, other services, by 17 million lats, or 11.6%, and electricity, gas and heat supply, by 9 million lats, or 4.2%.

Largest amounts of loans by end-September were still granted to such sectors of national economy as real estate transactions (32.3%), manufacturing industry (13.8%) and trade (11.5%), as well as financial activities and insurance business (10.2%) and construction sector (10.2%) (see Figure 4).

Figure 4

### SHARE OF LOANS ISSUED TO NATIONAL ECONOMY SECTORS IN CREDIT PORTFOLIO\* AND ANNUAL GROWTH RATE OF SUCH LOANS

(30.09.2009; as a percentage)



\* Banking loan portfolio comprises loans issued to resident financial institutions, public enterprises and private companies.

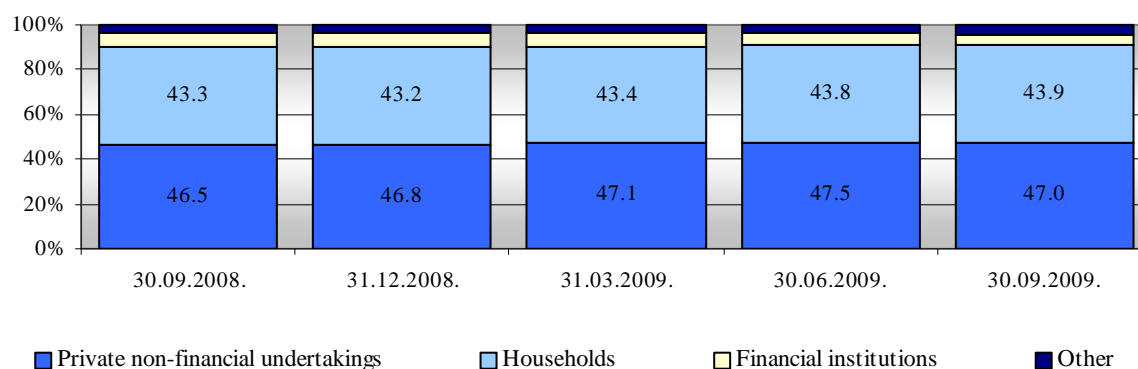
## Loan portfolio broken down by borrowers (residents)

By the end of 3Q 2009, of total amount of loans to non-banks, 89% were issued to residents, incl. private non-financial undertakings – 47%, households – 43.9% and financial institutions – 5% (compared to 47.5%, 43.8% and 4.8% on 30 June 2009) (see Figure 5). In the reporting quarter, the most substantial decrease was in the amount of loans issued to private non-financial undertakings, by 160 million lats, or 2.4%, and to households, by 71 million lats, or 1.1%, meanwhile loans issued to financial institutions and state non-financial undertakings in the reporting quarter grew by 26 million lats, or 3.9%, and 10 million lats, or 2.5%, respectively.

Figure 5

### SECTORAL BREAKDOWN OF BORROWERS

(as a percentage)

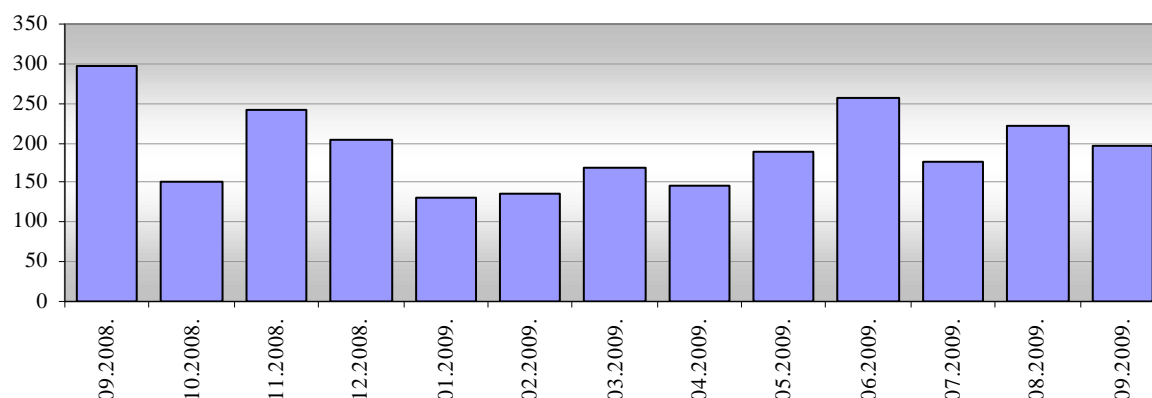


In 3Q 2009, 594 million lats were granted for non-financial undertaking loans anew including loans with unforeseen, modified loan agreement conditions, or almost as much as in the previous quarter (see Figure 6).

Figure 6

### TOTAL OF LOANS ISSUED ANEW TO NON-FINANCIAL INSTITUTIONS WITH MODIFIED LOAN AGREEMENT CONDITIONS

(in million lats)



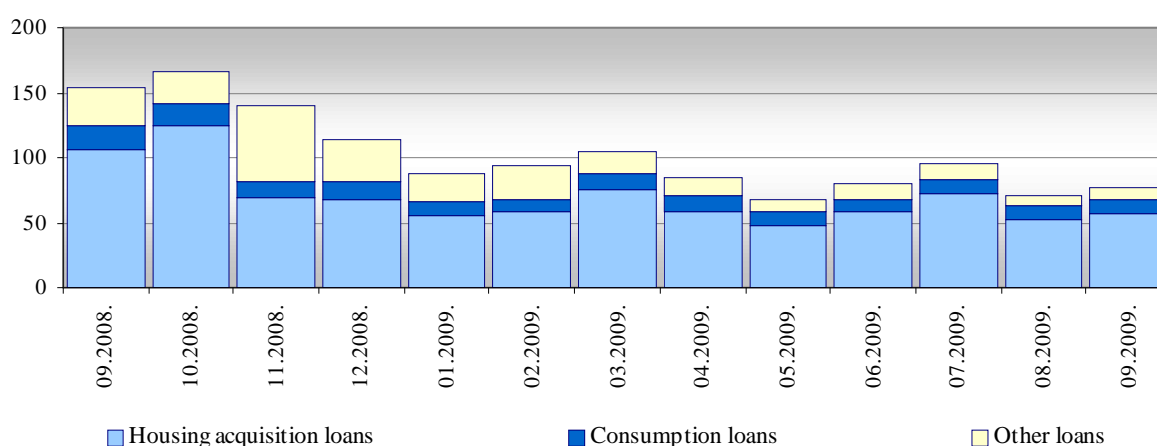
In the reporting quarter, the growth rate of housing loans was still on decline decreasing by 63 million lats, or 1.3% (compared to 55 million lats, or 1.1% in the previous quarter), as well as consumption loans by 14 million lats, or 1.9% (compared to 18 million lats, or 2.4%, in the previous quarter). At end-September, 4,888 million lats were issued for the acquisition of housing, while 745 million lats - for consumer loans, i.e. 79.4% and 12.1%, respectively, of total loans granted to households.

The amount of a loan issued to households anew, including loans with unforeseen, modified loan agreement conditions, grew from 231 million lats in 2Q to 243 million lats in the reporting quarter, or by 5.2%, incl. for the acquisition of housing – 182 million lats, but 32 million lats for consumption (see Figure 7).

Figure 7

**TOTAL OF LOANS ISSUED ANEW TO HOUSEHOLDS WITH MODIFIED LOAN AGREEMENT CONDITIONS**

(million lats)



In the reporting quarter the total number of loans issued to households was still decreasing, i.e. contracting by 15.9 thousand, and end-September reached 1,255 thousand, incl. the most rapid decrease in the number of payment card and current account loans – by 17.9 thousand, the number of loans issued to consumption shrank by 9.3 thousand, for the acquisition, reconstruction and repair of housing - 1.9 thousand, while the number of other loans issued to household rose by 13.1 thousand. By the end of September, of total number of loans granted to households, greater part or 63.6% were payment card and current account loans, 15.4% were consumption loans and 12.2% were loans issued for the purchase, reconstruction and repair of housing.

In 3Q 2009, the average amount of a loan issued to one household did not change materially and by end-September was: 32 thousand lats for purchase, reconstruction and repair of housing, 2.5 thousand lats for consumption, 367 lats - for payment cards.

**Loan portfolio broken down by currency**

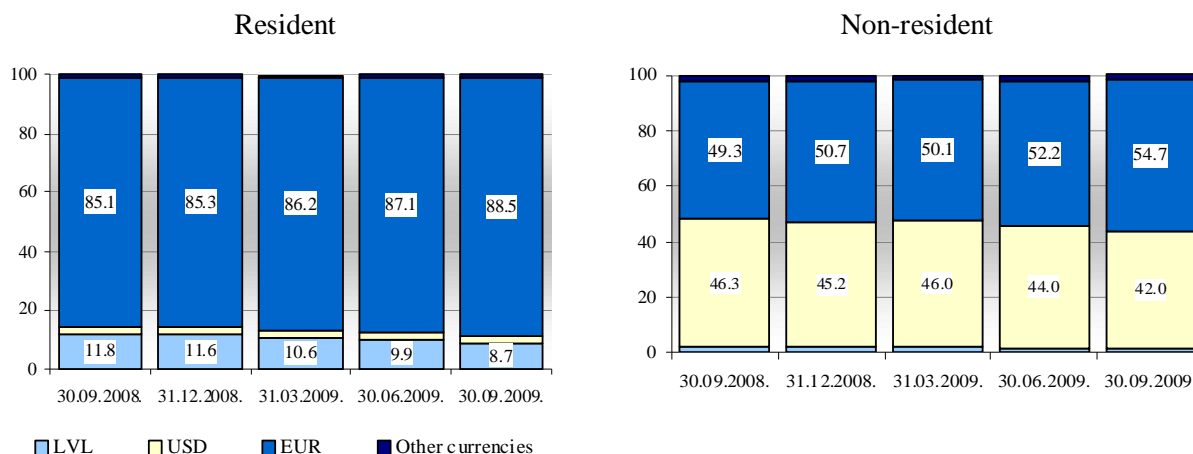
In the reporting quarter, a decrease in loan balance in all currencies, except euro, continued shrinking in resident loan portfolio. Following a decrease in loan balance in lats by 14.1% and

in USD dollars by 7.6%, the share of loans in above currencies in the banking loan portfolio contacted and by end-September was 8.7% and 2.1%, respectively, while the share of loans in euro already amounted to 88.5% by the end of September (compared to 9.9%, 2.3% and 87.1% on 30 June 2009) (see Figure 8).

Figure 8

### LOAN PORTFOLIO BROKEN DOWN BY CURRENCY

(as a percentage)



In the reporting quarter, following a decrease in non-resident loan portfolio by 33 million lats or 1.9%, euros were still dominating currency in the loan portfolio, 54.7%, as well as US dollars, 42% (compared to 52.2% and 44% on 30 June 2009) (see Figure 8).

### Loan portfolio broken down by loan type

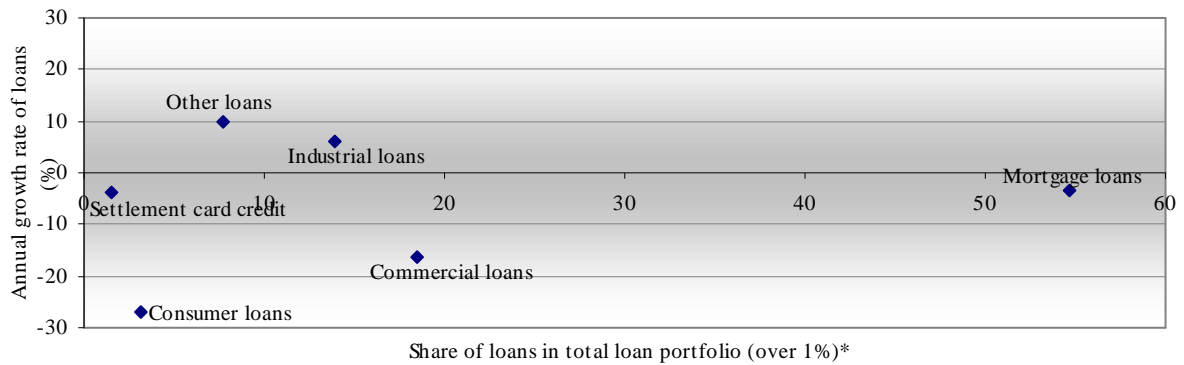
Though in 3Q 2009 the greatest decrease was mortgage loans (by 83 million lats or 1%) and commercial loans (for the increase of current assets of undertakings) (by 58 million lats or 2%), they still made up the greatest share in the banking total loan portfolio, namely, 54.7% and 18.5%, respectively (compared to 54.4% and 18.6% on 30 June 2009). Following an increase in industrial loans<sup>3</sup> by 5.9% as compared with the respective period of previous year, their share in total banking loan portfolio also grew from 12.5% to 13.9% y-o-y at end-3Q 2009 (see Figure 9).

Figure 9

### TYPES OF LOANS AND THEIR ANNUAL GROWTH RATE

(30.09.2009; as a percentage)

<sup>3</sup> Industrial loans – loans issued to a non-financial undertaking, financial institution or non-profit institution servicing households for the acquisition of fixed assets and financing other long-term investment projects, except the loans recognized as financial leasing or mortgage loan.



\* Banking loan portfolio comprises loans issued to residents except the loans to central/local governments and transit loans.

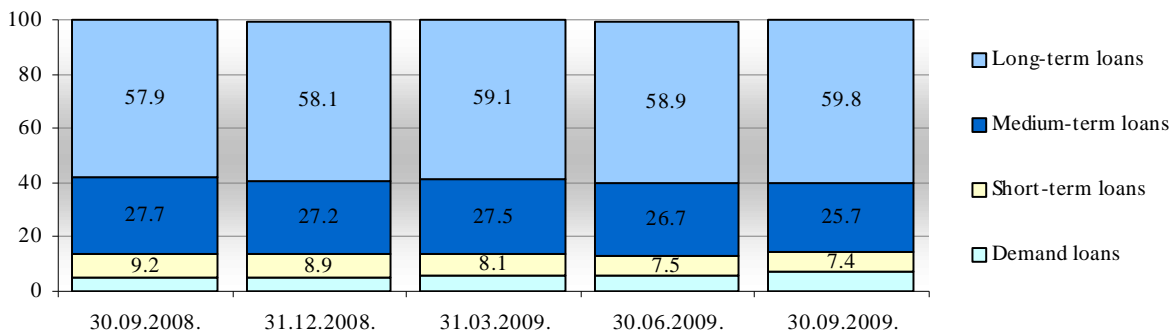
### Term structure of loan portfolio

At the end of the reporting quarter, the share of long-term loans (more than 5 years) in banking loan portfolio accounted for 59.8%, medium-term loans (between one and five years), 25.7%, short-term loans (up to one year), 7.4%, and demand loans, 7.1% (compared to 59.7%, 26.7%, 7.5% and 6.1%, respectively, on 30 June 2009) (see Figure 10).

Figure 10

### TERM STRUCTURE OF LOAN PORTFOLIO

(as a percentage)



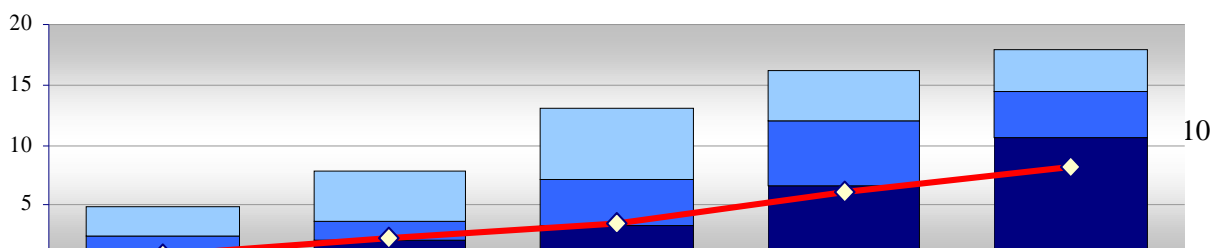
### Quality of loan portfolio

While economic downturn still continued in 3Q 2009, the borrowers' solvency did not show any improvement. The share of loans without delayed payments (principal amount and/or interest payment) in total loans decreased from 76.5% at end-2Q 2009 to 74.8% at the end of reporting quarter, whereas the share of loans with payments overdue more than 90 days in the loan portfolio made up 14.5%, or 2.290 million lats (compared to 12% at end 2Q 2009). Upon deterioration in loan portfolio quality in the reporting quarter provisioning for loan impairment grew by 299 million lats and at end-September totalled 1,273 million lats. By end-3Q 2009 banking provisions constituted 8.1% of banking loan portfolio (compared to 6.1% at end 2Q 2009) (see Figure 11).

Figure 11

### MORE THAN 30 DAYS PAST DUE LOANS AND PROVISIONS OF LOAN PORTFOLIO (%)

(30.09.2009; as a percentage)



At the end of reporting quarter the share of loans with payments overdue above 90 days in the loan balance for 14 banks did not exceed the average banking sector ratio, namely, 14.5%, whereas the share of those banks' assets in total assets of the banking sector accounted for 38.9% (compared to 80% at end of 2Q 2009) (see Table 1). Meanwhile the share of loans with payments overdue above 90 days in the loan balance for eight banks (constituting 18.1% in total banking sector assets) was above 20%.

Table 1

**BREAKDOWN OF BANKS BY PROPORTION OF LOANS WITH PAYMENTS OVERDUE ABOVE 90 DAYS IN BALANCE OF BANK LOAN PORTFOLIO**

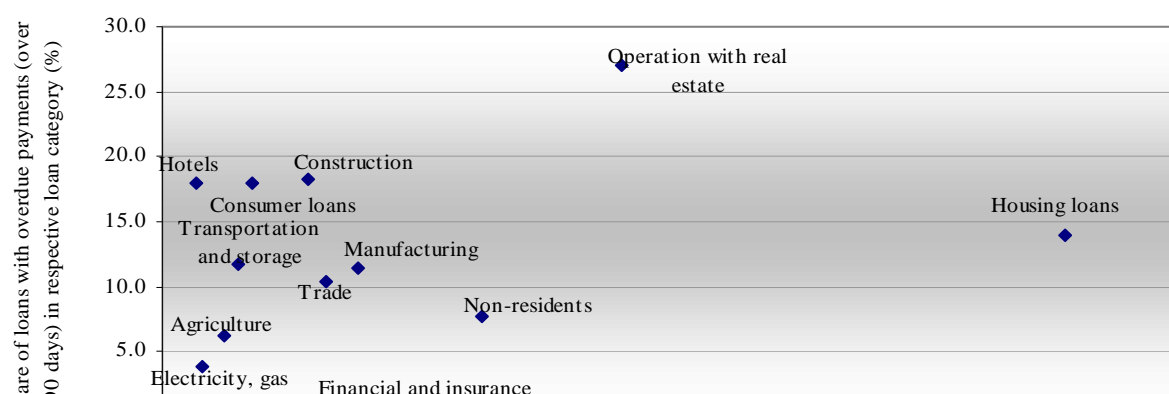
Share of loans with payments overdue above 90 days in a bank loan portfolio (%)	30.06.2009		30.09.2009	
	Number of banks and branches of foreign banks	Banking market share (% of total banking assets)	Number of banks and branches of foreign banks	Banking market share (% of total banking assets)
Under 7	10	21.2	6	16.6
7.1–14.5	7	58.8	8	22.3
14.6–20.0	5	16.7	5	43.0
Above 20	5	3.3	8	18.1

By end-3Q 2009 the greater part of loans with payments overdue above 90 days was comprised of loans granted to resident households for the acquisition of housing as well as loans to real estate transactions, i.e. 29.9% and 29.3%, respectively, of total bank lending (compared to 29.9% and 30.8% at end-2Q 2009) (see Figure 12).

Figure 12

**CONCENTRATION OF LOANS WITH PAYMENTS OVERDUE ABOVE 90 DAYS BROKEN DOWN BY LOAN CATEGORIES**

(30.09.2009; as a percentage)





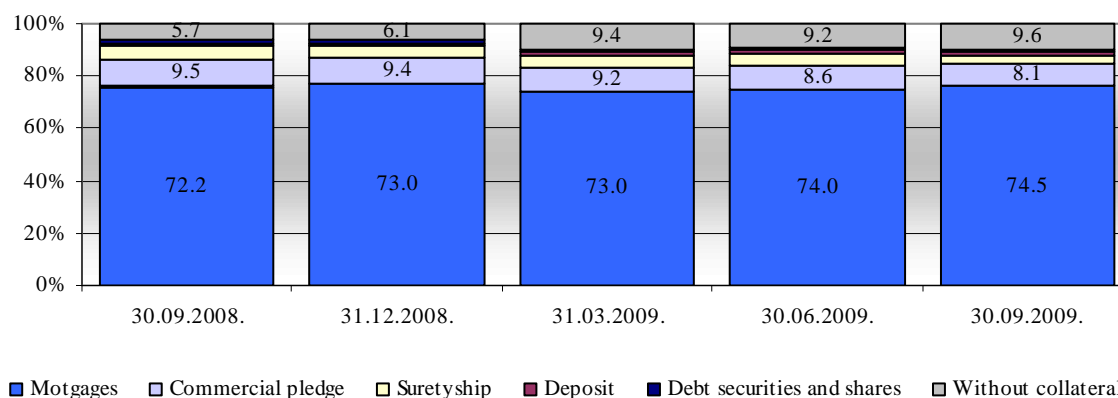
## Loan portfolio collateral

By end of 3Q 2009, of total loans 74.5% were secured by a mortgage<sup>4</sup>, of which most popular were housing first mortgages, 34.4%, and commercial property first mortgages, 26.7% (compared to 74%, 33.8% and 26.3% on 30 June 2009). Of other types of loan collateral, most popular still were commercial pledges, 8.1% (compared to 8.6% on 30 June 2009) (see Figure 13).

Figure 13

### TYPES OF LOAN PORTFOLIO COLLATERAL

(% to the loan balance)



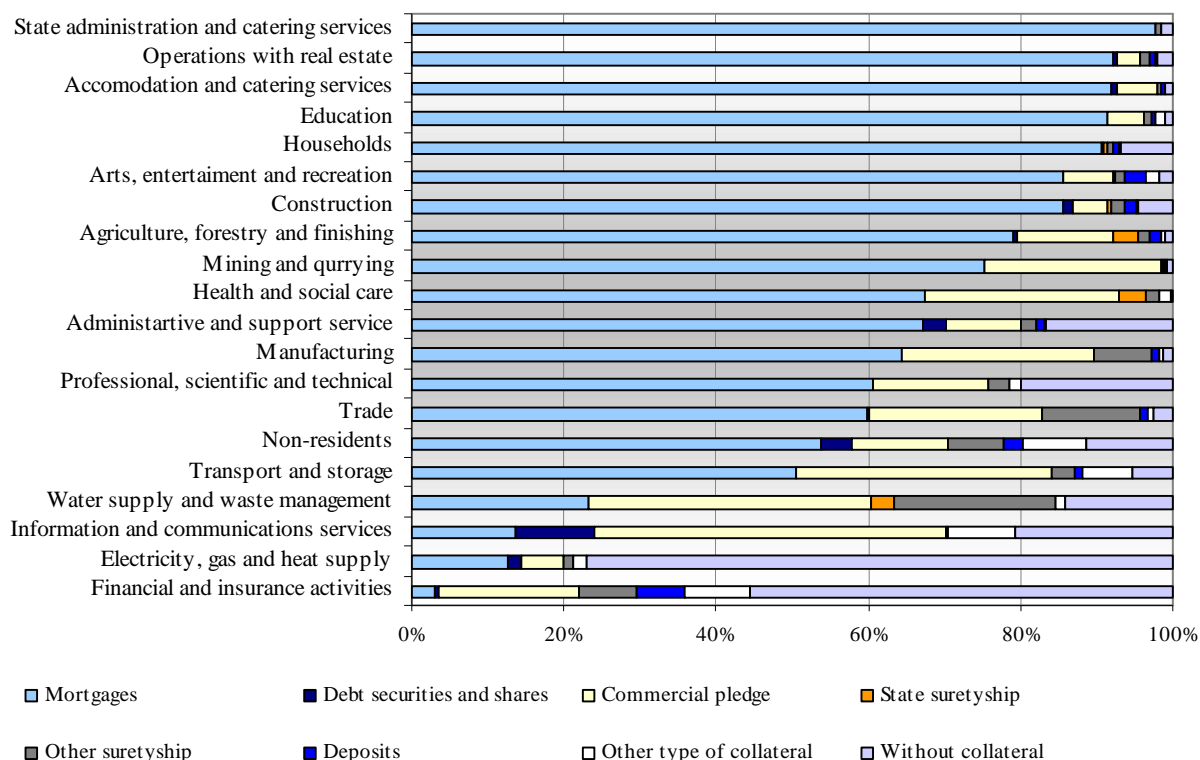
At the end of the reporting quarter mortgages prevailed as collateral type for loans issued to such sectors as state administration and defence, 97.7%, real estate transactions, 92.1%, dwelling and catering services, 92%, education, 91.4%, as well as construction, 85.6%. Whereas commercial pledges were popular collateral with such sectors as information and communication services, water supply and waste disposal, as well as transport and storage, by the end of September accounting for 46.2%, 37% and 33.5%, respectively, of total loans issued to the respective sector. Shares and debt securities were less popular type of loan collateral as well as deposits, which served as collateral for about 1.6% of total loans issued by banks. Of loans to the enterprises (mostly state and local government authorities), which represent electricity, gas and heat supply sectors, by end-September 77% were granted without any collateral, based on incoming future cash flows (i.e. 2.2% of total loans issued to national economy). Of loans secured by state suretyship and guarantee, major part or about 52% at end-September were student loans issued to resident households (see Figure 14).

Of loans issued to households, 90.6% were secured by mortgage; incl. loans for the acquisition, reconstruction and repair of housing were mortgage-backed by 99.7%.

<sup>4</sup> Mortgage is a pledge of real estate property registered with the Land Register, retaining a mortgager's property rights under restrictions set by a pledge holder. In case of a mortgager's default, the pledged property goes on sale.

Figure 14

**TYPES OF LOAN PORTFOLIO COLLATERAL BROKEN BY ECONOMIC SECTORS**  
(30.09.2009; as a percentage)



**DEPOSITS**

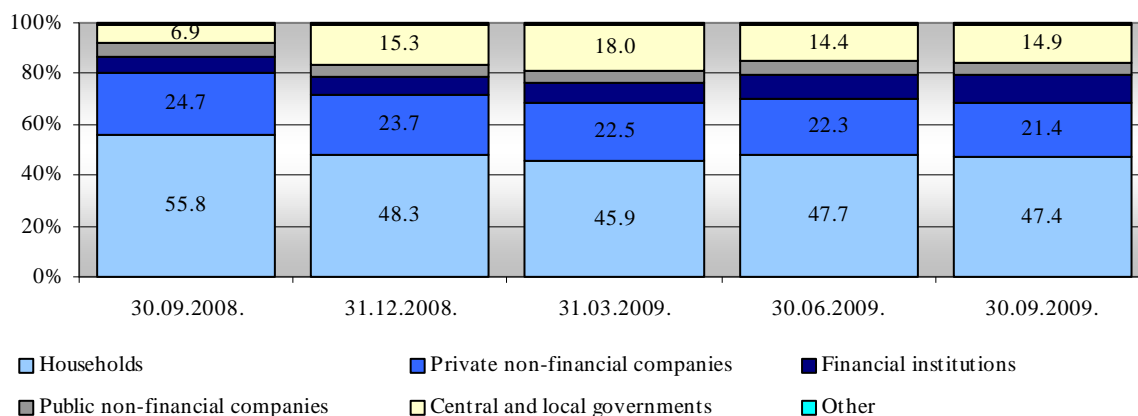
During 3Q 2009, total volume of deposits in the bank sector shrank by 240.5 million lats, or 2.6%, incl. residents deposits in times of economic downturn decreased by 201.6 million lats, or 3.4% (compared to 3% in 2Q 2009), meanwhile non-resident deposits contracted by 38.9 million lats, or 1.2% (compared to 6.5% in 2Q 2009). Resident deposits decreased in the reporting quarter primarily because of contracting volumes of household and private non-financial undertaking deposits, i.e. by 109 million lats and 93 million lats, or by 3.9% and 7.1%.

The share of resident deposits in total deposits at end-September totalled 63.6% (compared to 64.1% at end 2Q 2009), incl. a greater part of resident deposits were household deposits (47.4%), private non-financial undertaking deposits (21.4%), as well as central and local government deposits (14.9%) (see Figure 15). Deposits of private non-financial undertakings (76.4%) traditionally retained a major share of total non-resident deposits (compared to 76.8% at end 2Q 2009).

Figure 15

### SECTORAL BREAKDOWN OF DEPOSITORS (RESIDENTS)

(as a percentage)



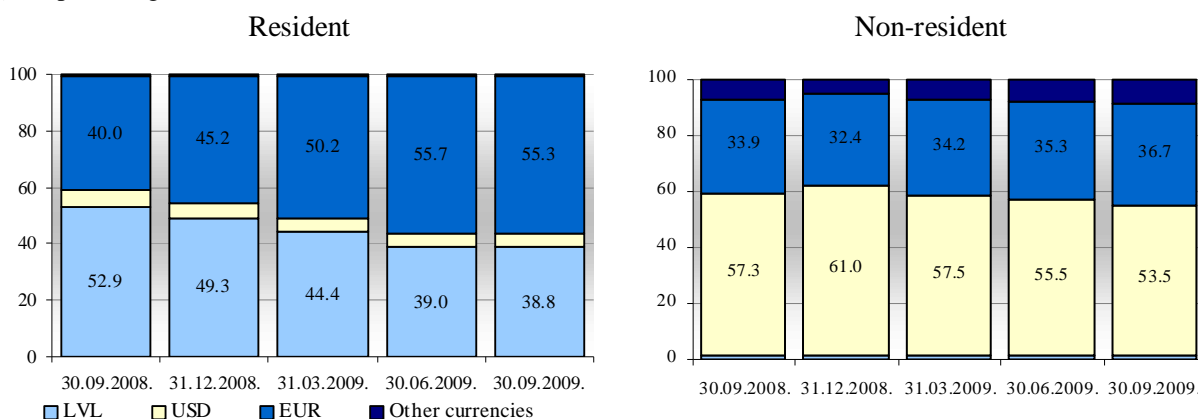
In the reporting quarter, structural changes in the deposit term structure still continued. In resident deposits, both demand deposit stock and short-term deposit stock shrank at a similar pace (by 3.5% and 3.6%, respectively), while in non-resident deposits following a simultaneous decrease in demand deposits (by 11.2%), the amount of short-term deposits materially rose (by 16.7%). By end-3Q 2009, short-term deposits (up to one year) had a major share in the banking sector total deposits (48.6%) and demand deposits (45.2%), whereas medium-term deposits (one to five years) totalled 6%, but long-term deposits (more than five years) constituted only 0.2% (compared to 44.2%, 49.7%, 5.9% and 0.2% on 30 June 2009).

In the reporting quarter there were no significant structural changes in the resident deposit currencies. Though the amount of resident deposits shrank both in lats and euro – by 3.8% and 4%, respectively, – they still made up a major share of total resident deposits, 38.8% and 55.3%, respectively (compared to 39% and 55.7%, respectively, on 30 June 2009). Meanwhile in non-resident deposits, following a continuous decrease in deposits in US dollars and lats, by 4.6% and 23.3%, respectively, their share contracted at end-September as well to 53.5% and 1.2%, respectively, while the amount of deposits in euro approximately grew by 2.6%, as well as their share rose up to 36.7% (compared to 55.5%, 1.5% and 35.3%, respectively, in 2Q 2009) (see Figure 16).

Figure 16

### RESIDENT DEPOSITS BROKEN BY CURRENCY

(as a percentage)



## PERFORMANCE INDICATORS

The banking sector on the whole reported losses of 579.2 million lats (after tax) in the first nine months of 2009, though 10 banks (with market share of 14.6% in total banking assets) operated with profit earning the total of 18.3 million lats.

In accordance with projections made by the Financial and Capital Market Commission already at the beginning of 2009 that upon the further worsening of national macro economic situation, an increase in losses related to crediting would be expected in the future, and losses in the first nine months of 2009 were also mainly due to the loan loss provisioning. Operational profit of the banking sector (profit before provisioning and taxes) in the period accounted for 268.6 million lats, or by 14.5% down from profits in the respective period of the previous year.

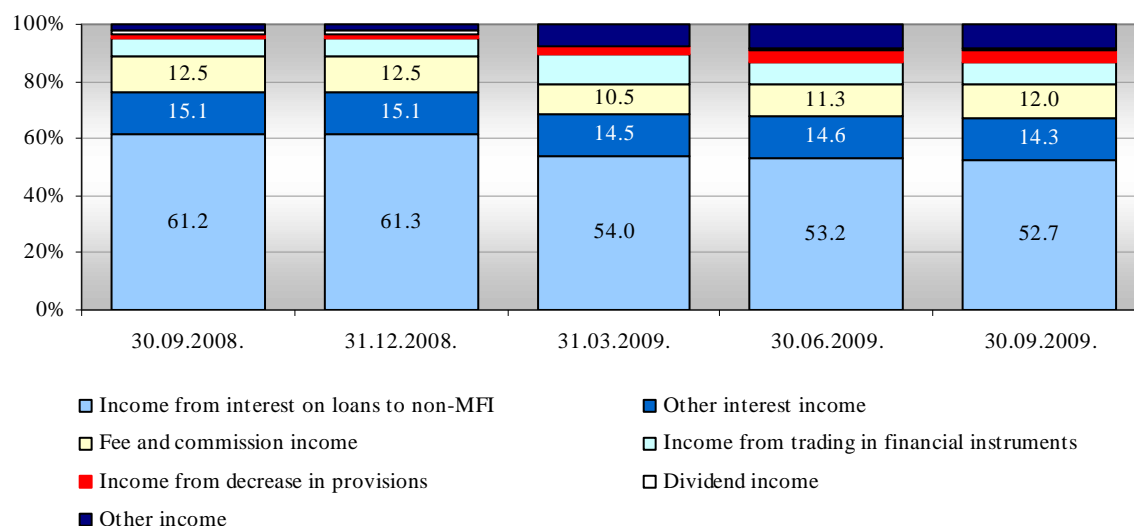
### Income and expense structure

Negative lending growth rate and worsening of loan quality in the reporting quarter still had an impact on the banking income and expense structure. In 3Q 2009, following a decrease in banking income from interest on loans issued to non-MFI (by 11.7%), their share in total banking income also continued shrinking and at end of September was 52.7% (compared to 53.2% on 30 June 2009). In the reporting quarter, the bank income from trading in foreign currency and revaluation of financial instruments rose, as well as income from fee and commission (see Figure 17).

Figure 17

### INCOME STRUCTURE

(as a percentage)



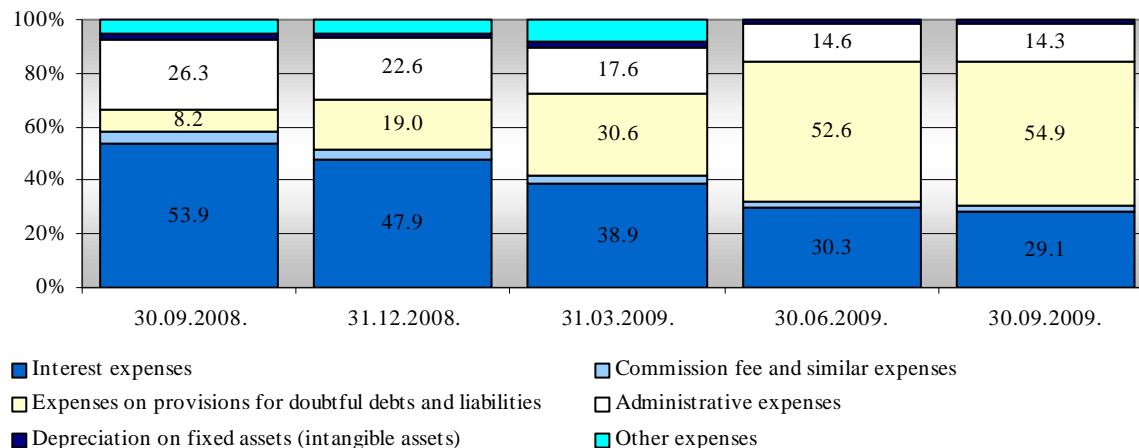
In 3Q 2009, upon a decrease both in total banking liabilities to MFI (by 2.9%) and the volume of non-MFI deposits (by 2.6%), also interest expense on these funds fell, i.e. by 21.3% and 0.9%, and at end of September they were only 25.3% of total banking expenses (compared to 26.6% on 30 June 2009). Following a notable worsening of the credit portfolio quality, the bank expenses on provisions for loan impairment and liabilities grew substantially. Also by end-September, they were major banking expense item (54.9%) as compared to 52.6% at end

of September. Following a decrease in administrative expenses of banks by 5.4%, their share in the expense structure fell to 14.3% (compared to 14.6% on 30 June 2009) (see Figure 18).

Figure 18

### EXPENSE STRUCTURE

(as a percentage)



### BANK EXPOSURES

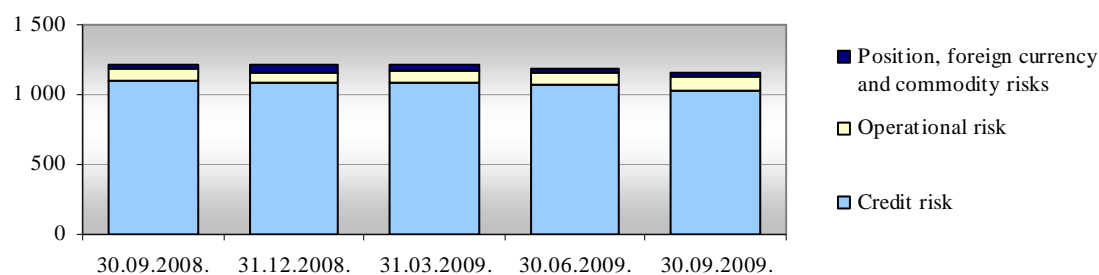
#### Capital requirements for credit risk, market risk and operational risk

During 3Q 2009, following a decrease in capital requirements for credit risk (by 3%), also total amount of banking capital adequacy requirements<sup>5</sup> diminished and at end-September totalled 1,150.4 million lats, incl. a major share, or 89.8%, capital requirement for the credit risk inherent in the banking book, 7.9% – capital requirement for operational risk and 2.3% – capital requirements for position, foreign currency and commodity risks (see Figure 19).

Figure 19

### BREAKDOWN OF CAPITAL ADEQUACY REQUIREMENTS

(million lats)



Following the ongoing deterioration in the banking asset quality and considering the necessity for notable additional provisioning for loan impairment, the banks attempted to strengthen their capital base both by raising share capital and subordinated capital. Upon an increase in the

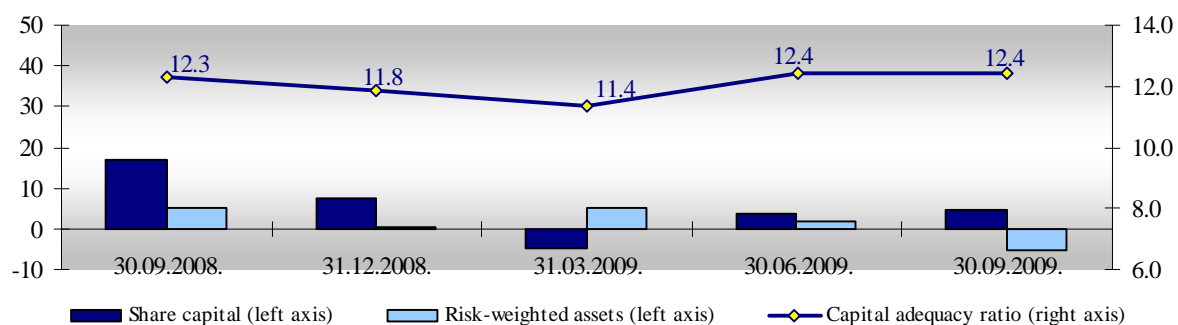
<sup>5</sup> The capital adequacy requirement reflects the bank's capital required for hedging against credit risk, market risks and operational risk.

banking own equity by 5.2% and a decrease in the amount of bank risk-weighted assets by 4.4% in the reporting quarter, the average capital adequacy ratio of the banking sector grew and at end of September totalled 13.6% (compared to 12.4% on 30 June 2009) (see Figure 20).

Figure 20

### ANNUAL GROWTH RATE OF RISK-WEIGHTED ASSETS AND SHARE CAPITAL AND CAPITAL ADEQUACY RATIO

(as a percentage)



At end-September capital adequacy ratio for three banks was above 9% while for other banks – 11% (see Table 2).

Table 2

### BANK GROUPS BROKEN DOWN BY CAPITAL ADEQUACY RATIO

Capital adequacy ratio (%)	30.06.2009		30.09.2009	
	Number of banks	Banking market share (% of total banking assets)	Number of banks	Banking market share (% of total banking assets)
below 10	1	-	3	20.5
10.1–12	6	49.8	4	19.0
12.1–15	5	30.6	4	19.0
15.1–20	5	13.0	7	40.6
above 20.1	4	2.4	3	0.9

### Liquidity risk

In 3Q 2009, the amount of liquid assets<sup>6</sup> in the banking sector rose by 0.9% following a continuous decrease in both the amount of deposits and liabilities to credit institutions, also the amount of current liabilities<sup>7</sup> decreased by 8.1% and the liquidity ratio of the banking sector increased totalling 54.4% by end-September (compared to 49.6% at end 2Q 2009) (credit institutions are obliged to maintain adequate liquid assets in sufficient amounts, but not less than 30% of total current liabilities) (see Figure 21).

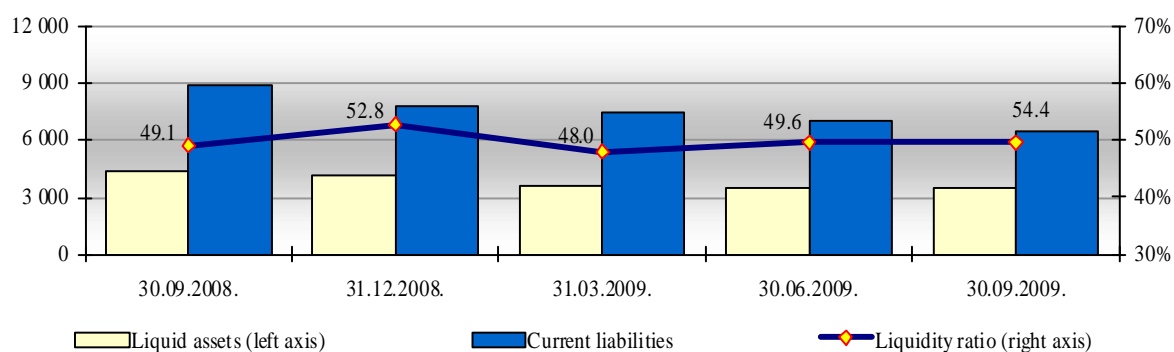
<sup>6</sup> Liquid assets = vault cash + claims on central banks and other credit institutions + fixed-income debt securities of central governments.

<sup>7</sup> Current liabilities – claim liabilities and liabilities with a residual maturity of not more than 30 days.

Figure 21

**LIQUID ASSETS, CURRENT LIABILITIES AND LIQUIDITY RATIO OF BANKS**

(thousand lats; as a percentage)



By end of reporting quarter, liquidity ratio for 18 banks exceeded 40% and the market share of those banks constituted 74.2% of total banking assets (see Table 3). For individual banks, liquidity ratio ranged from 34.8% to 99.1% at end-September (except four banks where liquidity ratio notably exceeded 100%).

Table 3

**BANK GROUPS BROKEN DOWN BY THEIR LIQUIDITY RATIO**

Liquidity ratio (%)	30.06.2009		30.09.2009	
	Number of banks	Banking market share (% of total banking assets)	Number of banks	Banking market share (% of total banking assets)
below 40	3	25.4	3	25.8
40.1 –50	8	37.7	8	36.3
50.1–70	5	29.7	3	2.9
above 70.1	5	7.2	7	35.0