

**MORTGAGE AND LAND BANK  
OF LATVIA**

**Interim Condensed Consolidated and Bank Financial  
Statements for the three months period ended 31 March 2011  
(unaudited)**

*Report of the Supervisory Council and the Board of Directors*

**3 months of 2011**

The economy of Latvia continued its recovery also in the 1<sup>st</sup> quarter of 2011 – the ratio of exports oriented industries grew, their volumes coming close to their pre-crisis levels at the end of 2010, the external trade deficit was still low, the profitability performance of Latvian companies improved, etc., which was somewhat offset by the increase of tax load due to budget consolidation measures, relatively fast return of inflation (4.2% at the end of March 2011), as well as persisting relatively high unemployment levels (14.4% at the end of March).

The beginning of 2011 was marked with a positive assessment of the economic development potential of Latvia acknowledged also by international rating agencies. Thus, *Fitch Ratings* by upgrading Latvian sovereign credit rating by a notch to the BBB-, brought it back to investment grade, it also assigned it a positive future outlook. It was followed by *Standard & Poor's Rating Services* upgrading the credit rating outlook of Latvia from stable to positive. Having upgraded the rating outlook for Baa3 assigned to Latvia's local and foreign currency ratings, the *Moody's Investors Service Ltd* also notched up from negative to stable the outlook of Mortgage Bank's long-term foreign currency deposits rating Baa3 in March 2010, still effective now. The Mortgage Bank is assigned the following ratings:

- long-term foreign currency deposits – Baa3,
- short-term foreign currency deposits – P3,
- financial strength rating – E+,
- rating of mortgage bonds – Baa2,

which are investment grade ratings.

The gross assets of the Mortgage Bank in the 1<sup>st</sup> quarter of 2011 shrunk by 58 million lats or 7%, amounting to 750.1 million lats at the end of March. Within the first three months of 2011 the gross loan portfolio of the Mortgage Bank has diminished by 3%, reaching 571.8 million lats, which was comprised by the development loans' portfolio of 234.2 million lats (41 % of the total portfolio) and commercial loans' portfolio in the amount of 337.7 million lats (59% of the total portfolio). The amount of deposits has not changed significantly during the period (357 million lats). The Bank has generated profit of 1.3 million lats in the 1<sup>st</sup> quarter.

On March 16, the Mortgage Bank used its own funds to repay in full the syndicated loans of 55.5 million euro (39 million lats), arranged by Raiffeisen Bank International AG and Sumitomo Mitsui Banking Corporation. The repayment of these loans extinguished all the commitments the Mortgage Bank had towards the international syndicated lenders.

In the 1<sup>st</sup> quarter of 2011, the Mortgage Bank proceeded with implementation of current state aid programmes. The Mortgage Bank gradually reduced its volume of the commercial loans portfolio pursuant to the Government-approved concept regarding transformation of the Mortgage Bank into development bank. As regards its commercial operations, the bank has stopped lending to new customers and provides commercial lending services only to the current customers according to the effective loan amount, and for restructuring purposes of the current commercial customer base of the bank.

The Mortgage Bank, in the 1<sup>st</sup> quarter of 2011, implemented the following promotional programmes, whereby support is provided to certain groups of entrepreneurs and population as tasked by the Government:

- Programme for Improvement of Competitiveness of Businesses;
- Start-up programme "Support to Self-employment and Business Start-ups";
- SME Growth Programme "Loans for Promotion of Development of Micro, Small and Medium Enterprises and Agricultural Co-operative Unions";
- Working Capital Loans for Farmers;
- Credit Fund in support of agriculture, rural territories and development of fish farming;
- Long-term investment lending programme to agriculture.

*Programme for Improvement of Competitiveness of Businesses*

To finance the programme, the Mortgage Bank received a loan facility of 100 million euro (70 million lats) from the Nordic Investment Bank (NIB) in 2009. For the same purpose, a Loan Fund was also established consisting of public financing of 61.6 million euros (43.3 million lats) and financing of the Mortgage Bank of 21.6 million euros (15.2 million lats). By 31 March 2011, the Programme for Improvement of Competitiveness of Businesses had granted loans for 148.6 million lats, including 60.6 million lats from the Loan Fund.

*Mortgage and Land Bank of Latvia*  
*Interim Condensed Consolidated and Bank Financial Statements*  
*for the three months period ended 31 March 2011 (unaudited)*

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*Report of the Supervisory Council and the Board of Directors (continued)*

*Start-up programme „Support to Self-employment and Business Start-ups”*

By 31 March 2011, 1584 applicants had applied for consultations and training, 813 participants of the programme had completed their training, 695 business plans were submitted to the Bank of which 599 were examined by credit committee and 371 projects were financially supported for the total loan amount of 4.8 million lats.

*SME Growth Programme*

In 2010 the Bank launched the SME Growth Programme “Loans for Promotion of Development of Micro, Small and Medium Enterprises and Agricultural Co-operative Unions”. In 2010 the Mortgage Bank received a tranche of 50 million euro from the European Investment Bank for funding of the programme. The total amount of the loan is 100 million euro. By 31 March 2011, the SME Growth Programme had granted loans for 11.7 million lats.

*Working Capital Loans for Farmers*

In 2010, the Mortgage Bank started granting working capital loans to farmers. Loans are granted in line with the Cabinet of Ministers Regulation No 403 of 27 April 2010 “Procedure for Granting State Aid for Acquisition of Working Capital for Production of Agricultural Produce”. The total financing volume of the programme is 10 million lats that the Mortgage Bank will receive from the State Treasury in the form of loans. By 31 March 2011, the Agriculture Working Capital programme had granted 263 loans for the total amount of 9.4 million lats.

*Credit Fund*

On 20 July 2010, the Cabinet of Ministers Regulation No 664 “Procedure of administration and monitoring the state and European Union support to agriculture, rural territories and development of fish farming, by establishing a Credit Fund” (hereinafter – Credit Fund) got approved, which provides for granting loans to finance projects approved by the Rural Support Service. Loans are to be granted to investments into agricultural enterprises – construction, procurement of fixed machinery and its equipment, procurement of building material and development of detail design. As at 31 March 2011, the Mortgage Bank had approved 3 projects for the total amount of 1.4 million lats.

*Agricultural investment loans*

The Bank continues lending under this programme, launched in 2005. According to the provisions of the programme, the loan amounts returned by repayments of borrowers are used for new loans under this programme.

In the 1<sup>st</sup> quarter of 2011 the Mortgage Bank serviced its clients in 10 branches located in Riga and district centres of Latvia and 24 sub-branches in various regions of country.

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**Supervisory Council (at 31 March 2011)**

Baiba Bāne	Chairman of the Council
Andžs Ūbelis	Deputy Chairman of the Council
Jānis Pone	Member of the Council

**Board of Directors (at 31 March 2011)**

Rolands Paņko	Chairman of the Board
Jēkabs Krieviņš	Deputy Chairman of the Board
Jānis Bērziņš	Member of the Board
Baiba Brigmane	Member of the Board
Gints Āboltiņš	Member of the Board

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*Statement of Responsibility of the Supervisory Council and the Board of Directors*

The Supervisory Council and the Board of Directors (Management) are responsible for preparing the financial statements from the books of prime entry of the Group and the Bank for each financial period that present fairly the state of affairs of the Group and the Bank as at the end of the financial period and the results of their operations and cash flows for that period according to the International Financial Reporting Standards as adopted by the European Union. Prudent and reasonable judgments and estimates have been made by the Management in the preparation of the financial statements.

Management confirms that suitable accounting policies have been used and applied consistently and reasonable and prudent judgments and estimates have been made in the preparation of the interim condensed consolidated and bank financial statements for the period ended 31 March 2011. Management also confirms that applicable International Financial Reporting Standards as adopted in EU have been used in preparation of the financial statements and that these financial statements have been prepared on a going concern basis. Appropriate accounting policies have been applied on a consistent basis.

Management is responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the Group and the Bank and to prevent and detect fraud and other irregularities. Management is also responsible for managing the Bank in compliance with the Law on Credit Institutions, regulations of the Bank of Latvia and the Financial and Capital Market Commission as well as other legislation of the Republic of Latvia.

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**COMPREHENSIVE INCOME STATEMENT**

(all amounts in thousands of Lats)

	3 months to 31 March 2011		3 months to 31 March 2010	
	Group	Bank	Group	Bank
Interest income	9,302	9,451	12,128	11,805
Interest expense	(5,237)	(5,239)	(8,285)	(8,292)
<b>Net interest income</b>	<b>4,065</b>	<b>4,212</b>	<b>3,843</b>	<b>3,513</b>
Fee and commission income	985	723	974	842
Fee and commission expense	(173)	(200)	(209)	(200)
<b>Net fee and commission income</b>	<b>812</b>	<b>523</b>	<b>765</b>	<b>642</b>
Dividend income	-	-	-	-
Net trading income	267	264	417	429
Other operating income	732	300	944	516
	<b>5,876</b>	<b>5,299</b>	<b>5,969</b>	<b>5,100</b>
Personnel expenses	(2,198)	(1,893)	(2,288)	(2,043)
Administrative expenses	(2,258)	(1,259)	(1,697)	(1,386)
Depreciation and amortisation	(443)	(402)	(489)	(447)
Impairment expenses	151	(441)	(10,840)	(10,956)
<b>Loss before income tax</b>	<b>1,128</b>	<b>1,304</b>	<b>(9,345)</b>	<b>(9,732)</b>
Income tax expense	(6)	-	-	-
<b>Net profit / (loss) for the period</b>	<b>1,122</b>	<b>1,304</b>	<b>(9,345)</b>	<b>(9,732)</b>
Net gain from investment securities available-for-sale	85	85	2,271	2,271
<b>Total comprehensive loss for the period</b>	<b>1,207</b>	<b>1,389</b>	<b>(7,074)</b>	<b>(7,461)</b>
<b>Net (loss) / profit for the period attributable to:</b>				
Equity holders of the Bank	1,107	-	(9,350)	-
Non-controlling interest	15	-	5	-
<b>Total comprehensive (loss) / profit for the period attributable to:</b>				
Equity holders of the Bank	1,192	-	(7,079)	-
Non-controlling interest	15	-	5	-

**STATEMENT OF FINANCIAL POSITION**

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(all amounts in thousands of Lats)

<u>Assets</u>	31/03/11		31/12/10	
	Group	Bank	Group	Bank
Cash and balances with Central Bank	41,497	41,497	68,177	68,177
Due from credit institutions	24,857	20,319	20,774	16,692
Derivative financial instruments	336	336	862	862
Trading securities	2,107	1,906	2,572	2,374
Investment securities – available for sale	59,945	65,889	71,504	77,765
Investment securities – held to maturity	22,986	22,986	24,614	24,614
Loans to customers	479,364	471,980	491,741	470,534
Deferred expenses and accrued income	1,429	1,291	1,182	2,049
Investment properties	11,316	1,159	10,574	1,159
Property and equipment	6,327	5,835	6,583	6,074
Intangible assets	1,698	1,333	1,811	1,447
Investments in subsidiaries and associated undertakings	-	818	-	818
Other assets	7,493	3,546	5,659	2,298
Assets held for sale	-	19,350	-	30,945
<b>Total assets</b>	<b>659,355</b>	<b>658,245</b>	<b>706,053</b>	<b>705,808</b>
<u>Liabilities</u>				
Due to credit institutions	130,437	130,437	167,771	167,771
Derivative financial instruments	102	102	13	13
Due to customers	358,780	360,673	361,163	363,622
Issued debt securities	24,061	24,697	32,589	33,046
Deferred income and accrued expenses	1,665	1,131	1,686	1,224
Provisions for off-balance sheet commitments	483	483	1,054	1,054
Current income tax liabilities	44	-	40	-
Deferred tax liabilities	10	-	10	-
Other liabilities	25,297	24,118	24,903	24,308
Subordinated liabilities	31,534	31,534	31,089	31,089
<b>Total liabilities</b>	<b>572,413</b>	<b>573,175</b>	<b>620,318</b>	<b>622,127</b>
<u>Shareholder's equity</u>				
Share capital	191,601	191,601	191,601	191,601
Reserve capital	2,524	2,063	2,524	2,063
Revaluation reserve on available for sale investments	118	118	33	33
Accumulated loss	(107,674)	(108,712)	(108,781)	(110,016)
<b>Total shareholder's equity attributable to shareholders of the Bank</b>	<b>86,569</b>	<b>85,070</b>	<b>85,377</b>	<b>83,681</b>
Non-controlling interest	373	-	358	-
<b>Total shareholder's equity</b>	<b>86,942</b>	<b>85,070</b>	<b>85,735</b>	<b>83,681</b>
<b>Total liabilities and shareholder's equity</b>	<b>659,355</b>	<b>658,245</b>	<b>706,053</b>	<b>705,808</b>

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**CONSOLIDATED STATEMENT OF CHANGES IN THE GROUP'S EQUITY**

(all amounts in thousands of Lats)

	Attributable to equity holders				Minority interest	Total equity
	Share Capital	Reserve capital	Revaluation deficit on available for sale investments	Retained earnings		
<b>Balance as at 31 December 2010</b>	<b>191,601</b>	<b>2,524</b>	<b>33</b>	<b>(108,781)</b>	<b>358</b>	<b>85,735</b>
Profit for the period	-	-	-	1,107	15	<b>1,122</b>
Other comprehensive expenses	-	-	85	-	-	<b>85</b>
<b>Total comprehensive (loss) / profit for the period</b>	<b>-</b>	<b>-</b>	<b>85</b>	<b>1,107</b>	<b>15</b>	<b>1,207</b>
<b>Balance as at 31 March 2011</b>	<b>191,601</b>	<b>2,524</b>	<b>118</b>	<b>(107,674)</b>	<b>373</b>	<b>86,942</b>

**STATEMENT OF CHANGES IN THE BANK'S EQUITY**

(all amounts in thousands of Lats)

	Share Capital	Reserve capital	Revaluation deficit on available for sale investments	Retained earnings	Total equity
<b>Balance as at 31 December 2010</b>	<b>191,601</b>	<b>2,063</b>	<b>33</b>	<b>(110,016)</b>	<b>83,681</b>
Profit for the period	-	-	-	1,304	<b>1,304</b>
Other comprehensive expenses	-	-	85	-	<b>85</b>
<b>Total comprehensive (loss) / profit for the period</b>	<b>-</b>	<b>-</b>	<b>85</b>	<b>1,304</b>	<b>1,389</b>
<b>Balance as at 31 March 2011</b>	<b>191,601</b>	<b>2,063</b>	<b>118</b>	<b>(108,712)</b>	<b>85,070</b>

## **1 GENERAL INFORMATION**

The Mortgage and Land Bank of Latvia was established as a state-owned commercial bank on 19 March 1993 by the Government of Latvia based on the Decree No 140 adopted by the Cabinet of Ministers. The Bank was registered with the Register of Enterprises of the Republic of Latvia on 3 June 1993. According to the Commercial Law the Bank was registered in the Commercial Register on 14 July 2004.

The operations of the Bank are regulated by the law On Credit Institutions and other effective laws of the Republic of Latvia, the Statutes of the Bank, the instructions of the Bank of Latvia and Financial and Capital Market Commission, as well as the decrees and regulations of the Cabinet of Ministers of the Republic of Latvia. The Bank is under the jurisdiction of the Ministry of Finance of the Republic of Latvia that represents the interests of the shareholder on behalf of the Cabinet of Ministers and holds 100% of the Bank's shares.

## **2 RISK MANAGEMENT**

The Group and the Bank manages all the major risks affecting the operation of the Group and the Bank in accordance with the Risk Management Policy approved by the Council of the Bank. The Risk Management Policy stipulates and describes the aggregate of measures used to ensure that a possibility of suffering losses is minimized in the event the invested or receivable resources would not be repaid or recovered in due time or full amount or the Group or the Bank would suffer other losses or would not derive the planned profit. Risk management is an integral component of the internal control system of the Group and the Bank and the risk management system has been established taking into account the size and structure of the Group and the Bank, as well as the best advisable practice, incl. the guidelines of Basel bank supervisory committee.

The Group and the Bank abides by the following principles in its risk management:

- risk assessment and management shall be an integral component of the every-day functions of the Group and the Bank;
- while assuming the risks the Group and the Bank shall be capable of implementing the aims and assignments defined in its development strategy in a longer run;
- the Group and the Bank shall operate by maintaining an optimum balance between profitability and safeguarding against the risks, i.e. the profitability must be as high as possible, however, the Group and the Bank shall not be exposed to material risks;
- in accordance with their authority and competence the employees of the Group and the Bank shall know the customer and understand fully the nature of each transaction (operation) to be able to identify and assess the risks associated with the transaction (operation) and find the best solution both for the customer and the Group or the Bank;
- the Group and the Bank shall assess the probable losses that it might incur by assuming the risks and avoid extraordinary losses in its operation;
- the Group and the Bank shall identify and assess the probable risks before launching new products or services or entering new markets;
- where necessary, the Group and the Bank shall reduce the risk limits, sell the assets subject to the risk or even cease operations on the respective markets should these be assessed as excessively risky.

In light of the changes in the world's financial markets and economy, the Group and the Bank continued improving the risk management system, developing and improving risk management methods, which enhance more accurate and timelier identification of the major risks characteristic to operations of the Group and the Bank and evaluate their impact on further operation of the Group and the Bank.

In managing the risks the Group and the Bank apply various methods and instruments for measuring risks, set the limits and maintain the appropriate controls. The Council of the Bank has approved the policies for managing the risks characteristic for operations of the Group and the Bank.

Each of the structural units involved in risk management maintains an appropriate internal control, efficiency assessment of which is the responsibility of the Internal audit department.

### ***Credit Risk***

The Group and the Bank are subject to the credit risk. The credit risk is the risk of the customer or co-operation partner being unable to or refusing to meet its liabilities towards the Group or the Bank in full amount and due time.

## 2 RISK MANAGEMENT (continued)

The Group and the Bank manages the credit risk according to the Credit Risk Management Strategy and Policies as well as internal regulations, procedures and instructions of credit operations.

The Credit Risk Management Strategy and Policies of the Bank describe and define the principles for the management of the credit risk and it relates to all activities of the Group and the Bank involving credit risk – lending, financial market transactions (operations), intermediary activities on behalf of the clients and issue of guarantees to third parties.

Management process of credit risk within the Group and the Bank encompasses establishment of guidelines and limitations, granting of loans or setting limits to particular clients or groups of interrelated clients; administration, monitoring and evaluation of files of clients or interrelated client groups, as well as appropriate control of the process, operation of management information system and evaluation of the total efficiency of the process.

In establishment of guidelines and limitations, the Group and the Bank primarily follows the common strategy of the Group and the Bank, credit risk management strategy, as well as their historic experience in credit risk management, which allows defining adequate limitations of concentration, as well as adequate assessment of creditworthiness and collateral, passing decisions in decision-making institutions of the appropriate level. As the common strategy of the Group and the Bank encompasses gradual transformation of the Bank into development bank, the risk stemming from implementation of framework funding programmes becomes an increasingly significant risk source for the Group and the Bank.

The Bank's Lending department and Promotional Programmes Office bear the responsibility for daily credit risk management in lending operations, incl. when setting criteria of creditworthiness and collateral adequacy, while decisions about assuming credit risk within the set limits are made by branch, regional and the Central lending committees, or the Board of the Bank. The daily supervision and administration of loans is conducted on the basis of each individual borrower's risk grade and affiliation, determined by organizational structure of the Group and the Bank.

The Risk management committee conducts the integrated monitoring of credit risk, incl. credit risk concentration and loan portfolio quality, while independent control of credit risk is performed by the Risk management department, its functions are detached from the business functions. Risk management department bears the responsibility for analysis of credit risk concentration, setting of limits and their control, quality assessment of the loan portfolio and building of provisions, as well as independent evaluation of lending operations and daily management of credit risk in operations with financial instruments.

Stress testing of the loan portfolio and scenario analysis is conducted within the Group and the Bank within the framework of the credit risk management on a regular basis, and not less than once a year, which includes changes of various macro-environment affecting factors (for instance, drop of real estate property prices, households' income decrease, contingent changes in development of various industries of national economy, and similar) and demonstrates the eventual impact on the Group's and the Bank's profitability, loan portfolio quality, volume of provisions and level of capital adequacy.

The Group and the Bank manages credit risk concentrations according to the Risk Exposures Controlling Policy that stipulates the methods of analysis of the credit risk concentrations and its controlling instruments including limits on credit risk concentrations. Credit risk concentration is managed by measuring and setting limits on the following concentrations:

- ratio of large exposure concentration and own funds (internal limit - 400%), as of 31.03.2011 was 28.6% (as of 31.12.2010 – 33.6% );
- ratio of single client's (related clients' group) large exposure and own funds, which may not exceed 25%, as of 31.03.2011 was 23.5% (as Bank of 31.12.2010 – 21.2% );
- ratio of risk exposures with persons related to the Bank and own funds, which may not exceed 15%, as of 31.03.2011 was 1.2% (as of 31.12.2010 – 1.0%).
- proportion of risk concentration in a single economic sector in the Bank's credit portfolio and own funds as of 31.03.2011 was 139.6% (as of 31.12.2010 – 131.9% ) in operations related to real estate;

Since the Bank's strategy is not focused on servicing the non-residents business, the proportion of the Bank's total claims to non-residents was small and as of 31.03.2011 was 7.6% (as 31.12.2010 – 7.3%) of the Bank's total assets. The Group and the Bank manages the country risk that results from the lending operations to non-residents according to the Country Risk Management Policy.

## **2 RISK MANAGEMENT (continued)**

The management of the Group and the Bank has performed calculation of losses on the basis of all the facts at its disposal, unbiased proofs of depreciation, and believes the calculations disclosed in the financial reports are reasonable, considering the available information. Nonetheless, having the present awareness, it might occur, as a result of the next year's actual events, differing from the assumptions, that the respective book values of assets and liabilities be corrected.

### ***Liquidity Risk***

The liquidity risk relates to the ability of the Group and the Bank to redeem the legally valid claims of its customers and other creditors in due time and secure that the increase of the anticipated claims presents reasonable costs.

The principles for management of liquidity risk are determined by the Liquidity Maintenance Strategy, Liquidity Risk Management Policy and Business Continuity Plan for Liquidity Crisis Situation. The Bank maintains that the liquid assets do not fall below 30% (set by the FCMC) of its short-term liabilities at all times. The Assets and Liabilities Committee of the Bank stipulates the guidelines for liquidity risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the liquidity risk.

The Bank uses the GAP method to evaluate the liquidity risk. The Bank has set liquidity net position limit in each significant currency and total liquidity net position limit as well as maximum deposit amount from a single depositor to control the liquidity risk. At least once a month, scenario analysis or stress testing is conducted, to reveal the impact of contingencies on liquidity of the Group and the Bank.

Compliance with the liquidity ratio (min – 30%) was 62.1% as of 31.03.2011 (as of 31.12.2010 – 84.8%).

### ***Foreign Currency Risk***

The foreign currency risk occurs due to the differences between the asset and liability positions of foreign currencies that, as a result of the fluctuations of the exchange rates, affect the cash flow and financial results of the Group and the Bank. The principles for the management of the foreign currency risk are outlined in the Foreign Currency Risk Management Policy of the Bank. Monitoring of the foreign currency risk is conducted by the Assets and Liabilities Management Committee of the Bank, whereas the Treasury Department provides for daily management of the foreign currency risk.

### ***Interest Rate Risk***

The interest rate risk is related to the influence of the fluctuations of the market rates onto the interest income and expenses of the Group and the Bank. To assess the interest rate risk the Group and the Bank analyses the maturity structure of the assets and liabilities sensitive to the changes in interest rates and susceptibility of the maturity structure to the potential fluctuations of the interest rates on a regular basis. The Assets and Liabilities Management Committee monitors the interest rate risk, whereas the Treasury Department is responsible for the daily management of the interest rate risk. The Bank has set limit on changes in economic value of the Bank at 17.5% of own funds and limit on changes in net interest income at 2% of own funds which, respectively, were 7.4% as of 31.03.2011 (as of 31.12.2010 – 12.5%) and 0.5% (as of 31.12.2010 – 0.4%).

### ***Operational risk***

The operational risk results from intentional or unintentional deviations from the standards adopted in daily operation of the Group and the Bank, for example human mistake or fraud, disturbances in the operation of the information systems, insufficient control procedures or their ignorance. The Group and the Bank manages operational risk according to the Operational Risk Management Policy. The operational risk is measured by using the method of self assessment and statistical analysis, whereas the operational risk information system, established within the Group and the Bank, is used to identify, analyze and control the Operational risk, it registers and analyses occurrences of operational risk and calculates the scale of actual or potential losses. Structural units of the Group and the Bank are responsible for the management of the operational risk in the daily operations, but the Risk Management Committee supervises the operational risk. The Risk Management Department is responsible for implementation of the operational risk management as well as the operational risk assessment in the Group and the Bank.

## 2 RISK MANAGEMENT (continued)

The Bank has implemented Business Continuity Plan under the operational risk management measures, which includes guidelines on actions to be taken by the Bank, its structural units and employees at occurrence of risks that can have substantial negative effect on the Bank's operations.

### *Capital Adequacy*

Capital adequacy shows the capital resources of the Group and the Bank that are required to protect them against risks, potential and characteristic to the current and future operations of the Group and the Bank.

Capital adequacy maintenance strategy and Capital adequacy evaluation process policy describes the processes of evaluation, planning and maintenance of the capital adequacy.

The goals of the Bank in capital management are:

- comply with the requirements of the Financial and Capital Market Commission, as well as the strategic goals to capital volume requirement and capital adequacy, established by the management of the Bank;
- maintain operation capability of the Group and the Bank, bringing profit to the shareholder and benefiting other interested parties;
- use the capital effectively and support the development of operations of the Group and the Bank by means of a healthy capital base.

Capital adequacy is evaluated on a regular basis and a report is monthly submitted to the supervisory institution, in accordance with the requirements of the Financial and Capital Market Commission.

The Group and the Bank completely follows the requirements of Basel II in their capital adequacy evaluation process. Own funds of the Group are constituted by aggregate of Tier I and Tier II capital, less the reduction of own funds.

In order to calculate the minimum capital charge for credit and market risks according the requirements of the Financial and Capital Market Commission, the Group and the Bank use the standardised approach, and basic indicator approach – for operational risk. As of 31.03.2011, the capital adequacy ratio of the Bank was 16.7% (as of 31.12.2010 – 16.7%) which exceeded the statutory minimum of 8% for the ratio of the own capital and total of risk-weighted assets and off-balance sheet items.

In order to maintain that the capital at disposal of the Group and the Bank is sufficient to cover all risks of the current and scheduled operations, the Group and the Bank conducts the internal capital adequacy evaluation process (ICAAP) once a year, calculating capital requirements for those significant risks which do not have minimum regulatory capital requirements determined. The results of the internal capital adequacy evaluation as of 31.03.2011 were as follows:

	<b>31/03/11</b>
	<b>Bank</b>
Capital base for internal capital adequacy evaluation	100,657
Total internal capital requirement	69,088
Internal capital adequacy ratio	11,7%
Surplus of capital base	31,569

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### 3 THE PERFORMANCE RATIOS OF THE BANK

Items	Accounting period	Previous accounting year
Return on equity (ROE) (%)	6.18%	-65.02%
Return on assets (ROA) (%)	0.67%	-5.60%

### 4 CONSOLIDATION GROUP

No	Name of commercial company	Code of place of registration, address of registration	Type of activity of commercial company *	Share of fixed capital (%)	Voting rights in commercial company (%)	Justification for including in the Group**
1.	SIA „Hipotēku bankas nekustamā īpašuma aģentūra”	LV –Latvija 40003426895	CKS	100	100	MS
2.	SIA „Hipolīzings”	LV – Latvija 40003616329	CFI	100	100	MS
3.	SIA „Risku investīciju sabiedrība”	LV – Latvija 40003952445	CFI	100	100	MS
4.	IPS „Hipo fondī”	LV – Latvija 40003403040	IPS	51.31	51.31	MS
5.	SIA „Rīgas Centra namu pārvalde”	LV – Latvija 40003266805	CKS	100	100	MS
6.	KS "Mazo un vidējo komersantu atbalsta fonds"	LV – Latvija 40003681329	CFI	47.62	47.62	KS

\* IPS – investment management company, CFI – other financial institution, CKS – other commercial company.

\*\* MS – subsidiary; KS – joint venture.

### 5 RATINGS ASSIGNED TO BANK BY RATING AGENCY MOODY'S INVESTORS SERVICE

Rating type	Ratings	Rating Approval date	Previous rating
For long-term foreign currency bank deposits	<b>Baa3</b>	25.06.2009.	<b>Baa3</b>
For short-term foreign currency deposits	<b>P3</b>	25.06.2009.	<b>P3</b>
The financial strength rating	<b>E+</b>	25.06.2009.	<b>D-</b>
The rating of mortgage bonds issued	<b>Baa2</b>	23.04.2009.	<b>A2</b>

Moody's Investors Service reports of the Bank may be found at: [www.hipo.lv](http://www.hipo.lv)

Additional information on the ratings assigned (incl. Legend of ratings) may be found at: [www.moody.com](http://www.moody.com)

### 6 POST BALANCE SHEET EVENTS

On 12 April, the Cabinet of Ministers, after revising the informative briefing produced by the Ministry of Finance (MoF) regarding the transformation plan of the State Joint-stock Company "Latvijas Hipotēku un zemes banka" (Mortgage bank), resolved to send the transformation plan of the Mortgage bank developed by SEB Enskilda, the consulting agency engaged upon invitation of the MoF, for consideration by the European Commission.

Besides, the Government also resolved to assign the MoF to perform a market research regarding the transformation scenario of the bank and its implementation strategy. An advisor will also be brought in for implementation of the transformation scenario of the bank, to be decided by the Cabinet separately.

*Mortgage and Land Bank of Latvia*  
*Condensed Consolidated and Bank Financial Statements*  
*for the three months period ended 31 March 2011 (unaudited)*

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The goal for transformation of the Mortgage bank is to establish a promotional institution for implementation of state aid programmes, by using the current infrastructure of the Mortgage bank, its intellectual and financial potential as efficiently as possible, attaining maximum benefit for the Government in transforming the bank. During the transformation process, the operation of the Mortgage bank will be focused on directions essential for the national economy – financing small and medium companies, promotion of business start-ups, infrastructure development and other national development projects within Cabinet programmes.

These condensed financial reports are to be viewed along with the Bank's Annual Report for 2010.