

# **LATVIJAS BANKA**

FINANCIAL STATEMENTS OF LATVIJAS BANKA  
FOR THE YEAR ENDED 31 DECEMBER 2015

INDEPENDENT AUDITORS' REPORT TO THE COUNCIL  
OF LATVIJAS BANKA

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## **ABBREVIATIONS**

APP	asset purchase programme
BIS	Bank for International Settlements
EC	European Commission
ECB	European Central Bank
ESCB	European System of Central Banks
EU	European Union
FCMC	Financial and Capital Market Commission
IMF	International Monetary Fund
NCB	National central bank
OECD	Organisation for Economic Co-operation and Development
OTC	over-the-counter
SDR	Special Drawing Rights
UK	United Kingdom
US	United States of America
PSPP	public sector asset purchase programme

## BALANCE SHEET

(at the end of the year; in thousands of euro)

	Note <sup>1</sup>	2015	2014
<b>ASSETS</b>			
Gold and gold receivables	6	<b>207 670</b>	210 774
Claims on non-euro area residents denominated in foreign currency	7	<b>2 949 979</b>	2 441 368
Receivables from the International Monetary Fund		153 780	144 069
Balances with banks and security investments, external loans and other external assets		2 796 199	2 297 299
Claims on euro area residents denominated in foreign currency	8	<b>541 073</b>	486 242
Claims on non-euro area residents denominated in euro	9	<b>169 490</b>	214 953
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	<b>263 730</b>	85 520
Longer-term refinancing operations		263 730	85 520
Other claims on euro area credit institutions denominated in euro	11	<b>2 491</b>	4 475
Securities of euro area residents denominated in euro	12	<b>3 015 433</b>	1 095 446
Securities held for monetary policy purposes		1 808 374	–
Other securities		1 207 059	1 095 446
Intra-Eurosystem claims	13	<b>3 802 596</b>	3 393 275
Participating interest in the European Central Bank		115 082	115 082
Claims equivalent to the transfer of foreign reserves		163 480	163 480
Other claims within the Eurosystem		3 524 034	3 114 713
Other assets	14	<b>166 225</b>	92 455
<b>TOTAL ASSETS</b>		<b>11 118 687</b>	8 024 508

<sup>1</sup> The accompanying Notes set out on pages 7 to 46 are an integral part of these financial statements.

<i>(continued)</i>	(at the end of the year; in thousands of euro)		
	Note	<b>2015</b>	2014
<b>LIABILITIES</b>			
Banknotes in circulation	15	<b>3 992 436</b>	3 849 170
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	<b>4 784 410</b>	2 423 356
Current accounts (covering the minimum reserve system)		4 784 410	2 073 356
Deposit facility		–	350 000
Other liabilities to euro area credit institutions denominated in euro	17	<b>8 830</b>	540
Liabilities to other euro area residents denominated in euro	18	<b>145 894</b>	126 919
General government		38 055	50 900
Other liabilities		107 839	76 019
Liabilities to non-euro area residents denominated in euro	19	<b>9 099</b>	23 986
Liabilities to euro area residents denominated in foreign currency	20	<b>155 228</b>	144 579
Liabilities to non-euro area residents denominated in foreign currency	21	<b>478</b>	–
Intra-Eurosystem liabilities	13	<b>1 312 104</b>	796 980
Liabilities related to TARGET2 and correspondent accounts (net)		1 312 104	796 980
Other liabilities	22	<b>258 853</b>	180 089
Capital and reserves	23	<b>451 355</b>	478 889
<b>TOTAL LIABILITIES</b>		<b>11 118 687</b>	8 024 508

## PROFIT AND LOSS STATEMENT

		(in thousands of euro)	
	Note	<b>2015</b>	2014 <sup>2</sup>
Net interest income	33	<b>44 953</b>	38 799
Interest income		64 696	50 097
Interest expense		-19 743	-11 298
Net result of financial operations, recognition of revaluation result in profit and loss statement and risk provisions		<b>-11 717</b>	-5 310
Realised gains arising from financial operations	34	37 216	11 135
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	-13 633	-1 645
Provisions for market risk and credit risk	36	-35 300	-14 800
Net expense from fees and commissions		<b>-1 388</b>	-1 213
Fees and commissions income		422	302
Fees and commissions expense		-1 810	-1 515
Income from participating interest	37	<b>4 157</b>	3 650
Net result of pooling of monetary income	38	<b>25 675</b>	31 953
Other operating income	39	<b>1 762</b>	3 666
<b>NET INCOME</b>		<b>63 442</b>	71 545
Remuneration	40	<b>-16 932</b>	-16 839
Social security costs	40	<b>-3 518</b>	-3 382
Depreciation of fixed assets and amortisation of intangible assets	14	<b>-3 722</b>	-3 685
Banknote and coin acquisition costs	41	<b>-1 955</b>	-2 633
Other operating expenses	42	<b>-7 278</b>	-8 246
<b>PROFIT OF THE REPORTING YEAR</b>		<b>30 037</b>	36 760

<sup>2</sup> Interest income and expense recognised in the profit and loss statement of Latvijas Banka for 2014 have been restated in line with the reporting of negative interest described in Note 2.24.

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of euro)

	Note	2015	2014
Profit of the reporting year		<b>30 037</b>	36 760
Revaluation	23	<b>-13 537</b>	36 006
Realisation of the accumulated revaluation result	23	<b>-33 773</b>	-27 166
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	<b>13 633</b>	1 645
Total changes in the valuation account	23	<b>-33 677</b>	10 485
<b>TOTAL</b>		<b>-3 640</b>	47 245

The financial statements, which are set out on pages 3 to 46, were authorised by the Board of Latvijas Banka on 10 March 2016.

### BOARD OF LATVIJAS BANKA



Māris Kālis  
Chairman of the Board



Ilze Posuma  
Deputy Chair of the Board



Jānis Blūms  
Member of the Board



Jānis Caune  
Member of the Board



Harijs Ozols  
Member of the Board



Raivo Vanags  
Member of the Board

## NOTES TO THE FINANCIAL STATEMENTS

### 1. PRINCIPAL ACTIVITIES

Latvijas Banka is the central bank of the Republic of Latvia and a member of the ESCB and the Eurosystem. It was established on 19 September 1922 (re-established in 1990). In its activities, Latvijas Banka complies with the Republic of Latvia and EU legislation as well as ECB legal acts in compliance with the Treaty on the Functioning of the European Union and the Statute of the ESCB and of the ECB.

Pursuant to the Law on Latvijas Banka, the primary goal of Latvijas Banka is to maintain price stability. As of 1 January 2014, the euro changeover day in Latvia, Latvijas Banka has the following primary tasks:

- participate in the formulation and implementation of the Eurosystem's monetary policy;
- manage the foreign reserves and other financial investments;
- ensure cash currency circulation in Latvia and participate in providing the cash currency circulation in the euro area;
- promote smooth functioning of payment systems;
- compile and publish statistical information in order to ensure the performance of the tasks of Latvijas Banka;
- cooperate with the ECB, the central banks of other EU Member States and other countries, as well as other financial institutions;
- operate as the financial agent of Latvia's government and provide financial services to other market participants;
- act as an advisor to the Saeima (Parliament) and Cabinet of Ministers of the Republic of Latvia on monetary policy issues and other issues related to the implementation of the tasks of Latvijas Banka;
- maintain the Credit Register;
- issue licences to legal persons listed in the Register of Enterprises of the Republic of Latvia, except credit institutions, for the purchase and sale of foreign currency as a commercial activity.

Latvijas Banka neither seeks nor takes instructions from the government of Latvia and other EU Member States, EU institutions and other national, foreign or international institutions and their entities. Latvijas Banka is independent in setting and implementing policy under its legal mandate. Latvijas Banka is supervised by the Saeima of the Republic of Latvia.

Latvijas Banka does not engage in any commercial activity, and its operation related to the execution of its tasks is mainly financed from income received from its investment management.

The Head Office of Latvijas Banka is situated at K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its branches in Riga and Liepāja.

### 2. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by Latvijas Banka in the preparation of these financial statements is set out below.

#### 2.1 Basis of preparation

These financial statements have been prepared in accordance with the Guideline of the ECB of 11 November 2010 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2010/20), Financial Accounting Policy of Latvijas Banka approved by Latvijas Banka's Council, and the requirements of the Law on Latvijas Banka governing financial reporting.

#### 2.2 Basis of measurement

These financial statements have been prepared in accordance with the historical cost basis of accounting. Gold, debt securities (except held-to-maturity debt securities and securities held for monetary policy purposes that are measured at amortised cost), participating interest (except the participating interest in the ECB), currency future contracts and interest rate derivatives are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 2.15. The comparison of the book value and fair value of these instruments is provided in Note 24.

#### 2.3 Fair value of financial assets and financial liabilities

Fair value is the price at which a financial asset could be sold or financial liability could be transferred in an orderly transaction between market participants at the measurement date.

Fair value of financial instruments is determined by Latvijas Banka using quoted prices in active markets, other financial market information sources or discounted cash flows. The discounted cash flows are modelled using quoted market prices of financial instruments and money market interest rates. The breakdown of assets measured at fair value, taking into account the hierarchy of fair value determination, is provided in Note 5.

## 2.4 Foreign currency and gold translation

For foreign currency translation Latvijas Banka applies foreign exchange rates published by the ECB. The price of gold is set on the basis of the quoted gold market price in US dollars and the exchange rate of the US dollar against the euro published by the ECB. The exchange rate of the SDR is set on the basis of the weights of the SDR basket of currencies published by the IMF and the exchange rates of the respective currencies published by the ECB.

Transactions denominated in foreign currencies are recorded in euro at the respective exchange rates on the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into euro at the exchange rates at the end of the reporting period. Non-monetary assets and liabilities, measured at cost or amortised cost, are translated into euro at the exchange rate for the respective foreign currency on the day of the transaction.

Transactions in foreign currencies are included in the calculation of net foreign currency position of the respective currency. The transactions in foreign currencies reducing the respective currency position result in realised gains or losses. Any gain or loss arising from revaluation of transactions in foreign currencies and foreign currency positions are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve ("Valuation account") in accordance with the principles referred to in Note 2.23. The principles referred to herein and in Note 2.23 for valuation and recording of transactions denominated in foreign currencies are also applied to gold.

The exchange rates of major foreign currencies (currency units per euro) and gold price (euro per troy ounce) in euro used in the preparation of the balance sheet for the year ended 31 December 2015 and the year ended 31 December 2014 are as follows:

	(at the end of the year)		
	2015	2014	Changes (%)
US dollar (USD)	1.0887	1.2141	-10.3
Japanese yen (JPY)	131.07	145.23	-9.8
Canadian dollar (CAD)	1.5116	1.4063	7.5
British pound sterling (GBP)	0.73395	0.7789	-5.8
Gold (XAU)	973.225	987.769	-1.5

## 2.5 Recognition and derecognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised in the balance sheet when Latvijas Banka becomes a contractual party in the respective financial transaction.

A financial asset is derecognised when the contractual rights to cash flows arising from the respective financial asset expire or are transferred, thereby risks and rewards related to the particular asset are transferred, and Latvijas Banka does not retain control over the asset. Financial liabilities are derecognised when the respective obligations are settled.

A regular way purchase or sale of financial assets is recognised and derecognised on the settlement day.

## 2.6 Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount in the financial statements is reported only in cases when there is a legally enforceable right to set off the recognised amounts, and there is an intention to dispose of the respective assets and settle the liability simultaneously.

## 2.7 Use of estimates and assumptions

Estimates and assumptions have been made in the preparation of the financial statements that affect the amounts of certain assets, liabilities and contingent liabilities reported in the financial statements. Future events may affect the above mentioned estimates and assumptions. The effect of a change in such estimates and assumptions is reported in the financial statements for the reporting year and each year in the future to which it refers.

The major estimates and assumptions in the preparation of the financial statements have been made with respect to the following: impairment of assets (see Note 2.19), the method for establishing the fair value of the BIS shares (see Note 14.2), the useful life of fixed assets and intangible assets (see Notes 2.17 and 2.18), the repurchasing probability of collector coins (see Note 2.21), provisions for market risk and credit risk (see Notes 2.22 and 36), the intention of holding a certain share of debt securities to maturity (see Note 2.9), the breakdown of fair value determination (see Note 5), and the method of recognising a part of the initial valuation account balance in profit and loss statement (see Note 23).



## **2.8 Gold and gold receivables**

Gold is stated at market value in the balance sheet in accordance with the principles described in Note 2.4.

Any gain or loss arising from transactions in gold and revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve in accordance with the principles described in Note 2.23.

## **2.9 Debt securities**

Debt securities are stated at fair value in the balance sheet, except those held to maturity and securities held for monetary policy purposes, measured at amortised cost. Securities held to maturity are securities with fixed or determinable payments and fixed maturity which Latvijas Banka intends to hold to maturity.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income (see Note 2.24).

Gain or loss arising from transactions in debt securities and revaluation of the debt securities stated at fair value are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the securities revaluation reserve in accordance with the principles referred to in Note 2.23.

## **2.10 Reverse repurchase agreements**

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not reported on Latvijas Banka's balance sheet. The related funding provided to the counterparty is reported on Latvijas Banka's balance sheet at nominal value as claims on the seller of the securities.

The difference between the purchase and resale price of securities is gradually recognised as interest income in the profit and loss statement over the term of the agreement.

## **2.11 Repurchase agreements**

Repurchase agreements are accounted for as financing transactions. Securities sold under repurchase agreements are reported on Latvijas Banka's balance sheet along with other securities that are not involved in these transactions. Funding received from such sales is reported on the balance sheet at nominal value as a liability to the purchaser of the securities.

The difference between the sale and repurchase price of securities is recognised as interest expense in the profit and loss statement over the term of the agreement.

## **2.12 Securities lending**

Securities lent under automated security lending programme agreements are reported on Latvijas Banka's balance sheet along with other securities that are not involved in these transactions. Only cash collateral placed on the account of Latvijas Banka is recognised in the balance sheet.

Income from securities lending transactions is recognised as interest income in the profit and loss statement.

## **2.13 Loans to credit institutions, deposits and similar financial claims and financial liabilities**

Loans to credit institutions, deposits and similar financial claims and financial liabilities are recorded at nominal value in the balance sheet.

## **2.14 Participating interest**

Participating interest includes long-term investments of Latvijas Banka in equity instruments. Latvijas Banka has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate. Equity instruments are reported at fair value in the balance sheet, except participating interest in the ECB, which is reported at cost in the balance sheet in accordance with the ECB's legal framework for accounting and financial reporting.

The change in fair value of participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve for equity instruments.

## **2.15 Derivative financial instruments**

Latvijas Banka enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, and interest rate and currency future contracts, which are reported in off-balance sheet accounts at their contract or notional amount. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on the transaction day at the spot rate of the transaction and are recorded in the balance sheet in euro at the exchange rate of the respective currency at the end of the reporting period. Other derivative financial instruments are reported in the balance sheet at fair value.

Interest on derivative financial instruments, including the spot and forward interest rate spread of forward exchange rate contracts and currency swap arrangements, is recognised in the profit and loss statement as interest income or interest expense over the term of the agreement. Any gain or loss arising from a change in fair value

of interest rate and currency future contracts is included in the profit and loss statement taking into account settlement. Any gain or loss arising from a change in fair value of other derivative financial instruments is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the revaluation reserve in accordance with the principles referred to in Note 2.23.

### 2.16 Accrued interest income and expense

Accrued interest income and expense are reported under balance sheet items of other assets or other liabilities.

### 2.17 Fixed assets

Fixed assets are tangible long-term investments with the useful life of over one year. Capitalisation limit of fixed assets is 150 euro, except the costs related to real estate improvements and replacement of fixed asset parts for which the Board of Latvijas Banka has set a higher capitalisation limit depending on their significance. Fixed assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure operation of Latvijas Banka.

Fixed assets are recorded at cost less accumulated depreciation and impairment, if any.

Depreciation is recognised using the straight-line method over the estimated useful life of the asset. Assets under construction or development, land and works of art are not depreciated. Buildings and structures are accounted by separate components, with individual useful life set for each such component.

In 2015, the useful lives set for fixed assets were not changed. In 2015 and 2014, the useful lives set for fixed assets were as follows:

	(years)	
	2015	2014
Buildings and their components, improvements to the territory, incl.	5–100	5–100
structures	100	100
finishing, equipment and engineering communications	5–20	5–20
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–7	2–7
Other fixed assets	5–15	5–15

In accordance with generally accepted principles for hedge accounting, the cost of individual fixed assets includes an effective result arising from financial instruments designated as hedges of exchange risk associated with development of the respective fixed assets.

### 2.18 Intangible assets

Intangible assets are long-term investments without physical substance with a useful life of over one year. Capitalisation limit of intangible assets is 150 euro. Intangible assets include software application rights and other rights.

Intangible assets are reported in the balance sheet at cost less accumulated amortisation and impairment, if any.

Acquisition costs of intangible assets are amortised over the useful life of the respective assets using the straight-line method; however, this period may not exceed 10 years.

Costs related to software development by Latvijas Banka are recognised in the profit and loss statement when incurred.

### 2.19 Impairment of assets

An asset is impaired when its carrying amount exceeds its recoverable amount. Upon detecting any indications of impairment of an asset, the recoverable amount of the respective asset is estimated. If the recoverable amount is less than the carrying amount of the respective asset, adequate impairment allowances for the respective asset are made. Such impairment allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

The ECB carries out impairment assessment of securities held for monetary policy purposes, identifying any potential changes in future cash flows and any other factors encumbering the fulfilment of the liabilities by

the securities issuer. Assets are impaired when the carrying amount of securities held for monetary policy purposes exceed their recoverable amount. The latter in its turn is defined as the present value of a future cash flow estimate. The ECB Governing Council approves the results of the asset impairment assessment carried out by the ECB.

## **2.20 Currency in circulation**

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a certain share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. The share allocated to the ECB is 8% of the total amount of euro banknotes issued by the Eurosystem; the remaining 92% are allocated to the NCBs in proportion to their share in the ECB's capital and reported under the balance sheet item "Banknotes in circulation". Of the total amount of euro banknotes issued by the Eurosystem, the share allocated to Latvijas Banka is larger than the actual amount of euro banknotes it has issued (see Note 15); consequently, claims on the ECB for the allocation of banknotes are reported under the balance sheet item "Intra-Eurosystem claims". In accordance with the ECB's legal framework for accounting and financial reporting, the balance sheet item "Banknotes in circulation" at the end of 2014 also comprises the nominal value of the lats banknotes in circulation which had not been exchanged for euro yet. The non-exchanged lats banknotes at the end of 2015 have been reported under the balance sheet item "Other liabilities".

Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited.

Euro coins and lats coins in circulation issued by Latvijas Banka, except collector coins, are reported under the balance sheet item "Other liabilities" at nominal value.

## **2.21 Collector coins**

Collector coins sold are not included in the balance sheet liabilities, as the repurchasing probability of those coins is low or the value of precious metals of which the coins are made exceeds the nominal value. Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred. The accounting principles established with respect to collector coins are applied to the lats gold circulation coins and collector coins.

## **2.22 Provisions**

Provisions are recognised in the financial statements when Latvijas Banka has incurred a present legal or constructive obligation arising from a past event or transaction and a reliable estimate can be made of the obligation and it can be expected to result in a cash outflow from Latvijas Banka.

On the basis of reasonable risk estimates, Latvijas Banka's Council decides on making provisions for market risk (price, interest rate and currency risks) and credit risk associated with Latvijas Banka's investment management and other financial transactions (see also Note 36).

## **2.23 Recognition of gains or losses on financial instruments, foreign currency and gold position**

Gains or losses on financial instruments, foreign currency and gold position are recognised in accordance with the following principles provided by the ECB's legal framework for accounting and financial reporting:

- (a) realised gains and losses shall be recognised in the profit and loss statement;
- (b) unrealised gains shall be recognised in the balance sheet item "Capital and reserves" as the revaluation reserve;
- (c) unrealised losses recognised in the balance sheet item "Capital and reserves" as the revaluation reserve at the end of the reporting year shall be transferred to the profit and loss statement if they exceed the previous revaluation gain on the respective financial instrument, foreign currency or gold position;
- (d) unrealised losses recognised in the profit and loss statement at the end of the reporting year shall not be reversed and offset by unrealised gains of the respective financial instrument, foreign currency or gold position in the subsequent years;
- (e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold position against unrealised gains in other financial instrument, foreign currency or gold position.

The average cost method shall be used to calculate realised and unrealised gains and losses of financial instrument, foreign currency and gold position. The average cost of financial instrument, foreign currency or gold position shall be increased or reduced by unrealised losses that are recognised in the profit and loss statement at year-end.

## **2.24 Interest income and expense**

Interest income and expense are recognised in the profit and loss statement on an accrual basis.

Interest income includes interest on securities, securities lending, deposits placed, loans granted, forward exchange rate contracts, currency and interest rate swap arrangements, intra-Eurosystem claims, as well as negative interest on deposits received. Interest on securities also includes premium and discount, which is amortised over the remaining life of the respective securities using the straight-line method.

Interest expense includes interest on deposits received from the Latvian government, credit institutions and other financial institutions, as well as interest on forward exchange rate contracts and currency and interest rate swap arrangements, intra-Eurosystem liabilities, as well as negative interest on deposits placed.

In the profit and loss statement received negative interest is reported as interest income; paid negative interest is reported as interest expense. Accrued negative interest on balance sheet liabilities is reported under the balance sheet item "Other assets"; accrued negative interest on balance sheet assets is reported under the balance sheet item "Other liabilities".

### **2.25 Realised gains or losses from financial operations**

Realised gains or losses from financial operations are recognised in the profit and loss statement at the time of disposal of financial instrument or at the time of settlement.

Realised gains or losses from financial operations include realised gains or losses of derivative financial instruments, disposal of debt securities, and foreign exchange transactions.

### **2.26 Income from participating interest**

The change in fair value of participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve for equity instruments.

Dividends on participating interest are recognised in the profit and loss statement when the right to receive payment is established.

Pursuant to the decision of the Governing Council of the ECB, the income gained by the ECB on the claims for the allocation of banknotes within the Eurosystem, and from the Securities Markets Programme, the asset-backed securities purchase programme, the third covered bond purchase programme, as well as from the public sector asset purchase programme (PSPP) shall be distributed as interim profit for the reporting year in which it accrues. The Governing Council of the ECB decides on the interim profit distribution in January of the following year; however, it may resolve not to do so in cases when the ECB's net profit for the reporting year is less than its income included in the ECB's interim profit distribution, as well as in the event the Governing Council decides to establish provisions for foreign exchange rate, interest rate, credit and gold price risks. In addition, the Governing Council of the ECB may resolve to make deductions from the interim profit distribution result in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes; the deductions may not exceed income on the claims for the allocation of banknotes within the Eurosystem.

Moreover, after the approval of the ECB's annual accounts, the Governing Council distributes the remainder of the ECB's annual profit of the reporting year to euro area NCBs in proportion to their shares in the ECB's capital (see Note 13.1).

Income from participating interest in the ECB is reported under the profit and loss statement item "Income from participating interest".

### **2.27 Net result of pooling of monetary income**

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs gain income from the implementation of the single monetary policy of the Eurosystem. Total monetary income of the Eurosystem equals the income on assets arising from the issue of euro banknotes and receiving deposits from credit institutions. The income is allocated to euro area NCBs in proportion to their shares in the capital of the ECB. For the first six years following the joining of the Eurosystem an NCB's monetary income is adjusted in compliance with a definite coefficient to avoid significant euro area NCB income fluctuations (see also Note 33).

The net monetary income pooled by Latvijas Banka includes the income derived from earmarkable assets of Latvijas Banka, reduced by expenses for the monetary liabilities of Latvijas Banka. The earmarkable assets of Latvijas Banka for the allocation of monetary income include gold, assets acquired as a result of monetary policy operations, intra-Eurosystem claims as well as other assets in the amount necessary to fully cover the monetary liabilities. Monetary liabilities of Latvijas Banka include banknotes in circulation, deposits of credit institutions resulting from monetary policy operations and intra-Eurosystem liabilities.

Latvijas Banka's monetary income received comprises Latvijas Banka's share in the Eurosystem's total monetary income set on the basis of Latvijas Banka's share in the ECB's capital.

### **2.28 Banknote and coin acquisition costs**

Banknote and coin acquisition costs are charged to the profit and loss statement at the time of banknote and coin acquisition.

### **2.29 Other expense and income**

Bank's other operating expense and income are recognised in the profit and loss statement on an accrual basis. The amount of accrued expense and income for the reporting period is calculated in accordance with the volume of services received or rendered in the reporting period. Lease payments are recognised in the profit and loss statement proportionally over the term of the respective agreement.

### **3. SUMMARY OF THE FINANCIAL POSITION AND FINANCIAL PERFORMANCE OF LATVIJAS BANKA**

#### **3.1 Financial position**

In 2015, Latvijas Banka's assets grew by 3 094.2 million euro, mostly on account of securities purchases for monetary policy and investment purposes.

In 2015, the ECB Governing Council made a decision on launching an expanded asset purchase programme (APP). Latvijas Banka implemented the PSPP, which is a part of the expanded APP, and under it purchased securities issued by the Latvian government and international institutions in the amount of 1 808.4 million euro, reported under the balance sheet item "Securities held for monetary policy purposes". Euro area NCBs purchased PSPP securities in proportion to their shares in the ECB's capital.

An increase in the assets under the balance sheet items "Claims on non-euro area residents denominated in foreign currency", "Balances with credit institutions and security investments, external loans and other external assets", and "Other securities" basically resulted from investment activities in line with the liquidity management principles set by the ECB's Governing Council (see also Note 4).

In 2015, the amount of loans granted to credit institutions by Latvijas Banka as a result of monetary policy operations (mostly targeted longer-term refinancing operations) grew by 178.2 million euro.

Other claims related to other operational requirements within the Eurosystem grew by 409.3 million euro, mostly on account of a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2015, banknotes in circulation increased by 143.3 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs. The outstanding amount of non-exchanged lats banknotes (71.3 million euro at the end of 2015), reported under the balance sheet item "Banknotes in circulation" at the end of 2014, is reported under the balance sheet item "Other liabilities".

At the end of 2015, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", increased by 2 361.1 million euro.

Mostly as a result of cross-border payments made by credit institutions and Latvijas Banka, liabilities to the ECB for the settlement result in TARGET2, reported under the balance sheet item "Intra-Eurosystem liabilities", increased to 1 312.1 million euro (797.0 million euro at the end of 2014).

Capital and reserves of Latvijas Banka decreased by 27.5 million euro on account of net changes in valuation of financial instruments (33.7 million euro) and the share of profits earned in 2014 and remitted to the state budget revenue in the amount of 23.9 million euro, while profits earned in 2015 had an increasing effect (30.0 million euro).

#### **3.2 Financial performance**

In 2015, Latvijas Banka's profit amounted to 30.0 million euro (36.8 million euro in 2014). Net interest income in 2015 grew by 6.2 million euro as compared to 2014.

A 14.6 million euro increase in interest income resulted from a 7.4 million euro rise in interest income on investment on account of higher investment amounts and an expanding share of higher yield financial instruments in the total amount of investment. Interest income on monetary operations grew by 8.0 million euro, basically as a result of PSPP securities purchases in 2015 and an increase in negative interest received on credit institution demand deposits.

An 8.4 million euro increase in interest expense was mostly a result of a rise in interest expense on investment in relation to the transactions carried out by Latvijas Banka for the purpose of hedging currency risk.

In 2015, realised gains from financial operations were 26.1 million euro higher than in 2014 on account of the result of currency future contracts concluded for the purpose of hedging currency risk and the result of interest rate future contracts. In view of Latvijas Banka hedging the risks related to gold price and foreign exchange fluctuations, the revaluation result of the respective hedged balance sheet items is reported under the balance sheet item "Capital and reserves". The realised gains from financial operations were positively affected by the result of the recognition of a part of the initial valuation account balance in profit and loss statement.

The recognition of the revaluation result on financial assets and positions in profit and loss statement amounted to 13.6 million euro on account of a rise in USD interest rates at the end of 2015.

The provisions established by the Council of Latvijas Banka for market risk and credit risk in 2015 were 20.5 million euro higher than in 2014, mainly as a result of an increase in the amount of investment as well as changes in the investment structure during 2015.

Pursuant to the Statute of the ESCB and of the ECB, the income generated by euro area NCBs through the implementation of the single monetary policy of the Eurosystem is allocated to euro area NCBs in proportion to their shares in the ECB's capital. In 2015, Latvijas Banka's net result of pooling of monetary income was 25.7 million euro.

Total recognised financial result, including changes in the "Valuation account" balance, decreased by 50.9 million euro, predominantly as a result of a 42.7 million euro fall in the result of the revaluation of

securities due to higher interest rates in Latvijas Banka's major investment markets (excluding the euro area) compared to 2014.

Latvijas Banka's future financial performance will be mostly affected by the monetary policy pursued by the Eurosystem and by interest rate developments in the financial markets of the euro area and US since Latvijas Banka is exposed to interest rate risk.

#### 4. FINANCIAL INVESTMENT POLICY

Investments are managed in compliance with the basic principles set out in the Procedure adopted by the Council of Latvijas Banka, inter alia preserving the value of investments, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting the monetary policy implemented by the Eurosystem.

Investments include assets reported under the balance sheet items "Gold and gold receivables", "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Other claims on euro area credit institutions denominated in euro" and "Other securities", as well as derivative financial instruments and spot exchange rate contracts whose book value is reported under relevant balance sheet items of other assets or other liabilities.

Investments are managed by classifying them into different investment portfolios by investment strategy and source of funding. Portfolios of borrowed funds include investments which correspond to Latvijas Banka's liabilities in foreign currencies to government or government deposits. Investments that are not included in the portfolios of borrowed funds (net investments) are included in the portfolios of 1–3 year fixed income securities, 1–10 year government fixed income securities, mortgage-backed securities, long-term fixed income securities, and other portfolios. A part of investments included in the 1–3 year fixed income securities portfolios and mortgage-backed securities portfolios are managed by external investment managers.

The parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for the 1–3 year fixed income securities, 1–10 year government fixed income securities and mortgage-backed securities portfolios and portfolios of borrowed funds.

The breakdown of investments by type of investment portfolio at the end of 2015 and 2014 was as follows:

	Portfolio value (in thousands of euro)		Proportion (%)	
	2015	2014	2015	2014
1–3 year fixed income securities portfolios	<b>3 561 588</b>	3 665 508	<b>68.5</b>	82.5
Mortgage-backed securities portfolios	<b>536 233</b>	267 672	<b>10.3</b>	6.0
1–10 year government fixed income securities portfolio	<b>371 829</b>	–	<b>7.2</b>	–
Long-term fixed income securities portfolio	<b>299 195</b>	149 843	<b>5.8</b>	3.4
Gold portfolio	<b>222 411</b>	211 846	<b>4.3</b>	4.8
Portfolios of borrowed funds	<b>155 228</b>	144 579	<b>3.0</b>	3.3
Latvian government securities portfolio	<b>49 323</b>	–	<b>0.9</b>	–
<b>Total</b>	<b>5 195 807</b>	4 439 448	<b>100.0</b>	100.0

The 1–3 year fixed income securities portfolio benchmark at the end of 2015 was the weighted 1–3 year government securities index of the UK, the US, euro area countries, Japan and Canada. In 2015, the government securities indices of Denmark and Singapore were excluded from the 1–3 year fixed income securities portfolio benchmark.

The mortgage-backed securities portfolio benchmark was the US mortgage-backed securities index.

In 2015, Latvijas Banka established a 1–10 year government fixed income securities portfolio; its benchmark was the weighted 1–10 year government fixed income securities index of the UK, the US, euro area countries, Japan and Canada.

The long-term fixed income securities portfolio comprises euro denominated government bonds of euro area governments included in the 1–3 year government securities index with the long-term credit rating from AA–/AA–/Aa3 to AAA/AAA/Aaa.

The benchmark for borrowed fund portfolios is formed in compliance with the parameters of respective liabilities.

In 2015, Latvijas Banka established the Latvian government securities portfolio comprising euro denominated Latvian government bonds with term to maturity of 5–10 years at the time of acquisition.

Latvijas Banka's investment benchmark currency is the euro, except for portfolios of borrowed funds, thus limiting the currency risk. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the currency of respective liabilities.

Following the liquidity management principles set by the ECB's Governing Council, the value of the investment portfolios has increased by 756.4 million euro in comparison with the end of 2014.

The description of the main methods used in financial risk management is provided in Note 25.1.

## BALANCE SHEET NOTES

### 5. ASSETS AT FAIR VALUE

Fair value of Latvijas Banka's assets is determined using the following hierarchy (see also Note 2.3):

– quoted market price. Fair value is determined using quoted prices for identical financial instruments in active markets;

– observable data. Fair value is determined using quoted prices for similar financial instruments in active markets, quoted prices for similar or identical financial instruments in inactive markets or using models where all significant inputs are observable;

– non-observable data. Fair value is determined using a model where significant inputs are non-observable.

At the end of 2015 and 2014, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2015 and 2014, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value method (see also Note 14.2).

At the end of 2015 and 2014, the breakdown of assets carried at fair value according to the fair value hierarchy was as follows:

	(in thousands of euro)			
	Quoted market price	Observable data	Non- observable data	Total
<b>As at 31 December 2015</b>				
Gold	207 670	–	–	207 670
Debt securities	3 736 100	484 277	–	4 220 377
Participating interest in the Bank for International Settlements	–	–	30 699	30 699
Interest rate swap arrangements	–	137	–	137
<b>Total</b>	<b>3 943 770</b>	<b>484 414</b>	<b>30 699</b>	<b>4 458 883</b>
<b>As at 31 December 2014</b>				
Gold	210 774	–	–	210 774
Debt securities	3 231 897	527 134	–	3 759 031
Participating interest in the Bank for International Settlements	–	–	28 176	28 176
<b>Total</b>	<b>3 442 671</b>	<b>527 134</b>	<b>28 176</b>	<b>3 997 981</b>

The debt securities, including accrued interest income on the above securities are reported under the balance sheet items "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Securities of euro area residents denominated in euro" and "Other assets".

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems Bloomberg and Interactive Data (quoted market price if the market of the respective financial instrument is active; observable data if the market is inactive). Where the above quoted price for a financial instrument is absent in the electronic information systems and the market for the financial instrument is inactive, the price provided by a market participant or the discounted cash flow is used for evaluating the financial instrument (observable data).

## 6. GOLD AND GOLD RECEIVABLES

	Troy ounces	In thousands of euro
As at 31 December 2013	248 706	217 923
During 2014		
Transfer of gold reserves to the European Central Bank	-35 322	-30 774
Increase in gold market value	x	23 625
As at 31 December 2014	213 384	210 774
During 2015		
Decrease in gold market value	x	-3 104
<b>As at 31 December 2015</b>	<b>213 384</b>	<b>207 670</b>

Latvijas Banka hedges the risk related to gold price fluctuations by entering into forward exchange rate contracts, currency swap arrangements, and currency future contracts (see Notes 3.2 and 26). Revaluation of gold and gold receivables, forward exchange rate contracts, and currency swap arrangements is recognised under the balance sheet item "Capital and reserves" as the revaluation reserve, whereas revaluation of currency future contracts, taking into account that they are settled, is recognised under the profit and loss statement item "Realised gains arising from financial operations".

At the end of 2015 and 2014, Latvijas Banka had no gold receivables.

## 7. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

### 7.1 Receivables from the International Monetary Fund

Pursuant to the Law On the Republic of Latvia Joining the International Monetary Fund, Latvijas Banka serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in euro comprise promissory notes issued by the Latvian government, Account No. 1 used for financial transactions with the IMF, and Account No. 2 used for the IMF administrative expenditure and receipts.

Latvia's claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian government promissory note issued to the IMF and is recorded as an asset denominated in SDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in euro and IMF allocations. At the end of 2015, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 153 780 thousand euro (144 069 thousand euro at the end of 2014), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 474 thousand euro (444 thousand euro at the end of 2014) held on its Accounts No. 1 and No. 2 (see also Note 19).



At the end of 2015 and 2014, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2015	2014	2015	2014
Latvia's quota in the International Monetary Fund	<b>180 864</b>	169 440	<b>142 100</b>	142 100
International Monetary Fund holdings in euro	<b>-180 816</b>	-169 395	<b>-142 062</b>	-142 062
Promissory notes of the Latvian government	-180 342	-168 950	-141 690	-141 690
Account No. 1	-452	-424	-355	-355
Account No. 2	-22	-21	-17	-17
Reserve position in the International Monetary Fund	<b>70</b>	66	55	55
SDR	<b>153 780</b>	144 069	<b>120 821</b>	120 823
General allocation	<b>-119 640</b>	-112 083	<b>-93 998</b>	-93 998
Special allocation	<b>-34 141</b>	-31 985	<b>-26 824</b>	-26 824
Latvia's net receivables from the International Monetary Fund	<b>69</b>	67	<b>54</b>	56

The reserve position in the IMF is the difference between Latvia's quota in the IMF and the IMF holdings in euro, excluding the balance on Account No. 2.

## 7.2 Balances with credit institutions and security investments, external loans and other external assets

	(in thousands of euro)	
	2015	2014
Debt securities	<b>2 589 637</b>	2 108 735
Demand deposits	<b>169 439</b>	132 373
Reverse repurchase agreements	<b>37 108</b>	56 173
Foreign currency in cash	<b>15</b>	18
Total	<b>2 796 199</b>	2 297 299

## 8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	(in thousands of euro)	
	2015	2014
Debt securities	<b>538 707</b>	482 752
Demand deposits	<b>2 366</b>	3 490
Total	<b>541 073</b>	486 242

## 9. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO

	(in thousands of euro)	
	2015	2014
Debt securities	<b>164 168</b>	203 266
Demand deposits	<b>5 322</b>	11 687
Total	<b>169 490</b>	214 953

## 10. LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

At the end of 2015, the total amount of Eurosystem loans in monetary policy operations reached 558 989 million euro (630 341 million euro at the end of 2014), including 263.7 million euro (85.5 million euro at the end of 2014) of loans granted by Latvijas Banka. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are allocated among euro area NCBs in proportion to their share in the ECB's capital (see Note 2.27).

### 10.1 Main refinancing operations

Main refinancing operations are open market operations executed through liquidity providing reverse transactions, conducted through weekly standard tenders with a maturity of one week. These operations play a key role in steering interest rates, managing market liquidity and signalling the monetary policy stance. At the end of 2014 and 2015, Latvijas Banka had granted no loans in main refinancing operations.

### 10.2 Longer-term refinancing operations

Longer-term refinancing operations are open market operations with a maturity of over 1 week, executed through reverse transactions with the aim to provide credit institutions with additional longer-term refinancing. At the end of 2015, the balance of longer-term refinancing operations conducted by Latvijas Banka stood at 10 000 thousand euro (0 at the end of 2014). Following the decision of the Governing Council of the ECB, targeted longer-term refinancing operations were launched in September 2014. These liquidity providing reverse operations are conducted by way of a fixed-rate tender procedure aiming to promote lending to households and non-financial corporations by credit institutions in euro area countries. At the end of 2015, the balance of the targeted longer-term refinancing operations conducted by Latvijas Banka stood at 253 730 thousand euro; these operations will mature on 26 September 2018 (at the end of 2014 the balance was 85 520 thousand euro, with 26 September 2018 being the date of maturity).

## 11. OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Other claims on euro area credit institutions denominated in euro include demand deposits in euro with euro area credit institutions amounting to 2 491 thousand euro at the end of 2015 (885 thousand euro at the end of 2014). At the end of 2014, Latvijas Banka's pledged assets for providing collateral for transactions in financial derivatives were included in this item, with the book value and market value of the pledged assets amounting to 3 590 thousand euro.

## 12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

In 2015 Latvijas Banka purchased securities issued by the Latvian government and international institutions under the PSPP; as a result, the balance sheet item "Securities held for monetary policy purposes" grew by 1 808.4 million euro.

Securities held for monetary policy purposes and securities held to maturity are measured at amortised cost. The table presents the book value of the PSPP securities and those of other euro area residents purchased by Latvijas Banka and comparison with their fair value at the end of 2015 and 2014, measured on the basis of a quoted market price in an active market (see also Note 5).

	(in thousands of euro)			
	Book value		Fair value	
	2015	2014	2015	2014
Securities held for monetary policy purposes	<b>1 808 374</b>	–	<b>1 798 721</b>	–
Latvian government securities	472 158	–	466 374	–
Securities issued by international institutions	1 336 216	–	1 332 347	–
Other securities	<b>1 207 059</b>	1 095 446	<b>1 223 569</b>	1 115 482
Securities not held to maturity	909 992	947 138	909 992	947 138
Securities held to maturity	297 067	148 308	313 577	168 344
<b>Total</b>	<b>3 015 433</b>	1 095 446	<b>3 022 290</b>	1 115 482

### 13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (–)

		(in thousands of euro)	
	Note	2015	2014
Participating interest in the European Central Bank	13.1	<b>115 082</b>	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	<b>163 480</b>	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	<b>3 495 103</b>	3 079 370
Claims related to other operational requirements within the Eurosystem	13.5	<b>28 931</b>	35 343
<b>Total intra-Eurosystem claims</b>		<b>3 802 596</b>	3 393 275
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	<b>–1 312 104</b>	–796 980
<b>Total intra-Eurosystem liabilities</b>		<b>–1 312 104</b>	–796 980
<b>Total intra-Eurosystem claims (net)</b>		<b>2 490 492</b>	2 596 295

#### 13.1 Participating interest in the European Central Bank

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, Latvijas Banka's ECB capital key is calculated on the basis of Latvia's population and gross domestic product data. The NCB capital keys are adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States. Since 1 January 2014 Latvijas Banka's ECB capital key is 0.2821%, equivalent to 30 537 thousand euro.

The Statute of the ESCB and of the ECB stipulates that a euro area NCB shall pay up its subscribed share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the valuation account for financial instruments, in proportion to its share in the ECB's capital. As of 1 January 2014, participating interest in the ECB consists of the paid up shares in the amount of 30 537 thousand euro in the ECB's capital, transfers to the financial instrument revaluation account amounting to 42 752 thousand euro and the difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro (see also Note 13.2).

ECB's capital shares are not traded in the public securities market, and Latvijas Banka's participating interest in the ECB can be increased or decreased only in the cases referred to in this Note.

	2015	2014
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	<b>10 825 007</b>	<b>10 825 007</b>
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	<b>30 537</b>	<b>30 537</b>
The percentage share of Latvijas Banka in the European Central Bank's capital (%)	<b>0.2821</b>	<b>0.2821</b>

At the end of 2015 and 2014, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	(%)	
	2015	2014
Nationale Bank van België/Banque Nationale de Belgique	<b>2.4778</b>	2.4778
Deutsche Bundesbank	<b>17.9973</b>	17.9973
Eesti Pank	<b>0.1928</b>	0.1928
Banc Ceannais na hÉireann/Central Bank of Ireland	<b>1.1607</b>	1.1607
Bank of Greece	<b>2.0332</b>	2.0332
Banco de España	<b>8.8409</b>	8.8409
Banque de France	<b>14.1792</b>	14.1792
Banca d'Italia	<b>12.3108</b>	12.3108
Central Bank of Cyprus	<b>0.1513</b>	0.1513
Latvijas Banka	<b>0.2821</b>	0.2821
Lietuvos bankas	<b>0.4132</b>	–
Banque centrale du Luxembourg	<b>0.203</b>	0.203
Bank Ċentrali ta' Malta/Central Bank of Malta	<b>0.0648</b>	0.0648
De Nederlandsche Bank	<b>4.0035</b>	4.0035
Oesterreichische Nationalbank	<b>1.9631</b>	1.9631
Banco de Portugal	<b>1.7434</b>	1.7434
Banka Slovenije	<b>0.3455</b>	0.3455
Národná banka Slovenska	<b>0.7725</b>	0.7725
Suomen Pankki – Finlands Bank	<b>1.2564</b>	1.2564
Subtotal for euro area NCBs	<b>70.3915</b>	69.9783
Българска народна банка (Bulgarian National Bank)	<b>0.8590</b>	0.8590
Česká národní banka	<b>1.6075</b>	1.6075
Danmarks Nationalbank	<b>1.4873</b>	1.4873
Hrvatska narodna banka	<b>0.6023</b>	0.6023
Lietuvos bankas	–	0.4132
Magyar Nemzeti Bank	<b>1.3798</b>	1.3798
Narodowy Bank Polski	<b>5.123</b>	5.123
Banca Națională a României	<b>2.6024</b>	2.6024
Sveriges Riksbank	<b>2.2729</b>	2.2729
Bank of England	<b>13.6743</b>	13.6743
Subtotal for non-euro area NCBs	<b>29.6085</b>	30.0217
Total	<b>100.0000</b>	100.0000

In 2015, the subscribed capital of the ECB remained unchanged. Lietuvos bankas joining the Eurosystem resulted in an increase of 43 052 thousand euro in the ECB's total paid-up capital.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2015 and 2014 were as follows:  
(in thousands of euro)

	Subscribed capital		Paid-up capital	
	2015	2014	2015	2014
Nationale Bank van België/ Banque Nationale de Belgique	268 222	268 222	268 222	268 222
Deutsche Bundesbank	1 948 209	1 948 209	1 948 209	1 948 209
Eesti Pank	20 871	20 871	20 871	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	125 646	125 646	125 646	125 646
Bank of Greece	220 094	220 094	220 094	220 094
Banco de España	957 028	957 028	957 028	957 028
Banque de France	1 534 899	1 534 899	1 534 899	1 534 899
Banca d'Italia	1 332 645	1 332 645	1 332 645	1 332 645
Central Bank of Cyprus	16 378	16 378	16 378	16 378
Latvijas Banka	30 537	30 537	30 537	30 537
Lietuvos bankas	44 729	–	44 729	–
Banque centrale du Luxembourg	21 975	21 975	21 975	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	7 015	7 015	7 015	7 015
De Nederlandsche Bank	433 379	433 379	433 379	433 379
Oesterreichische Nationalbank	212 506	212 506	212 506	212 506
Banco de Portugal	188 723	188 723	188 723	188 723
Banka Slovenije	37 400	37 400	37 400	37 400
Národná banka Slovenska	83 623	83 623	83 623	83 623
Suomen Pankki – Finlands Bank	136 005	136 005	136 005	136 005
Subtotal for euro area NCBs	7 619 885	7 575 156	7 619 885	7 575 156
Българска народна банка (Bulgarian National Bank)	92 987	92 987	3 487	3 487
Česká národní banka	174 012	174 012	6 525	6 525
Danmarks Nationalbank	161 000	161 000	6 038	6 038
Hrvatska narodna banka	65 199	65 199	2 445	2 445
Lietuvos bankas	–	44 729	–	1 677
Magyar Nemzeti Bank	149 363	149 363	5 601	5 601
Narodowy Bank Polski	554 565	554 565	20 796	20 796
Banca Națională a României	281 710	281 710	10 564	10 564
Sveriges Riksbank	246 042	246 042	9 227	9 227
Bank of England	1 480 244	1 480 244	55 509	55 509
Subtotal for non-euro area NCBs	3 205 122	3 249 851	120 192	121 869
Total	10 825 007	10 825 007	7 740 077	7 697 025

### 13.2 Claims equivalent to the transfer of foreign reserves to the European Central Bank

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs shall transfer a definite amount of their foreign reserves to the ECB. The amount of foreign reserves to be transferred shall be fixed in proportion to the each euro area NCB's percentage share in the ECB's capital. For the foreign reserves transferred to the ECB Latvijas Banka received a euro-denominated claim on the ECB in the amount of 163 480 thousand euro, i.e. in proportion to the value of the respective claims of other euro area NCBs. The difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro is reported as participating interest in the ECB (see also Note 13.1). For the foreign reserves transferred to the ECB Latvijas Banka receives interest income calculated at the interest rate on the main refinancing operations set by the ECB (see also Note 33).

### 13.3 Claims/liabilities related to TARGET2 and national central bank correspondent accounts (net)

TARGET2 system is a real-time gross settlement system for large value payments in euro. Claims and liabilities related to TARGET2 settlements originate as a result of cross-border payments settled in the central bank money. The above settlements result in bilateral claims and liabilities in the TARGET2 accounts held by NCBs. The net positions for the bilateral balances are attributed to the ECB and calculated on a daily basis, leaving each NCB with a single net position vis-à-vis the ECB. This is reported on the NCB's balance sheet as net claims or liabilities related to TARGET2 settlements.

In 2015, liabilities related to TARGET2 and national central bank correspondent accounts (net) increased as a result of the cross-border payments effected by credit institutions and Latvijas Banka.

Interest is paid on the above claims and liabilities as per the rate on the main refinancing operations set by the ECB.

### 13.4 Claims for the allocation of banknotes in the Eurosystem

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a definite share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. Of the total amount of euro banknotes issued, the share allocated to Latvijas Banka is larger than the amount of euro banknotes it has actually issued (see Note 15); in view of the above, the adjustment related to banknotes in circulation results in corresponding claims on the ECB for the allocation of banknotes, reported under the balance sheet item "Claims related to other operational requirements within the Eurosystem" (see Note 13).

### 13.5 Claims related to other operational requirements within the Eurosystem

Claims related to other operational requirements within the Eurosystem comprise claims on the ECB associated with the net result of pooling of monetary income and the ECB's interim profit distribution.

Monetary income received by Latvijas Banka in 2015 was higher than its monetary income pooled. It resulted in a claim on the ECB associated with the net result of pooling of monetary income, standing at 25 675 thousand euro at the end of 2015 (see also Notes 2.27 and 38).

Claims for the ECB's interim profit distribution in the amount of 3 255 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (see also Notes 2.26 and 37).

## 14. OTHER ASSETS

		(in thousands of euro)	
	Note	2015	2014
OTC financial derivative contracts and spot exchange rate contracts	24	47 561	2 638
Accrued income on debt securities		44 421	17 871
Fixed assets	14.1	38 844	40 256
Participating interest in the Bank for International Settlements	14.2	30 699	28 176
Intangible assets	14.3	1 908	1 815
Other accrued income		1 161	391
Prepaid expenses		1 056	875
Other		575	433
Total		166 225	92 455

## 14.1 Fixed assets

(in thousands of euro)

	Buildings, improve-ment of territory, and land	Furniture and office equip-ment	Computer and telecom-muni-cation equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
<b>As at 31 December 2013</b>							
Cost	59 071	5 144	4 739	7 021	1 660	8 055	85 690
Accumulated depreciation	-22 833	-3 990	-3 597	-4 475	-1 203	-6 621	-42 719
Net book value	36 238	1 154	1 142	2 546	457	1 434	42 971
<b>During 2014</b>							
Additions	212	82	832	356	65	86	1 633
Change in classification	-	-179	-	179	-	-	-
Disposals and write-offs	-2 026	-50	-548	-113	-84	-284	-3 105
Net change in cost	-1 814	-147	284	422	-19	-198	-1 472
Depreciation charge	-2 139	-144	-387	-430	-62	-307	-3 469
Change in classification	-	178	-	-178	-	-	-
Accumulated depreciation on disposals and write-offs	1 167	47	547	113	84	268	2 226
Net change in accumulated depreciation	-972	81	160	-495	22	-39	-1 243
<b>As at 31 December 2014</b>							
Cost	57 257	4 997	5 023	7 443	1 641	7 857	84 218
Accumulated depreciation	-23 805	-3 909	-3 437	-4 970	-1 181	-6 660	-43 962
Net book value	33 452	1 088	1 586	2 473	460	1 197	40 256
<b>During 2015</b>							
Additions	739	65	591	192	143	404	2 134
Disposals and write-offs	-39	-101	-343	-715	-26	-445	-1 669
Net change in cost	700	-36	248	-523	117	-41	465
Depreciation charge	-2 053	-129	-504	-423	-71	-288	-3 468
Accumulated depreciation on disposals and write-offs	22	98	340	662	25	444	1 591
Net change in accumulated depreciation	-2 031	-31	-164	239	-46	156	-1 877
<b>As at 31 December 2015</b>							
Cost	57 957	4 961	5 271	6 920	1 758	7 816	84 683
Accumulated depreciation	-25 836	-3 940	-3 601	-4 731	-1 227	-6 504	-45 839
<b>Net book value</b>	<b>32 121</b>	<b>1 021</b>	<b>1 670</b>	<b>2 189</b>	<b>531</b>	<b>1 312</b>	<b>38 844</b>

At the end of 2015 and 2014, the total cadastral value of land under the ownership and possession of Latvijas Banka was 2 962 thousand euro. Land is reported in the balance sheet of Latvijas Banka at cost (2 375 thousand euro at the end of 2015 and 2014).

At the end of 2015, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 767 thousand euro (18 thousand euro at the end of 2014).

A small share of Latvijas Banka's fixed assets (premises and equipment) are given on lease. Asset lease agreements where Latvijas Banka acts as a lessor are operating leases, therefore the assets given on lease are reported as fixed assets in Latvijas Banka's balance sheet. Lease payments, except those that are directly transferred to the state budget, are recognised in the profit and loss statement proportionally over the term of the

respective agreement. The depreciation of the assets given on lease is calculated on the basis of the depreciation policy described in Note 2.17 and reported in the profit and loss statement as depreciation charges.

#### **14.2 Participating interest in the Bank for International Settlements**

At the end of 2015 and 2014, Latvijas Banka owned 1 070 shares in the BIS, which corresponded to 0.19% of the total subscribed and paid-up BIS capital.

The total nominal value of Latvijas Banka's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1 338 thousand SDR or 25% (see also Note 46). At the end of 2015 and 2014, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka's management, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest published financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at the Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2015, the fair value of BIS shares was 30 699 thousand euro (28 176 thousand euro at the end of 2014).

#### **14.3 Intangible assets**

	(in thousands of euro)
<hr/>	
As at 31 December 2013	
Cost	6 239
Accumulated amortisation	-5 582
Net book value	<hr/> 657
<hr/>	
During 2014	
Additions	1 374
Amortisation charge	-216
As at 31 December 2014	
Cost	7 613
Accumulated amortisation	-5 798
Net book value	<hr/> 1 815
<hr/>	
<b>During 2015</b>	
Additions	347
Derecognised intangible assets	-1 452
Net change in cost	<hr/> -1 105
Amortisation charge	-254
Accumulated amortisation on derecognised intangible assets	1 452
Net change in accumulated amortisation	<hr/> 1 198
<hr/>	
<b>As at 31 December 2015</b>	
Cost	6 508
Accumulated amortisation	-4 600
<b>Net book value</b>	<hr/> <b>1 908</b> <hr/>



## 15. BANKNOTES IN CIRCULATION

	(in thousands of euro)	
	2015	2014
Euro banknotes	3 992 436	3 771 356
Euro banknotes issued by Latvijas Banka	497 333	691 986
Adjustment for banknote allocation in the Eurosystem	3 495 103	3 079 370
Lats banknotes	–	77 814
Total	3 992 436	3 849 170

As of 1 January 2015, the lats banknotes in circulation which had not been exchanged for euro yet were excluded from the balance sheet item "Banknotes in circulation" and are reported under the balance sheet item "Other liabilities". The euro coins issued by Latvijas Banka and the non-exchanged lats coins are also reported under the balance sheet item "Other liabilities" (see also Note 22).

## 16. LIABILITIES TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

### 16.1 Current accounts (covering the minimum reserve system)

Current accounts contain the credit balances on the transaction accounts of credit institutions that are required to hold minimum reserves. Minimum reserve balances have been remunerated at the latest available interest rate used by the Eurosystem in its tenders for main refinancing operations. Since June 2014, the lower rate of either zero per cent or the ECB's deposit facility rate has been applied to the reserves held in excess of the minimum requirements. At the end of 2015, balance on the current accounts placed with Latvijas Banka was 4 784 410 thousand euro (2 073 356 thousand euro at the end of 2014), including the minimum reserves in the amount of 230.6 million euro (206.0 million euro at the end of 2014).

### 16.2 Deposit facility

Deposit facility is a standing facility of the Eurosystem used by credit institutions to place their overnight deposits at a pre-specified rate. No such deposits were placed with Latvijas Banka at the end of 2015; the amount of deposits stood at 350 000 thousand euro at the end of 2014.

## 17. OTHER LIABILITIES TO EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Other liabilities to euro area credit institutions denominated in euro resulted from funds received as collateral for forward exchange contracts accounting for 8 830 thousand euro at the end of 2015 (540 thousand euro at the end of 2014).

## 18. LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO

Liabilities to other euro area residents denominated in euro comprise demand deposits by the Latvian government and other financial institutions. Government deposits comprise the Treasury demand deposits received by Latvijas Banka acting as the financial agent of the Latvian government (see also Note 43).

Deposits of other financial institutions mostly include the funds of the FCMC and the Deposit Guarantee Fund and Fund for the Protection of the Insured, both managed by the FCMC, in the amount of 106 952 thousand euro (73 562 thousand euro at the end of 2014).

## 19. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO

Liabilities to non-euro area residents denominated in euro mostly comprise funds (in the amount of 8 423 thousand euro) received as collateral for transactions in financial derivatives at the end of 2015.

	(in thousands of euro)	
	2015	2014
Other financial institutions	8 423	490
International Monetary Fund	474	444
European Commission	202	23 052
Total	9 099	23 986

## 20. LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Liabilities to euro area residents denominated in foreign currency comprise demand deposits of the Latvian government in foreign currency standing at 155 228 thousand euro at the end of 2015 (144 579 thousand euro at the end of 2014; see also Note 43).

## 21. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

At the end of 2015, liabilities to non-euro area residents denominated in foreign currency resulted from funds received as collateral for transactions in financial derivatives (478 thousand euro at the end of 2015; 0 at the end of 2014).

## 22. OTHER LIABILITIES

		(in thousands of euro)	
	Note	2015	2014
Lats banknotes in circulation		<b>71 261</b>	–
Lats coins in circulations	22.1	<b>64 265</b>	64 741
Euro coins in circulation	22.1	<b>52 484</b>	43 742
Provisions for market risk and credit risk	36	<b>50 100</b>	14 800
OTC financial derivative contracts and spot exchange rate contracts	24	<b>14 144</b>	51 894
Accrued expense and similar liabilities		<b>5 170</b>	3 801
Tax liabilities	22.2	<b>197</b>	175
Other		<b>1 232</b>	936
Total		<b>258 853</b>	180 089

### 22.1 Coins in circulation

Apart from the lats and euro circulation coins issued by Latvijas Banka and reported on the liabilities side of the balance sheet, euro collector coins, lats collector coins and precious metal circulation coins were also in circulation with the total nominal value of 5 787 thousand euro at the end of 2015 (5 627 thousand euro at the end of 2014). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Note 2.21).

## 22.2 Tax liabilities

At the end of 2015 and 2014, tax liabilities of Latvijas Banka were as follows:

	(in thousands of euro)						
	Personal income tax	State compul- sory social security contribu- tions (by employer)	State compul- sory social security contribu- tions (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2013	–	1	–	–	207	3	211
<b>During 2014</b>							
Calculated	3 288	3 382	1 547	154	827	2	9 200
Increase in deferred liabilities	–	94	–	–	–	–	94
Paid	–3 288	–3 477	–1 547	–154	–859	–5	–9 330
Liabilities as at 31 December 2014	–	–	–	–	175	0	175
<b>During 2015</b>							
Calculated	2 969	3 518	1 462	150	840	2	8 941
Decrease in deferred liabilities	–	–239	–	–	–	–	–239
Paid	–2 969	–3 273	–1 460	–150	–826	–2	–8 680
<b>Liabilities as at 31 December 2015</b>	<b>–</b>	<b>6</b>	<b>2</b>	<b>–</b>	<b>189</b>	<b>0</b>	<b>197</b>

In addition to the tax payments indicated herein, Latvijas Banka transfers to the state budget 65% of the profit for the reporting year (23 894 thousand euro in 2015; 38 349 thousand euro in 2014; see also Notes 23 and 43). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

## 23. CAPITAL AND RESERVES

(in thousands of euro)

	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2013	35 572	244 283	131 140	58 998	469 993
<b>During 2014</b>					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	10 485	x	10 485
Profit appropriated to the state budget	x	x	x	-38 349	-38 349
Profit transferred to the reserve capital	x	20 649	x	-20 649	0
Increase in the nominal capital	64 428	-64 428	x	x	0
Profit of the reporting year	x	x	x	36 760	36 760
As at 31 December 2014	100 000	200 504	141 625	36 760	478 889
<b>During 2015</b>					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	-33 677	x	-33 677
Profit appropriated to the state budget	x	x	x	-23 894	-23 894
Profit transferred to the reserve capital	x	12 866	x	-12 866	0
Profit of the reporting year	x	x	x	30 037	30 037
<b>As at 31 December 2015</b>	<b>100 000</b>	<b>213 370</b>	<b>107 948</b>	<b>30 037</b>	<b>451 355</b>

The capital and reserves of Latvijas Banka is comprised of the nominal capital, reserve capital and the valuation account, as well as the undistributed profit of the reporting year.

The legal framework does not provide for any capital adequacy requirements for Latvijas Banka; nevertheless, the amount of its capital should be adequate to promote credibility of the monetary policy implemented by Latvijas Banka, and to ensure implementation of its operations and financial independence when performing the tasks set forth by the Statute of the ESCB and of the ECB and the Law on Latvijas Banka. The implementation of the monetary policy as well as exposure to other financial and operational risks may adversely affect Latvijas Banka's income or result in losses to be covered from the capital and reserves of Latvijas Banka.

The nominal capital of Latvijas Banka is comprised of the state-allotted resources, transfers from the reserve capital and Latvijas Banka's profit allocations.

The Law on Latvijas Banka establishes that a part of Latvijas Banka's profit of the reporting year, calculated by applying the same percentage as the tax rate set for resident corporate entities of Latvia by the Law on Corporate Income Tax, together with a payment in the amount of 50% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget, as well as that the Council of Latvijas Banka, upon approving the annual report, may make a decision on reducing the percentage share of the payment for the usage of state capital where it is necessary for increasing the reserve capital of Latvijas Banka in relation to the financial risks Latvijas Banka is exposed to when executing its tasks. At the end of 2015 and 2014, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, unless the Council of Latvijas Banka decides otherwise, 65% of Latvijas Banka's profit of the reporting year or 19 524 thousand euro year shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2015 by the Council of Latvijas Banka.

Latvijas Banka's profit remaining after making the above deductions shall be transferred to the reserve capital as prescribed by the Law on Latvijas Banka. The reserve capital shall be formed to cover potential losses.

The valuation account comprises the positive result on revaluation of the financial instruments and gold. The accounting policy, harmonised with the principal accounting policies established by the ECB's legal framework for accounting and financial reporting and described in Note 2 stipulates that the realised gains are recognised in the profit and loss statement only after the disposal of a financial instrument or settlement while unrealised gains are recorded under the balance sheet item "Capital and reserves" as the revaluation reserve, thus facilitating the preservation of the capital under the impact of financial instrument price, interest rate and exchange rate fluctuations.

In 2015 and 2014, changes in the valuation account were as follows:

	(in thousands of euro)				
	2015	Recognition in profit and loss statement	Revaluation	Realisation	2014
Initial valuation account	<b>27 952</b>	x	x	-13 543	41 495
Revaluation reserve for equity instruments	<b>28 190</b>	-	2 523	-	25 667
Result on revaluation of foreign currencies and gold	<b>25 060</b>	214	-1 438	-2 225	28 509
Result on revaluation of interest rate swap arrangements	<b>185</b>	48	137	-	-
Result on revaluation of securities	<b>26 561</b>	13 371	-14 759	-18 005	45 954
<b>Total</b>	<b>107 948</b>	13 633	-13 537	-33 773	141 625

  

	2014	Recognition in profit and loss statement	Change in clas- sification	Revaluation	Realisation	2013
Initial valuation account	41 495	x	23 055	x	-15 735	34 175
Revaluation reserve for equity instruments	25 667	-	-	-270	-	25 937
Result on revaluation of foreign currencies and gold	28 509	133	-23 055	8 350	-	43 081
Result on revaluation of securities	45 954	1 512	-	27 926	-11 431	27 947
<b>Total</b>	141 625	1 645	0	36 006	-27 166	131 140

In accordance with the ECB's legal framework for accounting and financial reporting, on 1 January 2014 Latvijas Banka reclassified the accumulated result on revaluation of foreign currencies to the initial valuation account. The initial valuation account also comprises the accumulated result on revaluation of financial instruments and gold prior to the change in the accounting policy on 1 January 2007.

The balance on the initial valuation account is recognised in the profit and loss statement to compensate lower remuneration for claims related to the banknote allocation within the Eurosystem as per the coefficients applied in accordance with the decisions of the Governing Council of the ECB for the calculation of the remuneration adjustment for claims related to the banknote allocation within the Eurosystem in the first six years after an NCB joins the Eurosystem (see Note 33). The amount to be recognised in the profit and loss statement for the respective year is calculated by multiplying the balance on the initial valuation account as at 1 January 2015 with the share of the coefficient for calculating the compensation amount for the respective year in the total coefficients (indicated in Note 33) during the transition period when the adjustment amounts for the claims on banknote allocation in the Eurosystem are calculated.

The revaluation reserve for equity instruments has been established to account for the result on revaluation of the BIS shares.

## 24. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements, forward transactions in securities, and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's investments.

(in thousands of euro)

	Contract or notional amount		Book value			
			Assets		Liabilities	
	2015	2014	2015	2014	2015	2014
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	<b>4 384 675</b>	3 451 371	<b>46 517</b>	1 693	<b>13 217</b>	51 463
Spot exchange rate contracts	<b>359 907</b>	105 401	<b>560</b>	–	<b>432</b>	289
Forward transactions in securities	<b>723 093</b>	382 093	<b>299</b>	945	<b>447</b>	142
Interest rate swap arrangements	<b>16 385</b>	6 460	<b>185</b>	x	<b>48</b>	x
<b>Total</b>	<b>x</b>	x	<b>47 561</b>	2 638	<b>14 144</b>	51 894
Traded financial derivative contracts						
Interest rate future contracts	<b>573 263</b>	439 495	<b>x</b>	x	<b>x</b>	x
Currency future contracts	<b>179 512</b>	187 615	<b>x</b>	x	<b>x</b>	x

The book value of the OTC financial derivative contracts and spot exchange rate contracts is reported under the balance sheet items "Other assets" or "Other liabilities" (see also Notes 14 and 22). Since settlement has been made for the change in the fair value of future contracts, the change is reported as demand deposits under the respective balance sheet asset item.

The reconciliation of the net book value and net fair value of OTC contracts at the end of 2015 and 2014 was as follows. Fair value is determined applying discounted cash flow approach and money market interest rates (observable data; see Note 5).

(in thousands of euro)

	Net fair value		Net book value		Difference	
	2015	2014	2015	2014	2015	2014
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	<b>30 561</b>	–50 576	<b>33 300</b>	–49 770	<b>–2 739</b>	–806
Spot exchange rate contracts	<b>129</b>	–289	<b>128</b>	–289	<b>1</b>	–
<b>Total</b>	<b>30 690</b>	–50 865	<b>33 428</b>	–50 059	<b>–2 738</b>	–806

## **MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT**

### **25. RISK MANAGEMENT**

Financial and operational risks are the main risks associated with the activities of Latvijas Banka. Management of Latvijas Banka's risks is organised and implemented according to the Risk Management Policy of Latvijas Banka approved by the Council of Latvijas Banka. Therefore, the Board of Latvijas Banka has established a risk management framework under the basic principles set forth by the Council of Latvijas Banka, which is improved in line with the developments in financial markets and operations of Latvijas Banka as well as changes in external environment. Management of Latvijas Banka's financial and operational risks is reviewed by the Internal Audit Department and is monitored by the Budget Commission of Latvijas Banka, Security Supervision Commission, and Audit Committee, each of which is comprised of Members of the Council of Latvijas Banka.

#### **25.1 Financial risks**

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks Latvijas Banka is exposed to in its daily activities.

Latvijas Banka manages financial risks related to its investments in line with the Procedure, adopted by the Council of Latvijas Banka; the basic principles of its investment policy are described in Note 4. Investments are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for each financial instrument portfolio. The Risk Management Division of the Market Operations Department monitors the investment compliance with the established requirements.

For the purpose of investment management, including management of the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves tactical decisions and sets detailed limits for financial risks, as well as oversees the operation of the external managers. The Investment Committee of Latvijas Banka reviews the investment strategy once a quarter, and on a weekly basis receives and reviews reports on and forecasts for developments in financial markets, prepared by financial investment portfolio managers, reports by financial risk managers, and approves the investment management tactical decisions for the forthcoming week. The Market Operations Department informs the Council and the Board of Latvijas Banka about the results of investment management on a regular basis.

Latvijas Banka purchases assets under the PSPP in accordance with the decisions of the ECB's Governing Council. Latvijas Banka makes the purchases and manages financial risks in line with the guidelines of the ECB's Governing Council and the procedure adopted by the Board of Latvijas Banka. Financial risks arising as a result of implementing monetary policy are shared among the euro area NCBs in proportion to their shares in the ECB's capital, except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

##### **25.1.1 Market risk**

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates).

Latvijas Banka is exposed to interest rate risk primarily due to investing in foreign debt securities and interest rate derivatives that are subject to interest rate fluctuations and used within the course of investment management. Latvijas Banka manages interest rate risk by using a modified duration limit set individually for each investment portfolio.

Latvijas Banka's exposure to currency risk is determined by its investment structure. Latvijas Banka manages currency risk by establishing that the benchmark currency is the euro, thus hedging the currency risk, and using tracking error limits in relation to the respective benchmark. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark. The aggregate market and credit risk of 1–3 year fixed income securities portfolios, government 1–10 year fixed income securities portfolios, and mortgage-backed securities portfolios (see Note 4) is managed by determining the tracking error limit. Tracking error in 2015 and 2014 is disclosed in Note 28.

For investment portfolios, except for portfolios of borrowed funds, the benchmark currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the respective currency. Deviations from the benchmark currency structure give rise to the open currency position. In order to achieve the compliance of open foreign currency positions with the limits, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

The Risk Management Division of the Market Operations Department monitors the compliance of the modified duration, tracking error, and open currency positions with the Procedure adopted by the Council of Latvijas Banka and the related resolutions passed by the Investment Committee of Latvijas Banka.

Latvijas Banka's exposure to market risk (as at the end of 2015 and 2014) is disclosed in Notes 26–28.

### **25.1.2 Credit risk**

Credit risk is exposure to losses resulting from counterparty default. Latvijas Banka's exposure to credit risk results mainly from investments in foreign financial instruments, and as a result of monetary policy operations. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are shared among euro area NCBs in proportion to their share in the ECB's capital, except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

Latvijas Banka manages exposure to credit risk related to investments made in foreign financial instruments by establishing limits on investments of different credit quality. Credit quality is evaluated on the basis of ratings assigned by the international credit rating agencies Fitch Ratings, Moody's Investors Service, Standard & Poor's, and DBRS. Latvijas Banka is allowed to invest in financial instruments of certain credit quality of the OECD countries, as well as in Latvian government securities. Limits are also set on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. Forward transactions in mortgage-backed securities are partly secured with short-term financial instruments. To hedge the credit risk associated with OTC derivative counterparties, Latvijas Banka and the respective counterparties enter into Master Agreements of International Swaps and Derivatives Association, Inc. (ISDA Master Agreement) with Credit Support Annex, and the external managers of mortgage-backed securities portfolios enter with their counterparties into Treasury Market Practices Group (TMPG) Master Securities Forward Transaction Agreements. In order to monitor Latvijas Banka's credit risk exposure associated with its investments, the Risk Management Division of the Market Operations Department monitors compliance with the Procedure, adopted by the Council of Latvijas Banka.

In 2015 and 2014, loans granted to credit institutions in monetary policy operations were secured by securities collateral in compliance with the ECB requirements. The Market Operations Department monitors the adequacy of collateral of the respective loans and its eligibility and compliance with the ECB's requirements on a regular basis, as well as maintains a list of securities issued and held in the Republic of Latvia and eligible for monetary policy operations.

Latvijas Banka's exposure to market risk (as at the end of 2015 and 2014) is disclosed in Notes 30–32.

### **25.1.3 Liquidity risk**

Liquidity risk is associated with a failure to dispose investment in a short time and at a competitive market price. Along with Latvia's participation in the euro area, the need for liquidity as well as the risk associated with a failure to meet liabilities in a timely manner has moderated. Following its investment strategy, Latvijas Banka manages liquidity risk by investing a certain amount of its investments in liquid debt securities issued by international institutions, foreign governments and the corporate sector, short-term deposits with foreign financial institutions and other financial instruments. The liquidity structure of Latvijas Banka's assets and liabilities as at the end of 2015 and 2014 is disclosed in Note 29.

Liquidity risk can be limited by investment diversification. Latvijas Banka manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same class and in financial instruments of the same issuer.

### **25.2 Operational risks**

Operational risks are related to a potential negative impact on Latvijas Banka's operation, reputation or finances resulting from inadequate or erroneous execution of processes, actions on the part of an official or employee of Latvijas Banka, inadequate operation or unavailability of the infrastructure of information systems or an information system or the infrastructure, or external events.

Latvijas Banka's operational risk management is implemented by the Board of Latvijas Banka according to the basic principles defined by the Council of Latvijas Banka. The Board of Latvijas Banka has established the Operational Risk Management Committee of Latvija Banka to coordinate, on a day-to-day basis, the activities under the operational risk management process and to provide support to the Board of Latvijas Banka on operational risk management issues. The Committee is chaired by a Member of the Board of Latvijas Banka and is composed of the Operational Risk Manager, Information Risk Manager, the Head of the Technical Support Department, and the Head of the Security Department.

The security management of the information and information systems of Latvijas Banka is organised and implemented in accordance with the Information and Information Systems Security Policy of Latvijas Banka approved by Latvijas Banka's Council. In order to ensure confidentiality, access to and integrity of information, information at Latvijas Banka is classified on the basis of its level of confidentiality and accessibility and is protected against its unauthorised processing, use or disclosure. The information systems of Latvijas Banka are classified into levels depending on their impact on the implementation of processes and the confidentiality, integrity and availability requirements regarding the processed information. The owners of Latvijas Banka's information systems in cooperation with the Information Systems Department have established rules for the usage and access rights of the information system, as well as ensure the implementation of risk analysis of the respective information system. The Head of Information Systems Department ensures that the functionality and



performance of Latvijas Banka's information system infrastructure complies with the requirements set for the information systems, as well as the infrastructure's safe and continuous operation. Latvijas Banka conducts, on a regular basis, security risk analysis of information systems and electronically stored information and improves security measures and tools.

The management of Latvijas Banka's business continuity is organised and conducted in accordance with the Business Continuity Management Policy of Latvijas Banka, approved by the Council of Latvijas Banka, abiding by the internationally recognised standards and taking into account the ECB recommendations regarding business continuity management.

Latvijas Banka conducts, on a regular basis, educational sessions for employees on information and information systems security, operational risk management and management of business continuity.

An environment protected against physical hazards is organised and ensured on the premises of Latvijas Banka and during transportation of cash and other valuables in accordance with the Physical Security Policy of Latvijas Banka, adopted by the Council of Latvijas Banka, and other legislative acts of Latvijas Banka regulating the physical security management procedure for Latvijas Banka. Fire training is organised for the staff of Latvijas Banka, and training for the employees of the Security Department to maintain and improve their qualification is organised on a regular basis.

In order to limit the implications of operational risks, Latvijas Banka is insured against a possible impact of certain types of operational risks.

In 2015, operational risks, inter alia risks related to ensuring Latvijas Banka's business continuity, information and information systems, as well as physical security were appropriately managed and did not substantially hamper Latvijas Banka's operation.

## 26. CURRENCY STRUCTURE

(in thousands of euro)

	EUR	USD	JPY	CAD	GBP	Gold	Other	Total
<b>As at 31 December 2015</b>								
Total assets	7 460 510	2 371 111	429 391	195 462	447 962	207 670	6 581	11 118 687
Total liabilities	11 011 323	77 367	11 264	177	18 517	–	39	11 118 687
Net position on balance sheet	–3 550 813	2 293 744	418 127	195 285	429 445	207 670	6 542	0
Net position on financial instruments' off-balance sheet accounts	3 588 618	–2 296 007	–417 171	–193 680	–429 807	–207 686	–10 850	33 417
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>37 805</b>	<b>–2 263</b>	<b>956</b>	<b>1 605</b>	<b>–362</b>	<b>–16</b>	<b>–4 308</b>	<b>33 417</b>
<b>Structure of the net position on balance sheet and off-balance sheet accounts (%)</b>	<b>0.3</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.3</b>
Benchmark currency structure (%)	0	0	0	0	0	0	0	0.0
<b>As at 31 December 2014</b>								
Total assets	4 928 769	1 689 358	385 456	303 995	299 815	210 774	206 341	8 024 508
Total liabilities	7 929 904	66 766	10 148	186	17 402	–	102	8 024 508
Net position on balance sheet	–3 001 135	1 622 592	375 308	303 809	282 413	210 774	206 239	0
Net position on financial instruments' off-balance sheet accounts	2 950 588	–1 618 727	–373 470	–307 431	–278 226	–210 790	–211 200	–49 256
Net position on balance sheet and off-balance sheet accounts	–50 547	3 865	1 838	–3 622	4 187	–16	–4 961	–49 256
Structure of the net position on balance sheet and off-balance sheet accounts (%)	–0.6	0.0	0.0	0.0	0.1	0.0	–0.1	–0.6
Benchmark currency structure (%)	0	0	0	0	0	0	0	0

## 27. REPRICING MATURITY

The table below reflects Latvijas Banka's assets, liabilities and off-balance sheet accounts sensitive to a change in interest rates. Items reported in this table are stated at carrying amounts, except for interest rate and currency future contracts and forward transactions in securities that are stated at notional amounts and included in off-balance sheet accounts. A nearest contractual interest repricing or residual maturity date to 31 December of the reporting year is used for categorising items reported in this table.

(in thousands of euro)

	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years	Total
<b>As at 31 December 2015</b>						
Claims on non-euro area residents denominated in foreign currency	279 286	40 846	71 092	693 441	1 700 697	2 785 362
Claims on euro area residents denominated in foreign currency	3 951	–	–	231 896	304 966	540 813
Claims on non-euro area residents denominated in euro	5 313	25 997	–	84 825	53 346	169 481
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10 000	–	–	63 210	190 520	263 730
Other claims on euro area credit institutions denominated in euro	52	–	–	–	–	52
Securities of euro area residents denominated in euro	32 328	–	30 502	264 782	2 687 820	3 015 432
Intra-Eurosystem claims	3 687 513	–	–	–	–	3 687 513
Other assets	907	695	421	8 587	33 997	44 607
<b>Total interest-sensitive assets</b>	<b>4 019 350</b>	<b>67 538</b>	<b>102 015</b>	<b>1 346 741</b>	<b>4 971 346</b>	<b>10 506 990</b>
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 784 410	–	–	–	–	4 784 410
Other liabilities to euro area credit institutions denominated in euro	8 830	–	–	–	–	8 830
Liabilities to other euro area residents denominated in euro	145 008	–	–	–	–	145 008
Liabilities to non-euro area residents denominated in euro	8 584	–	–	–	–	8 584
Liabilities to euro area residents denominated in foreign currency	155 228	–	–	–	–	155 228
Liabilities to non-euro area residents denominated in foreign currency	478	–	–	–	–	478
Intra-Eurosystem liabilities	1 312 104	–	–	–	–	1 312 104
<b>Total interest-sensitive liabilities</b>	<b>6 414 642</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>6 414 642</b>
Net position on balance sheet	–2 395 292	67 538	102 015	1 346 741	4 971 346	4 092 348
Assets on financial instruments' off-balance sheet accounts	5 369 658	–	83 793	239 720	522 505	6 215 676
Liabilities on financial instruments' off-balance sheet accounts	5 733 023	–	–	6 797	442 439	6 182 259
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>–2 758 657</b>	<b>67 538</b>	<b>185 808</b>	<b>1 579 664</b>	<b>5 051 412</b>	<b>4 125 765</b>

(continued)

(in thousands of euro)

	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years	Total
As at 31 December 2014						
Total interest-sensitive assets	4 357 637	93 543	53 358	1 595 893	1 365 910	7 466 341
Total interest-sensitive liabilities	3 295 281	–	–	–	–	3 295 281
Net position on balance sheet	1 062 356	93 543	53 358	1 595 893	1 365 910	4 171 060
Assets on financial instruments' off-balance sheet accounts	4 004 686	–	–	280 929	283 887	4 569 502
Liabilities on financial instruments' off-balance sheet accounts	4 364 440	9 884	1 235	1 977	241 222	4 618 758
Net position on balance sheet and off-balance sheet accounts	702 602	83 659	52 123	1 874 845	1 408 575	4 121 804

## 28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–3 year fixed income securities and 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark (see also Note 25.1). At the end of 2015 and 2014, the actual (ex-post) tracking errors of the 1–3 year fixed income securities portfolios were 25 basis points and 19 basis points respectively, whereas the tracking errors of the mortgage-backed securities portfolios were 76 basis points and 66 basis points respectively. The actual (ex-post) tracking error of the 1–10 year government fixed income securities portfolio was 37 basis points at the end of 2015.

The expected (ex-ante) tracking error lay within the following basis point intervals during the year:

	Book value (at the end of the year; in thousands of euro)	Expected tracking error (number of business days)		
		10–39	40–69	70–99
<b>During 2015</b>				
1–3 year fixed income securities portfolios	3 561 588	250	–	–
Mortgage-backed securities portfolios	536 233	60	165	25
1–10 year government fixed income securities portfolio	371 829	63	–	–
<b>During 2014</b>				
1–3 year fixed income securities portfolios	3 665 508	249	–	–
Mortgage-backed securities portfolios	267 672	–	41	208

## 29. LIQUIDITY STRUCTURE

In the liquidity structure, asset items are reported on the basis of Latvijas Banka's capability to convert them into cash. Liabilities items are reported by their expected settlement date.

	(in thousands of euro)			
	Up to 3 months	Over 3 months	No fixed maturity	<b>Total</b>
<b>As at 31 December 2015</b>				
<b>Assets</b>				
Gold and gold receivables	207 670	–	–	<b>207 670</b>
Claims on non-euro area residents denominated in foreign currency	2 949 979	–	–	<b>2 949 979</b>
Claims on euro area residents denominated in foreign currency	541 073	–	–	<b>541 073</b>
Claims on non-euro area residents denominated in euro	169 490	–	–	<b>169 490</b>
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10 000	253 730	–	<b>263 730</b>
Other claims on euro area credit institutions denominated in euro	2 491	–	–	<b>2 491</b>
Securities of euro area residents denominated in euro	3 015 433	–	–	<b>3 015 433</b>
Intra-Eurosystem claims	28 931	–	3 773 665	<b>3 802 596</b>
Other assets	93 143	–	73 082	<b>166 225</b>
<b>Total assets</b>	<b>7 018 210</b>	<b>253 730</b>	<b>3 846 747</b>	<b>11 118 687</b>
<b>Liabilities</b>				
Banknotes in circulation	–	–	3 992 436	<b>3 992 436</b>
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 784 410	–	–	<b>4 784 410</b>
Other liabilities to euro area credit institutions denominated in euro	8 830	–	–	<b>8 830</b>
Liabilities to other euro area residents denominated in euro	145 894	–	–	<b>145 894</b>
Liabilities to non-euro area residents denominated in euro	9 099	–	–	<b>9 099</b>
Liabilities to euro area residents denominated in foreign currency	155 228	–	–	<b>155 228</b>
Liabilities to non-euro area residents denominated in foreign currency	478	–	–	<b>478</b>
Intra-Eurosystem liabilities	1 312 104	–	–	<b>1 312 104</b>
Other liabilities	70 819	–	188 034	<b>258 853</b>
<b>Total liabilities</b>	<b>6 486 862</b>	<b>–</b>	<b>4 180 470</b>	<b>10 667 332</b>
<b>Net position on balance sheet</b>	<b>531 348</b>	<b>253 730</b>	<b>–333 723</b>	<b>x</b>

*(continued)*

(in thousands of euro)

	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2014				
<b>Assets</b>				
Gold and gold receivables	210 774	–	–	210 774
Claims on non-euro area residents denominated in foreign currency	2 441 368	–	–	2 441 368
Claims on euro area residents denominated in foreign currency	486 242	–	–	486 242
Claims on non-euro area residents denominated in euro	214 953	–	–	214 953
Lending to euro area credit institutions related to monetary policy operations denominated in euro	–	85 520	–	85 520
Other claims on euro area credit institutions denominated in euro	4 475	–	–	4 475
Securities of euro area residents denominated in euro	1 095 446	–	–	1 095 446
Intra-Eurosystem claims	35 343	–	3 357 932	3 393 275
Other assets	21 264	–	71 191	92 455
<b>Total assets</b>	<b>4 509 865</b>	<b>85 520</b>	<b>3 429 123</b>	<b>8 024 508</b>
<b>Liabilities</b>				
Banknotes in circulation	–	–	3 849 170	3 849 170
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	2 423 356	–	–	2 423 356
Other liabilities to euro area credit institutions denominated in euro	540	–	–	540
Liabilities to other euro area residents denominated in euro	126 919	–	–	126 919
Liabilities to non-euro area residents denominated in euro	23 986	–	–	23 986
Liabilities to euro area residents denominated in foreign currency	144 579	–	–	144 579
Intra-Eurosystem liabilities	796 980	–	–	796 980
Other liabilities	71 580	–	108 509	180 089
<b>Total liabilities</b>	<b>3 587 940</b>	<b>–</b>	<b>3 957 679</b>	<b>7 545 619</b>
<b>Net position on balance sheet</b>	<b>921 925</b>	<b>85 520</b>	<b>–528 556</b>	<b>x</b>

### 30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2015	2014	2015	2014
European Central Bank	<b>3 802 877</b>	3 393 621	<b>34.2</b>	42.3
Central governments and other governmental institutions	<b>2 863 088</b>	1 728 885	<b>25.8</b>	21.5
Other financial institutions	<b>2 759 574</b>	1 391 751	<b>24.7</b>	17.3
Central banks and credit institutions	<b>1 296 377</b>	1 049 801	<b>11.7</b>	13.1
International institutions	<b>260 690</b>	326 059	<b>2.3</b>	4.1
Local governments	<b>85 998</b>	76 882	<b>0.8</b>	1.0
Non-financial corporations	<b>8 840</b>	14 403	<b>0.1</b>	0.2
Unclassified assets	<b>41 243</b>	43 106	<b>0.4</b>	0.5
<b>Total</b>	<b>11 118 687</b>	8 024 508	<b>100.0</b>	100.0

### 31. ASSETS BY THEIR LOCATION OR THE COUNTERPARTY'S DOMICILE

	Amount (in thousands of euro)		Proportion (%)	
	2015	2014	2015	2014
European Central Bank	<b>3 802 877</b>	3 393 621	<b>34.2</b>	42.3
Euro area countries	<b>3 859 903</b>	1 681 741	<b>34.7</b>	21.0
US	<b>1 137 245</b>	531 739	<b>10.2</b>	6.6
UK	<b>731 428</b>	630 096	<b>6.6</b>	7.9
Japan	<b>487 442</b>	407 393	<b>4.4</b>	5.1
Canada	<b>285 628</b>	380 999	<b>2.6</b>	4.7
Other European Union countries	<b>182 897</b>	346 537	<b>1.6</b>	4.3
Other countries and international institutions	<b>631 267</b>	652 382	<b>5.7</b>	8.1
<b>Total</b>	<b>11 118 687</b>	8 024 508	<b>100.0</b>	100.0

### 32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2015	2014	2015	2014
European Central Bank	<b>3 802 877</b>	3 393 621	<b>34.2</b>	42.3
AAA	<b>2 007 854</b>	2 115 702	<b>18.1</b>	26.4
AA	<b>3 664 525</b>	1 845 629	<b>32.9</b>	23.0
A	<b>1 317 148</b>	521 962	<b>11.8</b>	6.5
BBB	<b>18 938</b>	17 843	<b>0.2</b>	0.2
Different assets	<b>307 345</b>	129 751	<b>2.8</b>	1.6
<b>Total</b>	<b>11 118 687</b>	8 024 508	<b>100.0</b>	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above table show the breakdown of Latvijas Banka's assets as at the end of the reporting period. The rating "AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" – the counterparty's strong capacity to meet its financial commitments in the long term. "BBB" is a medium grade considered to be the lowest level of investment-grade rating.

### PROFIT AND LOSS NOTES

#### 33. NET INTEREST INCOME

	(in thousands of euro)	
	2015	2014
Interest income	<b>64 696</b>	50 097
Interest on investments	55 237	47 802
Interest on customer deposits	164	35
Interest on monetary policy operations	8 468	507
Interest on intra-Eurosystem claims	827	1 753
Interest expense	<b>-19 743</b>	-11 298
Interest on investments	-18 340	-7 806
Interest on customer deposits	-	-505
Interest on monetary policy operations	-113	-1 319
Interest on intra-Eurosystem liabilities	-1 290	-1 668
<b>Net interest income</b>	<b>44 953</b>	38 799

Net interest income was mainly derived from debt securities. In 2015, net interest income increased by 6 154 thousand euro in comparison with 2014. The increase in the amount of securities had a positive effect, while a pickup in the costs for hedging currency risks resulting from the widening of the spread between the interest rates of the euro and other investment currencies of Latvijas Banka had a negative impact.

Interest income from and interest expense on the intra-Eurosystem claims and liabilities are remunerated by applying the ECB's interest rate on the main refinancing operations and include income from foreign reserves transferred to the ECB and claims on allocation of banknotes in the Eurosystem, as well as expense on liabilities related to TARGET2 settlements.



According to the ECB Governing Council's decision on the allocation of monetary income for first six years following the euro changeover the remunerable part of the claims on banknote allocation in the Eurosystem is reduced in compliance with a definite coefficient to avoid significant NCB income fluctuations. The adjustment of the reduction of the remunerable part of Latvijas Banka's claims on banknote allocation in the Eurosystem in the course of the six years is as follows:

Reporting year	Coefficient (%)
2014	100.00000
2015	86.06735
2016	70.13472
2017	53.34835
2018	35.98237
2019	18.17225

In 2015, interest income on monetary policy operations increased on account of a lower negative deposit facility rate, higher average daily balance of credit institutions' demand deposits (see Note 16) and the implementation of the PSPP.

The application of the interest on deposits is stipulated in the Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU) and Guideline of the ECB of 5 June 2014 amending Guideline ECB/2014/9 on domestic asset and liability management operations by the national central banks (ECB/2014/22) (2014/339/EU) (see Note 43).

Interest income and expense recognised in the profit and loss statement of Latvijas Banka for 2014 have been restated in line with the reporting of negative interest described in Note 2.24. Interest income and expense have been reclassified by 523 thousand euro, with the net total interest income remaining unchanged.

#### **34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS**

Realised gains or losses arising from financial operations comprise the gains and losses from the disposal of debt securities, as well as realised gains and losses on derivative financial instruments and foreign exchange transactions.

Gains from the disposal of debt securities decreased by 2 262 thousand euro in comparison with 2014.

The realised result from financial operations was positively affected by the result on derivative financial instruments posting an increase of 22 272 thousand euro in comparison with 2014, mostly on account of the result of interest rate future contracts as well as the result of currency future contracts concluded for the purpose of hedging currency risks. In view of Latvijas Banka hedging the risks related to gold price and foreign exchange fluctuations, the positive result of the currency future contracts concluded for the purpose of hedging currency and gold price risk exposure is offset in equal value by the negative revaluation result of the hedged balance sheet items reported under the balance sheet item "Capital and reserves" as the revaluation result of foreign currency and gold, and the realised gains on foreign exchange transactions recognised in the profit and loss statement.

The realised result from financial operations was also positively affected by the recognition of a part of the initial valuation account balance in profit and loss statement in the amount of 13 543 thousand euro (see also Note 23).

#### **35. RECOGNITION OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS IN PROFIT AND LOSS STATEMENT**

The revaluation result of several debt securities, interest rate swap arrangements, and foreign currency positions at the end of 2015 and 2014 was negative, and it has been recognised in the profit and loss statement while the positive result on the revaluation of debt securities, interest rate swap arrangements, and foreign currency positions has been reported under the balance sheet item "Capital and reserves" as the revaluation result of securities and foreign currency (see also Note 23).

At the end of 2015, the negative result on revaluation of debt securities amounted to 13 371 thousand euro (1 512 thousand euro at the end of 2014). At the end of 2015, the negative result on revaluation of foreign currencies was 214 thousand euro (133 thousand euro at the end of 2014), and the negative result on revaluation of interest rate swap arrangements stood at 48 thousand euro at the end of 2015 (0 at the end of 2014).

#### **36. PROVISIONS FOR MARKET RISK AND CREDIT RISK**

Financial risks of Latvijas Banka relate primarily to its investments in financial instruments, as well as the implementation of the single monetary policy operations associated with Latvijas Banka's participation in the

Eurosystem and sharing of the related risks and financial results . Latvijas Banka's assets are mostly exposed to market risk (interest rate and currency risks) and credit risk (credit rating downgrade and default risks). Latvijas Banka carries out assessment of its financial risks and financial buffers in compliance with the ECB's common methodology for Eurosystem financial risk assessment. According to the methodology for Eurosystem financial risk assessment, the Expected Shortfall measure with confidence level of 99% (ES99%) for a risk horizon of one year is used. ES99% describes the losses determined by the average value of 1% of the most unfavourable simulated profitability scenarios. The above methodology takes account of various market risk and credit risk factors as well as uses historical data and assumptions of the Eurosystem/ESCB's Risk Management Committee. ES99% includes assumptions concerning development of adverse financial market factors, e.g. a drop in the gold price, euro appreciation, interest rate rise, widening of the interest rate spreads, credit rating downgrades. Market and credit risk factors are modelled simultaneously to derive the parameters characterising the market situation (credit ratings, yield curve parameters, exchange rates, stock and commodity prices, etc.) upon which the financial result of the Eurosystem's and NCB's financial assets under the specific scenario depends.

Based on the above risk estimates, in 2015 the Council of Latvijas Banka decided to establish provisions in the amount of 35 300 thousand euro (14 800 thousand euro in 2014) for market risk and credit risk with regard to investment management transactions of Latvijas Banka. The increase in provisions is affected by the higher levels of investments by Latvijas Banka in the existing investment portfolios of Latvijas Banka and those established in 2015 (see also Note 4), including a larger share of higher-yield instruments in aggregate investment. Considering the limitations applied in calculating ES99% and the conservative approach to risk estimates, the targeted amount of provisions for mortgage-based securities portfolios is smaller than the estimated ES99%, whereas no provisions have been created for the portfolio of Latvian government securities. It has been planned to continue accumulating provisions for market risk and credit risk for a longer time period, reaching the targeted amount in five years from starting the build-up of provisions in 2014. The above policy is based on the assessment of the overall level of financial risks, as well as the projected amount of income available for accumulating the provisions. Review of the targeted amount of provisions takes place on a regular basis; the level of financial risks, the available financial reserves and long-term prospects of the financial market development are taken account of when setting it. Provisions for the market risk and credit risk are reduced when financial risks materialise provided they are not offset against the accumulated revaluation result and other income, as well as when financial risks moderate.

### 37. INCOME FROM PARTICIPATING INTEREST

Income from participating interest comprises dividends received from the participating interest in the BIS in the amount of 305 thousand euro (261 thousand euro in 2014; see also Note 14.2) and income from the ECB's profit distribution in the amount of 3 852 thousand euro (3 389 thousand euro in 2014, see also Note 2.26).

### 38. NET RESULT OF POOLING OF MONETARY INCOME

	(in thousands of euro)	
	2015	2014
Monetary income pooled	-10 269	-8 247
Monetary income received	35 944	40 200
Net result of pooling of monetary income	25 675	31 953

In 2015, the net result of pooling of monetary income decreased by 6 278 thousand euro in comparison with 2014, mostly on account of lower total interest income of the Eurosystem on securities held for monetary policy purposes.

### 39. OTHER OPERATING INCOME

	(in thousands of euro)	
	2015	2014
Income from disposal of demonetised lats coins	-	1 583
Income from sale of collector coins	1 333	1 526
Other	429	557
Total	1 762	3 666

#### 40. REMUNERATION AND SOCIAL SECURITY COSTS

(in thousands of euro)

	2015	2014
Remuneration		
Remuneration of Members of the Council and the Board	-1 556	-1 557
Remuneration of other personnel	-15 376	-15 282
Total remuneration	-16 932	-16 839
Social security costs	-3 518	-3 382
Total remuneration and social security costs	-20 450	-20 221

Remuneration of those Members of the Board of Latvijas Banka who are also Heads of Departments of Latvijas Banka includes remuneration for performance of these duties.

The number of employees in 2015 and 2014 was as follows:

	2015	2014
Number of employees at the end of the year		
Members of the Council and the Board	13	13
Other personnel	527	527
Total at the end of the year	540	540
Average number of employees per period	543	569

#### 41. BANKNOTE AND COIN ACQUISITION COSTS

(in thousands of euro)

	2015	2014
Acquisition of circulation coins	-1 203	-1 775
Acquisition of collector coins	-752	-858
Total	-1 955	-2 633

## 42. OTHER OPERATING EXPENSES

	(in thousands of euro)	
	2015	2014
Maintenance and operation of information systems	-3 341	-2 763
Municipal services	-832	-944
Business travel	-622	-606
Maintenance of buildings, territory and equipment	-581	-626
Personnel training	-280	-228
Telecommunication services and system maintenance	-263	-235
Risk insurance	-252	-299
Information and public relations	-235	-538
Acquisition of low value office supplies	-181	-178
Tax on real estate	-149	-152
Event services	-101	-130
Transport provision	-79	-162
Disposal of material values	-20	-837
Other	-342	-548
Total	-7 278	-8 246

Other expenses also comprise the remuneration in the amount of 29 thousand euro paid to SIA KPMG Baltics for the audit of 2015 financial statements of Latvijas Banka (34 thousand euro in 2014 to SIA Ernst & Young Baltic).

## OTHER NOTES

### 43. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

Latvijas Banka, whose capital is wholly owned by the Republic of Latvia, carries out transactions with the Treasury, acting as the financial agent of the Latvian government. Performing this function, Latvijas Banka services the Treasury's accounts in euro and foreign currencies. Latvijas Banka is independent in making its own decisions on entering into the above transactions. The Treasury demand deposits are recorded under the balance sheet items "Liabilities to other euro area residents denominated in euro" and "Liabilities to euro area residents denominated in foreign currency".

The interest rates and foreign exchange rates used in the transactions with the Latvian government are market-based according to the ECB's decisions. No commission fees are applied to transactions with the Latvian government.

Pursuant to Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU) and Guideline of the ECB of 5 June 2014 amending Guideline ECB/2014/9 on domestic asset and liability management operations by the national central banks (ECB/2014/22) (2014/339/EU), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of 2015 (-0.127%), but positive at the end of 2014 (0.144%)) to the Treasury's deposits in euro in the amount of up to 200 million euro. As regards the total outstanding amount of the Treasury's settlement accounts in euro and foreign currencies exceeding 200 million euro, Latvijas Banka applies the deposit facility rate set by the ECB (it was negative both at the end of 2015 (-0.30%) and at the end of 2014 (-0.20%)).

At the end of 2015 and 2014, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	Amount (in thousands of euro)	
	2015	2014
<b>Claims</b>		
Securities held for monetary policy purposes	<b>472 158</b>	—
Other securities	<b>48 468</b>	—
Accrued interest on debt securities	<b>10 929</b>	—
<b>Total claims</b>	<b>531 555</b>	—
<b>Liabilities</b>		
Demand deposits in euro	<b>38 055</b>	50 900
Demand deposits in foreign currencies	<b>155 228</b>	144 579
Tax liabilities	<b>197</b>	175
<b>Total liabilities</b>	<b>193 480</b>	195 654

In 2015 and 2014, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 22.2 and 23):

	(in thousands of euro)	
	2015	2014
<b>Income (–)/expense and Latvijas Banka's profit appropriated to the state budget</b>		
Interest on debt securities	<b>–1 154</b>	—
Negative interest (–) on government deposits	<b>–57</b>	—
Recognition of revaluation result on debt securities in profit and loss statement	<b>412</b>	—
Interest expense on government deposits	—	504
Taxes	<b>8 941</b>	9 200
Profit appropriated to the state budget	<b>23 894</b>	38 349
<b>Total net expense and Latvijas Banka's profit appropriated to the state budget</b>	<b>32 036</b>	48 053

#### **44. PLEDGED ASSETS**

Securities and other financial instruments purchased by Latvijas Banka with the market value of 5 778 thousand euro, as at the end of 2015 (25 142 thousand euro at the end of 2014), have been pledged to provide collateral for forward exchange rate contracts and interest rate and currency future contracts.

#### **45. SECURITIES LENDING**

On behalf of Latvijas Banka its agents conclude securities lending transactions, as part of an automated security lending programme, where securities held by Latvijas Banka are lent against cash or other securities collateral. Securities lending transactions provide additional income without any material impact on investment liquidity as the securities lent are readily available to Latvijas Banka. The above agents administer the securities lending transactions and monitor the eligibility of the securities lending transactions and related collateral.

To improve securities market liquidity, in 2015 Latvijas Banka, simultaneously with other euro area NCBs, started lending securities purchased under the PSPP; Latvijas Banka conducts the above lending under the automated security lending programme.

At the end of 2015, the fair value of the securities lent, determined using quoted prices in an active market, was 53 692 thousand euro (305 181 thousand euro at the end of 2014); inter alia, the fair value of securities purchased and lent under the PSPP stood at 7 050 thousand euro at the end of 2015 (0 at the end of 2014).

At the end of 2015 and 2014, the fair value of collateral provided in securities lending transactions was as follows:

	(in thousands of euro)	
	<b>2015</b>	2014
Foreign currency cash	<b>35 771</b>	284 876
Debt securities	<b>18 587</b>	26 196
<b>Total</b>	<b>54 358</b>	311 072

Foreign currency cash or securities received in the agent account of Latvijas Banka's automated security lending programme as collateral for securities lending transactions is not recognised in Latvijas Banka's balance sheet (see also Note 2.12).

#### **46. CONTINGENT LIABILITIES AND COMMITMENTS**

The uncalled portion of the BIS shares held by Latvijas Banka is 75% of their nominal value; these shares are callable following a respective decision of the BIS Board. At the end of 2015 the uncalled portion of the BIS share holding was 4 013 thousand SDR (5 108 thousand euro; 4 013 thousand SDR (4 785 thousand euro) at the end of 2014; see also Note 14.2).

At the end of 2015, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 5 787 thousand euro (5 627 thousand euro at the end of 2014). These coins may be represented to Latvijas Banka at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

In 2015, the Eurosystem's TARGET2-Securities platform was launched enabling the central securities depositories and NCBs to provide cross-border securities settlement services. Latvijas Banka is carrying out preparations for migration of securities market participants in Latvia to TARGET2-Securities platform in 2017 and shares its costs together with other NCBs. Latvijas Banka plans to contribute approximately 1.2 million euro in 2016–2019. TARGET2-Securities platform is expected to operate on a full cost-recovery basis and income from commission fees in the medium term will cover its costs.



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## **Independent Auditors' Report**

### **To the Council of Latvijas Banka**

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of Latvijas Banka ("the Bank"), which comprise the balance sheet as at 31 December 2015, and the profit and loss statement and the statement of total recognised gains and losses for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 3 to 46.

#### *Board's Responsibility for the Financial Statements*

The Board of the Bank is responsible for the preparation and fair presentation of these financial statements in accordance with the Guideline of the European Central Bank of 11 November 2010 on the Legal Framework for Accounting and Financial reporting in the European System of Central Banks (recast) (ECB/2010/20), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the law "On Latvijas Banka" governing financial reporting. The Board of the Bank is also responsible for such internal controls as the Board of the Bank determines are necessary to enable the preparation of these financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether these financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of these financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the Bank's preparation and fair presentation of these financial statements 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 internal controls. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by the Board of the Bank, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



*Opinion*

In our opinion, the financial statements give a true and fair view of the financial position of Latvijas Banka as at 31 December 2015, and of its financial performance for the year then ended in accordance with the Guideline of the European Central Bank of 11 November 2010 on the Legal Framework for Accounting and Financial reporting in the European System of Central Banks (recast) (ECB/2010/20), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the law "On Latvijas Banka" governing financial reporting.

*Other matters*

The respective corresponding figures are based on the Bank's financial statements for the year ended 31 December 2014, which were audited by another independent audit firm who expressed an unqualified opinion on those financial statements in their report dated 10 March 2015.

KPMG Baltics SIA  
Licence Nr. 55

A handwritten signature in blue ink, appearing to be 'A. Movsisjana', written in a cursive style.

Armine Movsisjana  
Chairman of the Board  
Sworn Auditor  
Certificate No 178  
Riga, Latvia  
10 March 2016