AS LHV Group

Consolidated Annual Report 2009

(translation of the Estonian original)

Consolidated annual report	**01.01.2009 – 31.12.2009**

Business name	AS LHV Group
Commercial Registry no.	11098261
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
Fax	(372) 6800410
E-mail	lhv@lhv.ee
Main activities	Activities of holding companies
	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	Rain Lõhmus
Supervisory Board	Andres Viisemann
	Tiina Mõis
	Hannes Tamjärv
	Heldur Meerits
	Raivo Hein
Auditor	AS PricewaterhouseCoopers

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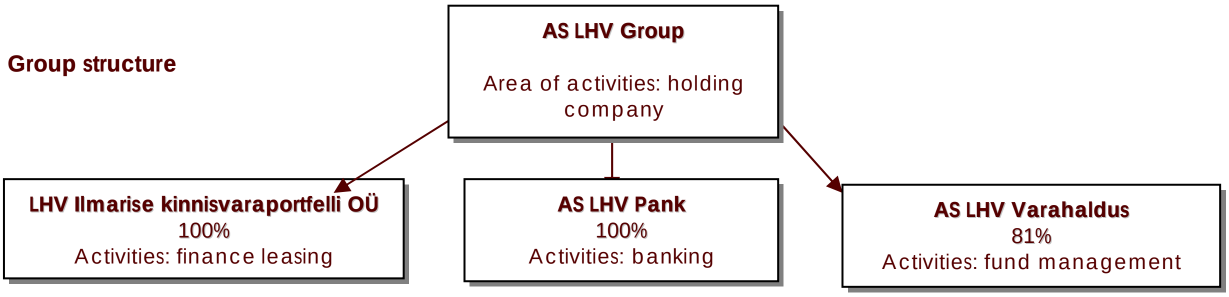
MANAGEMENT REPORT

Group structure



Key events in 2009 and at the beginning of 2010:

- **Application for a license of a credit institution**

At 6 May 2009, the Estonian Financial Supervision Authority granted LHV Bank the activity license of a credit institution. Together with the granting of the license of a credit institution, the activity license of an investment firm was annulled as a financial institution can simultaneously hold only one of these particular activity licenses. After becoming a credit institution, LHV Bank operates as a cross-border provider of banking services in Latvia and Lithuania. At 25 May 2009, LHV Bank became a member of the Estonian Banking Association.

- **New products of the bank**

After being granted the activity license of a credit institution, AS LHV Pank started offering term deposits to its clients and issuing loans to companies. At 3. May 2010 AS LHV Pank launched domestic and international payments.

- **Fund management**

At the beginning of 2010 the total asset value of the funds under management of AS LHV Varahaldus exceeded 1 billion kroons.

- **Share issues**

At 13 February 2009, the subscription of the new shares of AS LHV Group in the total amount of EEK 95.17 million was completed. Successful share issue enabled LHV Bank to increase its share capital to EEK 100 million at 24 April 2009.

As at 31.12.2009 the Group had almost 70 employees (2008: 60). In the financial year the salaries paid to employees amounted to 24,5 million kroons (2008: 19,8 million kroons). No remuneration was paid to the management board member of AS LHV Group.

At the year-end 2009, an insurance contract was concluded with the insurance agency Chartis Europe SA (former AIG Europe SA) concerning professional indemnity and crime coverage which became effective from 1 January 2010.

AS LHV Pank

The **mission** of LHV Bank is to foster Estonia's economy and social sustainability. The **vision** of LHV Bank is to be the primary and preferred bank of new generation in Estonia. This represents a bank without multiple offices, ATMs and cash transactions but which is accessible everywhere. A clear and simple online bank is targeted primarily at providing easy to use services to customers. Payments with the debit card of LHV Bank and if necessary, getting cash from ATMs, will be possible everywhere. The **values** of LHV Bank are personal approach and convenience. Each customer has a personal bank assistant who knows the customer's needs and opportunities. It is always easy and convenient to use the bank's services.

LHV Bank's target group consists of private customers with earnings above average and small and medium sized business clients. As compared to other banks, LHV Bank's main strength is providing investment services. LHV Bank has over 13 000 customers. LHV Bank operates the most active portal of financial markets, used by approximately 20 000 people per week.

After being granted the activity license of a credit institution, two new products were introduced to the bank's range of products - deposits and loans. Demand and term deposits are accepted both from private as well as legal persons. The volume of LHV Bank's deposits increased to EEK 505.2 million of which demand deposits totalled EEK 114.0 million and term deposits totaled EEK 391.2 million.

The loan portfolio of LHV Bank, including the leveraged loans or those granted using securities as collateral which had been included in the product portfolio already previously, increased to EEK 142.5 million by the year-end. After being granted the activity license of a credit institution, the bank entered into collaboration agreements with the Credit and Export Guarantee Fund KredEx and the Rural Development Foundation to launch its lending activities more efficiently. In the third quarter, the bank started to issue domestic guarantees.

In the first half of the year, several larger projects – authentication, payment system (clearing and settlements) and a new online bank were started. In the fourth quarter, the bank card project was set to. The transition of customer authentication from the password-based system to the one using ID cards, mobile-ID and PIN calculators will significantly increase the security of online banking. The accession to payment systems will enable customers to make regular transactions, including domestic and international payments. The goal of the new online bank is to provide as clear, simple and stylish self-service as possible. The projects of authentication and payments are expected to be completed by the end of the 1st quarter of 2010 and that of an online bank during 2010, to be followed by a comprehensive introduction of new opportunities to the customers. The issuance of bank cards is expected to be launched at the year-end 2010.

In respect of brokerage activities, new markets were made available to the customers in the 4th quarter. In addition to the former markets, it is now possible to trade the shares of Denmark, Norway, Spain, Italy and Austria, the shares in the alternative lists of Denmark and Sweden called First North, and more than 750 shares listed on London SETS and London IOB markets. In the third quarter, the underwriting of new Baltic options was completed.

From 2nd February 2009, Mihkel Oja was removed from the Management Board and Indrek Nuume was elected as a new member. Going forward, Mihkel Oja will focus on managing AS LHV Varahaldus. Indrek Nuume has a long-term banking experience, having helped to strengthen the competence of LHV Bank in the credit area. The Management Board of LHV Bank has five members: Erki Kilu, Kerli Lõhmus, Jüri Heero, Erki Kert and Indrek Nuume.

The internal control department of LHV Bank established in 2008 consists of three positions: Internal Auditor, Compliance Specialist and Risk Manager. The establishment of an independent internal control department at the bank was completed with the hiring of Internal Auditor at 5 January 2009. At the beginning of the year, the internal control department prepared the audit plan for 2009 which was approved by the bank's Supervisory and Management Boards. During the year, the internal control department performed several audits and control systems were introduced in the bank's various areas. Also, reporting formats were developed for the Management and Supervisory Boards.

In addition to the investment committee and securities appraisal committee, a credit committee, and an asset and liability management committee were established after the bank was granted the activity license of a credit institution. The credit committee is engaged in the management of the bank's credit risks, including the review of the customer's loan applications. The asset and liability management committee is engaged in the management of the bank's liquid funds. The bank's investment portfolio was established in the 2nd quarter of the year to invest available funds more efficiently, the amount of which totalled EEK 61.8 million at the year-end.

The positions of a credit analyst and a lawyer were created with the aim of strengthening the credit area. For managing new projects, the positions of a clearing and settlements manager, a development manager of e-channels and a card development manager were created during the year. The position of a customer relations manager was created to increase the quality of customer service; a software developer and an IT analyst were additionally hired in the 4th quarter to increase IT development efficiency.

In conjunction with the creation of several new positions, an additional floor in the City Plaza office building was taken into use in November 2009.

Business environment

The recession which had begun in all three Baltic States in 2008 worsened considerably during 2009. Almost all sectors of economy were impacted by the sharp contraction of economy, led by real estate, retail and transportation. However, in the second half of the year, the first signs of stabilisation could particularly be seen in Estonia, helped by the recovery of the main export partners and the maintenance of a competitive position due to the moderate reduction in wages and prices. For the year 2010, LHV Bank forecasts an economic recovery beginning in the second half of the year and a slight pick-up of inflation. However, the economic situation will remain tense and risks in respect of global economic growth have not disappeared anywhere.

In 2009, the banking sector was characterised by a contraction of loan volumes, a sharp increase of overdue loans and stabilisation of the volume of deposits. The volume of loans granted both to private persons as well as businesses turned negative after a long growth trend. As compared to 2008, the balance of the loans granted to both private persons as well as businesses decreased (3% and 5%, respectively), and the declining trend continued steadily until the year-end. In addition to the decline in the loan balance, the balance of overdue loans increased significantly, whereby the most problematic sector was real estate (both commercial real estate as well as housing). The volume of deposits remained pretty much stable and at the same level as in 2008.

The decline in real estate prices which started in the spring of 2007 stalled in the second half of 2009. The halting of the downward trend was alleviated by more relaxed financing conditions, growth of economic confidence as well as transaction costs which had become relatively favourable (from their peak, the transaction costs in Tallinn's apartment market have fallen by more than 50%). The bottom of economic confidence in Estonia was reached in the early spring of 2009 and similarly to the other EU countries, it has significantly improved since then.

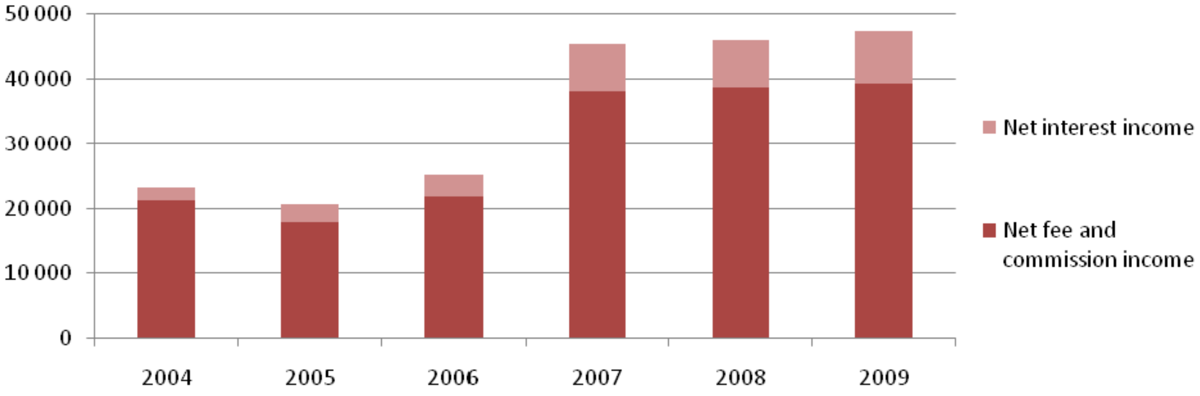
Alleviation of global macroeconomic tensions and restoration of risk-taking led to strong growth in securities markets in the spring of 2009. The broad-based index of US stock markets, S&P 500, increased by 23% in a year and from the bottom in mid-March, a total of 65%. The Baltic stock markets also increased strongly, led by Tallinn whose index OMXT increased by 47% in a year. Although the trading activity on the Tallinn Stock Exchange declined, the increase was propelled by expectations in respect of accession to the Euro zone at the beginning of 2011 as well as growth of macroeconomic stability. Similarly to stock markets, raw material markets also recovered from the post-crisis shock.

Financial results

EEK million	**2009**	**2008**	**change**
net fee and commission income	39,3	38,6	2%
net interest income	8,0	7,4	8%
net gain on financial assets	8,9	-3,8	-
total net operating revenues	56,2	42,2	33%
other income	4,4	4,3	2%
operating expenses	-57,0	-49,5	15%
profit	3,6	-3,0	-

EEK million	**31.12.2009**	**31.12.2008**	**change**
loan portfolio *	142,5	33,1	332%
investment portfolio	61,8	-	-
deposits	505,2	-	-
equity	102,6	34,6	197%
balance sheet total	640,3	66,4	864%
*excl. loans to related parties			
number of customers	13 112	11 028	19%
number of employees	60	48	25%

The following chart provides an overview of the net revenues of LHV Bank (in thousands kroons):



In 2009, fee and commission, interest as well as finance income all grew. Brokerage fees made 79% (10% growth), safekeeping fees 11% (9% decline) and other fees 10% of fee and commission income. With regard to brokerage income, intermediation of US shares, options and futures made 70%, Baltic shares 18% and other shares and fund units 12% of the total. As to the break-up of brokerage fees by countries, 71% was earned in Estonia (12% growth), 7% in Latvia (23% decline) and 22% in Lithuania (2% decline). The decline in safekeeping fees was related to the decline in value of clients assets at the beginning of 2009.

With regard to interest income, interest income on leveraged loans made up 36%, interest on corporate loans made up 25%, and interest on deposits and loans to related persons made up 37% of it. As at the year-end, the volume of loans secured by securities totalled EEK 47.2 million and the volume of loans issued to businesses totalled EEK 95.3 million.

With regard to finance income, revenues from investment portfolio totalled 59%, revenues from currency translation differences 37% and revenues from trading portfolio 4% of it.

During the year, staff-related costs increased by 30% and other operating expenses increased by 5%. The profit for the year totalled EEK 4.0 million.

The number of customers who have deposited their funds at LHV Bank increased by 19%, to over 13 000. The volume of customer securities increased to almost EEK 2,2 billion (34% growth). With regard to services, portfolio management volumes increased the most, by 143% in a year, reaching EEK 282 million.

Sponsorship

In 2010, LHV Bank will continue to sponsor the Estonian Traditional Music Center, helping it to arrange Viljandi Traditional Music Festival in the summer. The Estonian Traditional Music Center represents a collaboration partner for LHV Bank enabling it to make its contribution to the preservation of the Estonian national culture.

LHV also sponsors young sailors by having purchased new Optimist yachts for the Estonian Optimist Class Association. The yachts are rented out to clubs and schools where young people interested in sailing can use the yachts for a symbolic fee. The association is using the rental fees received from clubs and schools to arrange competitions and camps for children, and training for their coaches.

At 10 December 2009, the Estonian Business School and LHV Bank signed a collaboration agreement, laying the basis for obtaining higher education in the area of investment management in Estonia. The specialisation in investment management is aimed at full-time BBA students studying international business management at the EBS in the 2010/2011 academic year. The studies will be conducted in English and at the end of the studies, the first level Chartered Financial Analysts® (CFA) exam will be taken.

AS LHV Varahaldus

AS LHV Varahaldus is a fund management company. In 2009 the main business activity of the company was to provide fund management services to five mandatory pension funds, one supplementary pension fund and three equity Eurofunds (UCITSs).

Changes in the 2nd pillar fund family

In 2009, the Company decided to change the names of LHV's mandatory pension funds along with the changes in the funds' terms and conditions. The changes became effective at 01.01.2010. The words referring to investment strategies (e.g. bonds) were removed from the funds' names. The new names illustrate the risk level of funds ("L" is high, "M" is medium, "S" is low and "XL" is especially high and "XS" is especially low).

Previous name	New name
LHV New Markets PF	LHV Pension Fund XL
LHV World Equities PF	LHV Pension Fund L
LHV Balanced Strategy PF	LHV Pension Fund M
LHV Dynamic Bonds PF	LHV Pension Fund S
LHV Quality Bonds PF	LHV Pension Fund XS

From 2010, the entrance fees of LHV's mandatory pension funds were no longer charged and the management fees of two funds were lowered – the management fee of LHV Pension Fund M was lowered from 1.63% to 1.6% and the management fee of LHV Pension Fund XS was lowered from 1.2% to 0.9%.

In comparison of rates of return, LHV's 2nd pillar pension funds continued to be successful

Out of pension funds with progressive investment strategies (up to 50% of the assets are invested in equities) offered in Estonia, LHV Pension Fund XL and LHV Pension Fund L managed by the Company were the <u>first</u> and <u>second</u> best funds in terms of their rates of return. Among pension funds with balanced investment strategies (up to 25% of the assets are invested in equities, LHV Pension Fund M under the Company's management ranked <u>first</u> in terms of their rates of return. Among the funds investing only in bonds, i.e. conservative funds, LHV Pension Fund X and LHV Pension Fund XS under the Company's management ranked <u>first</u> and <u>second</u> in terms of their rates of return.

The percentage of people continuing to make their contributions to mandatory funded pension plans is the highest at LHV

In conjunction with a temporary change made to the contribution phase of the 2nd pillar, the holders of the 2nd pillar plans had to decide by the end of November whether to continue making voluntary contributions to the pension plan or not. Those who did not wish to file an application to continue making their contributions to mandatory funded pension plans, have no contributions to the 2nd pillar funds in 2010. The percentage of those who decided to file an application to continue making their contributions was the highest among the clients of LHV pension funds (active clients as at the beginning of 2010 have been considered).

3rd pillar

The supplementary funded pension fund plans offered in Estonia differ from each other in respect of the percentage invested in equities, therefore, it is more difficult to compare their rates of return. On average, LHV Supplementary Pension Fund invests 75% in equities. In the financial year, the fund was the second in respect of its rate of return.

Equity Funds

The Company manages three Eurofonds that invest in equities. All investment funds are publicly offered in Estonia, Latvia and Lithuania and LHV Persian Gulf Fund is also publicly offered in Sweden, Finland and Norway.

Amount of assets managed

At the end of 2009, the total amount of assets managed by LHV Varahaldus was 834 million kroons. At the beginning of 2010, when the applications of the 2nd pillar clients who could transfer their amounts accumulated in other pension funds to LHV pension funds became effective, the volume of assets under management of LHV Varahaldus increased to EEK 1,072 million.

LHV Ilmarise Kinnisvaraportfelli OÜ

The main activity of LHV Ilmarise Kinnisvaraportfelli OÜ is real estate leasing (finance lease). The company issued bonds in amount of 18 million kroons to finance the real estate leasing receivables. Due to the small volume of the company´s activities it was decided by AS LHV Pank to buy out the finance lease receivables and prematurely redeem issued bonds, as a result of which the company will end its business.

Priorities for 2010

AS LHV Group will continue to focus on the financial sector in its activities.

AS LHV Pank is focusing on growing the balance sheet volumes through collecting deposits and offering continuously better and wider range of products to clients. The bank will continue to grow its loan portfolio.

AS LHV Varahaldus plans to increase its market share in the market of mandatory pension funds and increase the volume of assets in equity funds through positive returns and attracting of new investors.

CONSOLIDATED FINANCIAL STATEMENTS

Management Board's declaration

The Management Board confirms the correctness and completeness of the 2009 consolidated financial statements of LHV Group as presented on pages 10-58.

The Management Board confirms that:

- the consolidated financial statements have been compiled in accordance with International Financial Reporting Standards as adopted in the European Union;
- the consolidated financial statements present a true and fair view of the Group's financial position, the results of operations and its cash flows;
- AS LHV Group and the entities in its consolidation group are going concerns.

....

Rain Lõhmus

Member of the Management Board

Tallinn, 22.06.2010

Consolidated statement of comprehensive income

(in thousands Estonian kroons)

	Note	2009	2008
Fee and commission income	6	61 881	59 794
Fee and commission expense	6	-8 085	-7 045
Net fee and commission income		**53 796**	**52 749**
Interest income	7	16 033	9 976
Interest expense	7	-7 738	-2 072
Net interest income		**8 295**	**7 904**
Net gain/loss from trading	8	3 644	-3 799
Net gain from financial assets designated at fair value	8	14 560	-9 332
Dividend income	8	17	1
Net gain/loss from financial assets		**18 221**	**-13 130**
Other income	9	4 446	7 211
Operating expenses	10	-83 612	-65 436
Operating profit / loss		**1 146**	**-10 702**
Loss for impairment of investment in associate	5	-24 268	0
Loss for the year		**-23 122**	**-10 702**
Comprehensive loss for the year		**-23 122**	**-10 702**
Loss and comprehensive loss attributable to shareholders of the parent		**-22 425**	**-8 086**
Minority interest		**-697**	**-2 616**

The notes on pages 15 to 58 are an integral part of these consolidated financial statements.

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Consolidated balance sheet

(in thousands Estonian kroons)

	Note	31.12.2009	31.12.2008
Assets			
Balances with other banks	11	294 054	21 854
Balances with investment companies	11	37 486	0
Balances with central bank	11	88 525	0
Derivatives	12	3 003	96
Other financial assets at fair value through profit or loss	13	113 058	45 112
Loans granted	14	142 489	26 401
Receivables from customers	15	4 173	3 292
Finance lease receivables	16	4 118	4 246
Other assets	17	3 136	2 185
Goodwill	5	16 332	8 723
Tangible assets	18	4 834	7 422
Intangible assets	18	574	222
Total assets		**711 782**	**119 553**
Liabilities			
Loans received and deposits from customers	19	527 780	12 224
Financial liabilities at fair value through profit or loss	13	123	542
Accrued expenses and other liabilities	20	20 918	6 642
Deferred income	14	460	1 345
Finance lease liabilities		325	414
Bonds issued	21	4 190	4 342
Provisions	22	1 100	600
Total liabilities		**554 896**	**26 109**
Shareholders' equity			
Minority interest		7 642	16 945
Shareholders' equity attributable to shareholders of the parent			
Share capital	23	116 215	68 630
Share premium		58 796	11 211
Reserves		3 485	3 485
Accumulated deficit		-29 252	-6 827
Total shareholders' equity attributable to shareholders of the parent		**149 244**	**76 499**
Total shareholders' equity		**156 886**	**93 444**
Total liabilities and shareholders' equity		**711 782**	**119 553**

The notes on pages 15 to 58 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

(in thousands Estonian kroons)

	Note	2009	2008
Cash flows from operating activities			
Fee and commission income received		69 628	64 817
Fee and commission expense	6	-8 085	-7 045
Operating and other expenses paid		-79 581	-62 099
Dividends received		17	1
Interest received		18 066	11 718
Interest paid		-7 494	-1 843
Cash flows from operating activities before change in operating assets and liabilities		**-7 449**	**5 549**
Change in operating assets			
Settlement of foreign currency forward contracts		-2 907	-42
Net acquisition/disposal of trading portfolio		3 230	-11 576
Loans granted and receivables from customers		-116 991	23 415
Term deposits with other banks	11	-81 461	0
Mandatory reserve in central bank	11	-88 525	0
Stock exchange security deposit		11	60
Other receivables and prepayments		-962	411
Change in operating liabilities			
Demand deposits of customers	19	113 929	0
Term deposits of customers	19	391 184	0
Loans received	19	11 252	-10 679
Issued bonds	19	-810	827
Financial liabilities of trading portfolio		-419	542
Other liabilities and deferred income		14 341	-2 522
Net cash generated from operating activities		**234 423**	**5 985**
Cash flows from investing activities			
Purchase of tangible assets	18	-964	-4 214
Proceeds from disposal of tangible assets	18	0	29
Net cash handed over less proceeds from disposal of subsidiary	5	-41 667	0
Change in investment portfolio		-58 252	6 428
Net cash used in investing activities		**-100 883**	**2 243**
Cash flows from financing activities			
Paid in share capital	23	95 170	3 345
Finance lease payments made		-89	-119
Redeemed bonds	21	-152	-142
Interest paid	7	-244	-254
Net cash generated from financing activities		**94 685**	**2 830**
Net increase in cash and cash equivalents		**228 225**	**11 058**
Cash and cash equivalents at beginning of the year	11	21 854	10 796
Cash and cash equivalents at end of the year	**11**	**250 079**	**21 854**

The notes on pages 15 to 58 are an integral part of these consolidated financial statements.

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PricewaterhouseCoopers, Tallinn

Consolidated statement of changes in equity

(in thousands Estonian kroons)

	Share capital	Share premium	Reserves	Retained earnings / accumulated deficit	**Total**	Minority interest	**Total**
Balance as at 01.01.2008	**66 400**	**10 096**	**2 830**	**1 914**	**81 240**	**19 561**	**100 801**
Paid in share capital	2 230	1 115	0	0	3 345	0	**3 345**
Transfer to statutory reserve	0	0	655	-655	0	0	**0**
Total comprehensive loss for 2008	0	0	0	-8 086	-8 086	-2 616	-10 702
Balance as at 31.12.2008	**68 630**	**11 211**	**3 485**	**-6 827**	**76 499**	**16 945**	**93 444**
Balance as at 01.01.2009	**68 630**	**11 211**	**3 485**	**-6 827**	**76 499**	**16 945**	**93 444**
Paid in share capital	47 585	47 585	0	0	95 170	0	95 170
Purchase of minority interest	0	0	0	0	0	-8 606	-8 606
Total comprehensive loss for 2009	0	0	0	-22 425	-22 425	-697	-23 122
Balance as at 31.12.2009	**116 215**	**58 796**	**3 485**	**-29 252**	**149 244**	**7 642**	**156 886**

More detailed information is provided in Note 23.

The notes on pages 15 to 58 are an integral part of these consolidated financial statements.

Notes to the financial statements

NOTE 1 General information

AS LHV Group is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. AS LHV Group is a holding company whose subsidiary AS LHV Pank provides banking, financial advisory and securities brokerage services to Estonian, Latvian and Lithuanian customers. AS LHV Varahaldus provides fund management service. LHV Ilmarise Kinnisvaraportfelli OÜ offers real estate leasing services.

These consolidated financial statements were authorised for issue by the Management Board at 22 June 2010.

The ultimate controlling party of AS LHV Group is Rain Lõhmus with 54% of voting rights (see Note 23).

NOTE 2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented and to all the companies in the Group, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2009 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. The consolidated financial statements have been prepared under the historical cost convention, exept as disclosed in some of the accounting policies below: “financial assets and liabilities at fair value through profit or loss”, including derivatives.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

The financial year started at 1 January 2009 and ended at 31 December 2009. The financial figures have been presented in thousands of Estonian kroons unless specifically referred differently in specific disclosure.

Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these consolidated financial statements which became mandatory for the Group’s accounting periods beginning on or after 1 January 2009. The overview of these standards and the Group management estimate of the potential impact of applying the new standards and interpretations is given below.

(a) International Financial Reporting Standards, published amendments to existing standards and interpretations by International Financial Reporting Standars Committee (IFRIC), that became effective on 1 January 2009

IFRIC 11 “IFRS 2 - Group and Treasury Share Transactions” The interpretation contains guidelines on the following issues: an entity grants its employees rights to its equity instruments that may or must be repurchased from a third party in order to settle obligations towards the employees; or an entity or its owner grants the entity's employees rights to the entity's equity instruments. Adoption of the interpretation did not have any significant impact on the Group’s financial statements.

IFRIC 14, IAS 19 “The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction” - The interpretation contains guidance on when refunds or reductions in future contributions may be regarded as available for the purposes of the asset ceiling test in IAS 19. The interpretation did not have any effect on the Group’s financial statements.

IAS 1 "Presentation of Financial Statements" - The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which includes all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities are allowed to present two statements: a separate income statement and a statement of comprehensive income. The Group has elected to present a single statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The revised IAS 1 had an impact on the presentation of the Group's financial statements but had no impact on the recognition or measurement of specific transactions and balances.

Amendment to IFRS 7 "Improving Disclosures about Financial Instruments" - The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity is required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The enhanced disclosures are included in these financial statements.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method for making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The amendments did not affect the financial statements significantly.

Amendments to IFRIC 9 and IAS 39 - Embedded Derivatives (issued in March 2009) - The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The amendment did not have an impact on these financial statements.

(b) New standards, amendments and interpretations that are mandatory for the Group and are effective for annual periods beginning at or after 1 January 2009 but not relevant to the Group´s operations

Amendments to IFRS 2 - Group Cash-settled Share-based Payment Transactions

IFRS 8 - Operating Segments

Amendments to IAS 23 - Borrowing Costs

IAS 32 and amendment to IAS 1 - Puttable Financial Instruments and Obligations Arising on Liquidation

IFRIC 12 – Service Concession Arrangement

IFRIC 13 – Customer Loyalty Programmes

IFRIC 15 – Agreements for the Construction of Real Estate

IFRIC 16 – Hedged of a Net Investment in a Foreign Operation (effective from 1 October 2008) IFRIC 17 – Distribution of Non-Cash Assets to Owners
IFRIC 17 - Distributions of Non-Cash Assets to Owners
IFRIC 18 – Transfers of Assets from Customers
IFRS 1 and amendment to IAS 27 – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

(c) New standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

**** Amendment to IAS 24 "Related Party Disclosures"** (issued in November 2009 effective for annual periods beginning on or after 1 January 2011) - The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party.

IAS 27 "Consolidated and Separate Financial Statements" (effective for annual periods beginning on or after 1 July 2009) - The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group does not expect the amended standard to have a material effect on its financial statements.

IFRS 3 (revised) "Business Combinations" (revised in January 2008 effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009) - The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. IFRS 3 is not relevant to the Group as it does not expect a business combination to occur.

**** IFRS 9, Financial Instruments Part 1: Classification and Measurement** (issued in November 2009 effective for annual periods beginning on or after 1 January 2013) - IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-

instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

(d) New standards, amendments and interpretations to standards that are not yet effective and are not expected to have a material effect on Group's financial reporting

Amendment to IAS 32 "Classification of Rights Issues" (issued in October 2009 effective for annual periods beginning on or after 1 February 2010) - The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives. The amendment is not expected to have a material impact on the Group's financial statements.

Amendment to IAS 39 "Eligible Hedged Items" (effective with retrospective application for annual periods beginning on or after 1 July 2009) - The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Group's financial statements as the Group does not apply hedge accounting.

IFRS 1 "First-time Adoption of International Financial Reporting Standards" (is effective for annual periods beginning after 31 December 2009, early adoption permitted) - The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The revised standard does not have any effect on the Group's financial statements.

Amendment to IFRS 5 and consequential amendments to IFRS 1) "Non-current Assets Held for Sale and Discontinued Operations" (effective for annual periods beginning on or after 1 July 2009) - This amendment to IFRS 5 is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that an entity committed to a sale plan involving loss of control of a subsidiary would classify the subsidiary's assets and liabilities as held for sale. The revised guidance should be applied prospectively from the date at which the entity first applied IFRS 5. The amendment is not expected to have any impact on the Group's financial statements.

**** Amendments to IFRS 2 "Group Cash-settled Share-based Payment Transactions"** (effective for annual periods beginning on or after 1 January 2010) - The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The amendments expand on the guidance given in IFRIC 11 to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard. The amendment is not expected to have significant impact on the Group´s financial statements.

** **Amendments to IFRS 1 "Additional Exemptions for First-time Adopters"** (effective for annual periods beginning on or after 1 January 2010) - The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments will not have any impact on the Group's financial statements.

** **Amendment to IFRS 1 "Limited exemption from comparative IFRS 7 disclosures for first-time adopters"** (effective for annual periods beginning on or after 1 July 2010) - Existing IFRS preparers were granted relief from presenting comparative information for the new disclosures required by the March 2009 amendments to IFRS 7 'Financial Instruments: Disclosures'. This amendment to IFRS 1 provides first-time adopters with the same transition provisions as included in the amendment to IFRS 7. The amendment is not expected to have any impact on the Group's financial statements.

** **IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments** (effective for annual periods beginning on or after 1 July 2010) - This IFRIC clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the profit and loss account based on the fair value of the equity instruments compared to the carrying amount of the debt. The amendment is not expected to have any impact on the Group's financial statements.

** ***Amendment to IFRIC 14 " Prepayments of a Minimum Funding Requirement" (*effective for annual periods beginning on or after 1 January 2011) - This amendment will have a limited impact as it applies only to

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companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement. The amendment is not expected to have any impact on the Group's financial statements.

** ***Improvements to International Financial Reporting Standards, issued in April 2009*** *(*amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010) - The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its financial statements.

** These standards, amendments and interpretations to existing standards have not yet been adopted by the EU.

2.2 Consolidation

A subsidiary is an entity controlled by the parent company. Control is presumed to exist when the parent company owns, directly or indirectly through its subsidiaries, more than 50% of the voting power of the subsidiary or otherwise has power to govern the financial and operating policies of the subsidiary.

The purchase method of accounting is used to account for the acquisition of subsidiaries (except for acquisitions among enterprises under common control). The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. According to the purchase method, the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary are recognised at their fair values at the acquisition date, irrespective of the extent of any minority interest, and the excess of the cost of acquisition over the fair value of the identified net assets of the acquired subsidiary is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the statement of profit or loss.

Goodwill represents the excess of the cost of an acquisition over the fair value of the company's share of the net assets acquired at the date of acquisition, reflecting the part of the acquisition cost that was paid for the assets that are not separately identifiable for the balance sheet purposes. Goodwill acquired from acquisition of a subsidiary is recorded in balance sheet as an intangible asset on a separate line. Goodwill is not amortised, but an annual impairment test is performed for goodwill. The impairment test is performed by comparing the carrying amount of the goodwill to its recoverable amount. Goodwill is allocated to cash-generating units for the purpose of impairment testing and the recoverable amount is determined by discounting the expected cash flows of the relevant cash generating unit. An impairment loss is recognized for the amount by which the carrying amount of the goodwill exceeds its recoverable amount.

In the consolidated financial statements, the financial information of all subsidiaries under the control of the parent company is combined on a line-by-line basis. All intragroup receivables and liabilities and the Group's intra-company transactions and the resulting income and losses as well as unrealised gains on these transactions have been eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Minority interests in the net income and equity is included within equity in the consolidated balance sheet separately from the equity attributable to the shareholders of the parent company and as a separate item in the consolidated statement of comprehensive income.

Revenues and expenses of the subsidiaries acquired within the financial year are consolidated into the group statement of comprehensive income starting from the date of acquisition to the end of the financial year. Result of operations of subsidiaries disposed of during the year is consolidated into group statement of comprehensive income from the beginning of the financial year until the date of disposal.

The 2009 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank, AS LHV Varahaldus and LHV Ilmarise Kinnisvaraportfelli OÜ.

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27 "Consolidated and Separate Financial Statements".

In the parent separate primary financial statements, disclosed to these consolidated financial statements (see Note 29), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

2.3 Associates

An associate is an entity over which the Group has significant influence but which it does not control. Generally, significant influence is assumed to exist when the Group holds between 20% and 50% of the voting rights.

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognised at cost which is thereafter adjusted for post-acquisition changes in the investor's share of the investee's equity (changes both in the profit/loss of the associate as well as other equity items) and with elimination or depreciation/amortisation of the differences between fair values and carrying amounts of the investee's assets, liabilities and contingent liabilities as determined in the purchase analysis. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets.

When the Group's share of losses in the associate accounted under the equity method exceeds the carrying amount of the associate, the carrying amount of the investment is reduced to zero and such long-term loans granted to the associate that in substance form a part of the investment are written down. Further losses are carried off-balance sheet. When the Group has guaranteed or incurred obligations on behalf of the associate, the respective liability as well as the loss under the equity method are recorded in the balance sheet. Other receivables from the associate are valued by the probability of proceeds.

An investment in the assets and liabilities of the acquired associate and goodwill that arose on acquisition is presented as a net amount in the balance sheet line "Investments in associates".

At each balance sheet date, it is assessed whether there is any indication that the recoverable amount of the investment has fallen below its carrying amount. If any such indications exist, an impairment test is performed. To determine the recoverable amount of the investment, the principles described in section 2.7 are used as the basis.

Luottotalo Fenno OY is an associate in the consolidated financial statement of AS LHV Group.

2.4 Foreign currency translation

(a) Functional and presentation currecny

The functional and presentation currency of the entities in the Group is the Estonian kroon.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia (central Bank) prevailing at the dates of the transactions. Monetary assets and liabilities and non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of comprehensive income under the line "net gain/loss from trading". Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss as "net gain/loss from trading", and other changes in the carrying amount are recognised in other comprehensive income. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss on line "net gain/loss from trading". Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in other comprehensive income.

2.5 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with central bank and other banks, term deposits with original maturities of three months or less, that are available for use without any significant restrictions.

2.6 Financial assets

Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss
- loans and receivables
- financial assets available-for-sale

The classification depends on the purpose for which the financial assets were acquired. Management of the bank determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

- financial assets held for trading (incl. derivatives)
- financial assets designated at fair value through profit or loss at inception

A financial asset is classified as **held for trading** if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges.

Regular purchases and sales of financial investments are recognised on the settlement date in the balance sheet. Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to the consolidated income statement. After initial recognition, financial assets in this category are measured at fair value. Changes in fair values of these assets are recognised consistently, either as a profit or loss in the statement of comprehensive income of the accounting period under "net gain/loss from trading". Dividend income on financial assets reported at fair value through profit or loss is included in the income statement line „Dividend income" when the Group has the right to receive dividends.

In case of listed securities (i.e. the securities which have active market), the current purchase (bid) price is considered as the fair value of investments. To find the fair value of investments not actively traded in the market, alternative methods such as the price of recent transactions (under market conditions), the discounted cash flow method or option valuation models are used.

Financial assets designated at fair value through profit or loss at inception - securities are classified into this group, if the company has upon initial recognition designated the securities to be recorded as at fair value through profit or loss and as a result the changes in the fair value of these securities are consistently recognized in the profit or loss of the reporting period.
Financial assets and financial liabilities are designated at fair value through profit or loss when:

- doing so significantly reduces measurement inconsistencies
- certain investments, such as debt or equity investments, are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are recognized in the balance sheet when the cash is paid to the customer and are initially recognized at fair value plus transaction costs and are derecognized only when they are repaid or written-off, regardless of the fact that part of them may be recognized as costs through providing allowances for loans. After initial recognition, the Group recognises loans and receivables at amortised cost (less principal repayments and any potential impairments, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest rate method.
Trade receivables arise from providing services to the customers and are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method (less provision for impairment, see 2.6).

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.
In the current reporting period the Group does not have any available-for-sale financial assets.

2.7 Impairment of financial assets

The Group assesses at least at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

For valuation of loans and receivables several risks are prudently considered. The collection of each specific receivable is assessed on an individual basis, taking into consideration all known information on the solvency of the debtor. The Group assesses whether objective evidence of impairment exists considering such situations as: the buyers' financial difficulties, bankruptcy or inability to fulfil their obligations to the Group. For assessment of loan losses, the probability of collecting the loan and interest payments over the coming periods are considered, as well as discounted present value of estimated collections, discounted at the financial asset's original effective interest rate, and anticipated proceeds from the realization of collateral (if the loan is secured, excluding future credit losses that have not been incurred), which together help to assess the amount of loss incurred of the loan. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. For these assessed incurred loan losses, the relevant allowance has been established. Any impairment losses are charged to the income statement. Doubtful receivables are written down in the balance sheet to the collectible amount.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement. Irrecoverable receivables are removed from the balance sheet against the related allowance for loan impairment.

Interest income on loans is presented on the statement of comprehensive income under "Interest income".

2.8 Derivative financial instruments

Derivative financial instruments (futures, forward, swap and option contracts) are initially recognised in the balance sheet at the fair value net of transaction costs at the settlement date and are subsequently valued at fair value through profit or loss. If derivatives are quoted on an active market, market value is used as a fair value. If not, the valuation techniques are used to find the fair value. Profits and losses from derivatives are recognised as income or expense of the period in the statement of comprehensive income under "net profit/loss from trading". These transactions are booked in balance sheet as assets, if their fair value is positive and as liabilities, if the fair value is negative. The fair values of derivative assets and liabilities recorded in balance sheet are not netted. The Company does not use hedge accounting to account for its derivative financial instruments.

2.9 Finance lease receivables

Finance lease transactions are lease transactions under which all significant risks and rights from using the assets are immediately transferred from the Group to the lessee. Legal ownership of assets is transferred to the customer at the end of the lease term. Receivables arising from finance lease agreements are recognised at the net present value of the minimum lease payments receivable, less principal payments of receivables. Each lease payment received from the lessee is allocated between principal payment of the finance lease receivable and financial income. Financial income is allocated over the lease term under the assumption that the lessor's periodic rate of return is constant in respect of the outstanding net investment of the finance lease at any point in time. In case initial service fees are collected at issuance, these are included into the calculation of effective interest rate and lessor's net investment.

The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased object and excess collateral, the financial position and trustworthiness of the customer. Impairment of receivables is shown as a negative amount within the respective asset category. Impairment of lease receivables is assessed similarly to the principles described above in note 2.6.

2.10 Tangible assets

Tangible assets are non-current assets used in the operating activities of the Group with a useful life of over one year. An item of tangible assets is initially recognised at its cost which consists of the purchase price (incl. customs duties and other non-refundable taxes) and other expenditures directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to operating expenses when they are incurred.

An item of tangible assets is carried in the balance sheet at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers, furniture and fixtures is 33%, for improvements of rental space either 20% or amortization throughout the rental period, depending on which is shorter. Depreciation is calculated starting from the month of acquisition until the carrying value reaches the residual value of the asset. In case the residual value becomes to be greater than the carrying value of the asset, no further depreciation expense is calculated.

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if that has become appropriate, at each balance sheet date. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell and its value in use), it is written down immediately to its recoverable amount recognising impairment loss in statement of profit or loss for the period.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in operating expenses /other income in the statement of profit or loss for the period.

2.11 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis. The annual amortisation rate for purchased licenses is 33%. At each balance sheet date the appropriateness of amortization rates, methods and residual values are assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use.

2.12 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the company's share of the net assets acquired at the date of acquisition, reflecting the part of the acquisition cost that was paid for the assets that are not separately identifiable for the balance sheet purposes. Goodwill acquired from acquisition of a subsidiary is recorded in balance sheet as an intangible asset on a separate line. Goodwill is not amortised, but an annual impairment test is performed for goodwill. The impairment test is performed by comparing the carrying amount of the goodwill to its recoverable amount. Goodwill is allocated to cash generating units for the purpose of impairment testing and the recoverable amount is determined by discounting the expected cash flows of the relevant cash generating unit. An impairment loss is recognized for the amount by which the carrying amount of the goodwill exceeds its recoverable amount. .Impairment losses of goodwill can not be reversed.

2.13 Financial liabilities

Deposits from customers are initially recorded at the value date in their fair value less transaction costs and are subsequently measured at amortised cost using effective interest rate method on the balance sheet line "Loans received and deposits from customers", accrued interest liabilities are included on same line. Accrued interest expense is recognised in statement of comprehensive income line „Interest expense".

Loans assumed and bonds issued are initially recognised at fair value less transaction costs (cash proceeds less transaction costs). Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognised at fair value.

A financial liability at fair value through profit or loss is an instrument held for trading purposes and is recognised at fair value at each reporting date. All other financial liabilities are subsequently measured at amortised cost using the effective interest rate method. Borrowing costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the statement of comprehensive income during the term of the instrument using the effective interest rate. Interest costs are included in the statement of comprehensive income line "Interest costs".

Structured bonds consist of a deposit and an option embedded in the bond. As the value of the option depends on the return on the underlying asset being the value of the fund unit, it represents a derivative which is not closely related and the Group has therefore elected to recognise the option portion of the bonds in a separate balance sheet line "financial liabilities at fair value through profit or loss" at fair value based on the market value. The interest payable on the deposit is recognized in the statement of comprehensive income under "Interest expense" and the change in the fair value of the option under "Net gain/loss from trading”.

2.14 Financial Guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the liabilities under such guarantees are recognised at the outstanding value of guarantee stated as higher of unamortized fees and provision under IAS 37, based on experience with similar transactions and judgement of the management. In the statement of comprehensive income the fee income earned on a guarantee is recognised on a straight line basis over the life of the guarantee. The amounts to be disbursed to settle the guarantee obligation are recognised in the balance sheet as a provision on the date it becomes evident that it is probable that the guarantee is to be disbursed.

2.15 Payables to employees

Payables to employees include vacation pay accrual calculated in accordance with employment contracts and the laws of the Republic of Estonia in force as at the balance sheet date. The liability related to the payment of vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the balance sheet and as personnel costs in the income statement.

2.16 Provisions and contingent liabilities

Liabilities arising from an obligating event before the balance sheet date that have either a legal or contractual basis or that have arisen from the Company’s current operating practice (legal or constructive obligation) that require the giving up of assets, whose realisation is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and whose amount can reliably be estimated but whose timing or amount are not definitely known are recognised as provisions in the balance sheet. The provisions are recognised based on the management’s estimates regarding the amount and timing of the expected outflows. A provision is recognised in the balance sheet in the amount which according to the management is necessary as at the balance sheet date for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and expense from change in carrying value of provisions is included within expenses in the accounting period. Provisions are not set up to cover future losses.

When it is a probable that the provision is expected to realise later than 12 months after the balance sheet date it is recorded at discounted value (present value of expected outflows), unless the discounting effect is immaterial.

Other potential or existing liabilities (promises, guarantees and other commitments) whose realisation is less probable than non-realisation or whose accompanying costs cannot be determined reliably, that in certain circumstances may become obligations, are disclosed in the notes to the financial statements as contingent liabilities. Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

2.17 Distinction between short- and long-term financial assets and liabilities

Any financial assets from which the resources are expected to flow to the Group within 12 months are recognised as current assets. Assets with expected inflows also after 12 months period after the balance sheet date are recognised as long-term assets in the part to be received after the 12 months period.

Financial liabilities are classified as current when they are due within twelve months after the balance sheet date or if the Group does not have an unconditional right to defer the payment for later than 12 months

after the balance sheet date. Loans whose due date is within 12 months after the balance sheet date but which are refinanced as non-current after the balance sheet date but before the financial statements are authorised for issue are recognised as current. Loans that the lender has the right recall at the balance sheet date due to violation of contractual terms are also classified as current.
For all long-term financial assets and liabilities the long-term part is separately disclosed in respetive disclosure to these consolidated financial statements.

2.18 Revenues and expenses
Revenues and expenses are accounted for using the accrual basis of accounting. Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the Group, the amount of the revenue can be measured reliably and services were rendered by the Group. Revenue from services rendered in the ordinary course of business by the Group is recognised at the fair value of the fee received or receivable. Expenses are recognised when the company has received the goods or services.

Fee and commission income (incl. custody and portfolio management fees) are recognised on accrual basis when the service has been provided and the Group has a right of claim to the receivable. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party (purchase or sale of businesses, acquisitions etc) are recognised on completion of the underlying transaction. Portfolio management, other consultation fees and management fees related to investment funds are recognized according to agreement, usually over the period in which the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance linked fees or fee components are recognized when the performance criteria are fulfilled. Other one-time service revenues and other revenues are recognized on accrual basis at the moment of executing the respective transactions.

Fee and commission expenses are recognised after the service has been provided and when the liability has arisen.

Interest income and expense is recognized in statement of profit or loss for all interest-bearing financial instruments carried at amortized cost using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future impairment losses. The calculation includes all significant fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Dividend income is recognised when the legal right to receive dividends is established.

2.19 Asset management – fiduciary activities
The Group is engaged in providing asset management services. Such assets that have been given to the Group to manage by third parties and that the Group does not own are not included in the balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

2.20 Finance and operating leases - Group as the lessee

Leases of tangible assets where the lessee acquires substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases.

Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the repayment of a liability and finance charges (interest expense). The interest element of the finance cost is charged to the statement of comprehensive income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period (effective interest rate method). Tangible non-current assets acquired under finance leases are depreciated similarly to acquired assets over the shorter of the useful life of the asset or the lease term.In the financial year, the Group did not have any finance lease agreements.

Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the lease term. The Group uses mainly operating lease for renting the premises, cars and computer equipment. Rental expense is recognized in statement of comprehensive income as "operating expenses".

2.21 Taxation and deferred income tax

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. Instead of net profit, dividends payable out of retained earnings are subject to taxation at rate of 21/79. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid for.

2.22 Offsetting

Offsetting between financial assets and liabilities is performed only when there is a legal right for it and these amounts are intendes to be settled simultaneously or on a net basis.

2.23 Statutory reserve

Statutory reserve is formed to comply with the requirements of the Commercial Code. Reserve capital is formed from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be transferred to the statutory reserve, until reserve reaches one-tenth of share capital. Statutory reserve may be used to cover a loss, or to increase share capital. Payments to shareholders from statutory reserve are not allowed.

2.24 Changes in the presentation of the balance sheet and statement of comprehensive income

AS LHV Pank, subsidiary of the Group, has formerly recognised under the loans granted also specified other receivables from customers. In these financial statements these other receivables and related allowances for impairment have been transferred and the balances for 31.12.2008 have been adjusted respectively. Balance sheet item "loans granted" as at 31.12.2008 has been decreased by 61 thousand kroons and balance sheet item "receivables from customers" has been increased respectively. Receivables from customers form a balance of 76 thousand kroons gross and respective allowance provided for impairment in amount of 15 thousand kroons (see also Note 15).

As a result of the Group´s subsidiary AS LHV Pank becoming a licensed bank since May 2009, some line items in the balance sheet of the Group have been changed: receivables from other banks, formerly recognised on line cash and cash equivalents in the balance sheet are now recognised as "balances with other banks" and "balances with investment companies". The corresponding figuresl for 2008 have been adjusted respectively. Additional lime items "balances with central bank" and "loans received and deposits from customers" have been added. The Group continues to present the operating activities in the statement of cash flows using the direct method, but the inflows and outflows of loans granted and deposits accepted are now presented in net amounts. Cash flows for 2008 have been restated respectively and loans received and repaid in net amount of 11 674 thousand kroons have been transferred to cash flows from operating activities (formerly recorded under financing activities).

NOTE 3 Risk management

The principles of identification, management and control of risks at LHV Group are set out in the policies and procedures approved by the Supervisory Board. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of LHV Group in order to ensure the reliability, stability and profitability of the entities of the Group. The Group's risk management system is centralised in order to ensure effective application of risk management principles. Independent from the units taking risk positions, the internal control department carries out control over the risk management. The rules and procedures of risk management are constantly revised and updated in case of need.

3.1 Capital management

The goal of the Group's capital (incl. debt) management is to:

- ✓ comply with capital requirements as established by supervision authorities;
- ✓ ensure continuity of the Group's business and ability to generate returns for its shareholders;
- ✓ maintain a strong capital base supporting the development of business.

Debt is managed according to internal rules and the Asset and Liability Management Committee (ALCO) oversees capital management. The ALCO is involved in the development of an optimal balance sheet structure, it monitors liquidity and interest rate risk, and makes recommendations for raising additional share capital, if necessary, in order to ensure the bank's further development and to comply at any given time with the prudential requirements established for credit institutions.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. Reports dealing with the compliance with prudential and capital requirements for covering the risks are submitted quarterly to supervision authorities. In 2009, the Group did not experience any problems in respect of compliance with capital adequacy requirements. The Group does not use internal rating based (IRB) models for calculating capital requirements. The Group's own funds consist of Tier 1, 2 and 3 own funds. The Group does not have any Tier 2 or 3 own funds (subordinated loans, preference shares). As at 31.12.2009, the Group's consolidated Tier 1 own funds totalled 132 338 thousand kroons (31.12.2008: 84 499 thousand kroons).

The own funds of the LHV Bank as an credit institution need at any given time exceed the minimum amount of share capital laid down in the the Credit Institutions Act (5 million euros or 78 233 thousand kroons).
A capital adequacy level, i.e. the ratio of the bank's own funds to risk-weighted assets shall be at least 10%.

The own funds of LHV Varahaldus as the fund manager need at any given time exceed the minimum amount of share capital laid down in the Investment Funds Act (3 000 euros or 46 940 thousand kroons), 25 per cent of fixed overhead and 2% of the market value of managed pension funds. In 2008, the Group incurred a financial loss in the amount of 10 039 thousand kroons related to the decline in the market value of funds units managed by the Group. Due to this loss, the Group's own funds declined considerably. In order to meet the minimum requirement set for own funds in the Act, the Group issued on three occasions subordinated bonds denominated in euros in the total amount of 12 517 thousand kroons with the interest rate of 16% and maturity of 7 years. The parent AS LHV Group purchased the bonds.

Tier 1 own funds because the Group has neither any other types of own funds nor instruments to be deducted from own funds.

(in thousands Estonian kroons)

Capital base	**31.12.2009**
Paid-in share capital	116 215
Share premium	58 796
Reserves	3 485
Accumulated deficit	-6 827
Loss for the year	-22 425
Intangible assets (subtracted)	-16 906
Total Tier 1 own funds = net own funds for capital adequacy calculation	**132 338**
Capital requirements	
Central government and central banks with standardised approach	4 426
Credit institutions and investment firms with standardised approach	21 684
Retail claims with standardised approach	8 161
Investment funds´s shares with standardised approach	2 906
Other assets with standardised approach	2 648
Total capital requirements for covering the credit risk and counterparty credit risk	**39 825**
Capital requirement against foreign currency risk	3 263
Capital requirement against interest position risk	2 574
Capital requirement against equity portfolio risks	149
Capital requirement against option derivatives	32
Capital requirement for operational risk with standardised approach	7 087
Total capital requirements*	**52 930**
Capital adequacy (%)	**25,00**
Tier 1 Capital Ratio (%)	**25,00**

(in thousands Estonian kroons)

Capital base	**31.12.2008**
Paid-in share capital	79 841
Reserves	3 485
Retained earnings	3 875
Loss for the year	-10 702
Minority interest	16 945
Intangible assets (subtracted)	-8 945
Total Tier 1 own funds = net own funds for capital adequacy calculation	**84 499**
Risk-weighted assets	
Carrying amount of assets in category I	13 329
Carrying amount of assets in category II	21 842
Carrying amount of assets in category III	9 662
Carrying amount of assets in category IV	74 624
Risk-weighted off-balance sheet transactions	
Capital requirement against foreign currency risk	1 203
Capital requirement against trading portfolio risks	661
Total capital requirements	**10 251**
Capital adequacy (%)	**82,43**

3.2 Financial risk management

The main financial risks arising from the activities of LHV pank are:

- ✓ credit risk,
- ✓ market risk,
- ✓ liquidity risk,

3.2.1 Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet its obligations to the Group. Credit risk arises from cash and cash equivalents, derivatives and deposits with banks and other financial institutions, but mostly credit exposures to customers, including outstanding loans, other receivables and committed transactions. In order to hedge credit risk, the Group analyses the operations and financial position of its customers and business partners. After authorising the loan, the solvency of the customer and the value of the collateral are regularly monitored.

LHV Pank gives margin loans backed by securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on market value of the assets held as collateral in the investment account, and on the general limit set by LHV Pank which is currently 1 million kroons (or an equivalent in a foreign currency) per customer through LHV Pank's website. The granting of major loans assumes an analysis of the portfolio offered as collateral by the customer and the decision is within the competence of the Management Board. The list of acceptable marketable financial instruments and the levels of the required collateral are published on LHV Pank website www.lhv.ee. The credit risk arising from financial leverage is mitigated by constant monitoring of the market values of the financial instruments required as collateral. When the value of the collateral assets falls below the established limit, LHV Pank is entitled to demand a transfer of additional collateral to the account or pay off the loan in the customer's account without the customer's trade order, liquidating the collateral asset for this purpose.

Since 2009, LHV Pank also issues business loans. Prior to issuing a loan, a credit risk analysis is performed for each customer, including an analysis of the customer's economic activities, reporting and cash flows, background checks, the company's structure, management and owners' related risk, an analysis of the industry and economic environment. The Credit Committee makes decisions in respect of risk-taking on the basis of a unanimous resolution. The maximum limit of a loan issued to a customer by LHV Pank is 20% of net own funds (NOF, whereby the legal limit is 25% of NOF). The requirements for loan collateral are established in the Bank's Credit Policy. After issuing the loan, follow-up monitoring of each customer's financial position is performed at least once a quarter. Problem loans are monitored on a continuous basis.

The Credit Committee sets limits for taking credit risk associated with bonds, taking into consideration the issuer's rating. The ALCO or authorised employees make decisions regarding investments within the limits set.

Stress tests are carried out for evaluating the credit risk of leveraged loans in order to determine potential losses in case of changes in the value of collateral and for evaluating the credit risk of other loans, the probability of the lender becoming insolvent, the amount of loans not covered by collateral at the time of insolvency and the amount of the resulting related expected loss is assessed. If necessary, decisions are made in respect of allocating additional risk capital in order to cover credit risk.

LHV Pank considers the loan as non-performing and writes it down when the loan payments have not been collected by the due date and/or the expected cash flows from the realisation of collateral are not sufficient for covering the carrying value of the loan principal and interest payments. Homogeneous loans may be provided for impairment on a group basis but due to the small size of the bank's loan portfolio, LHV Pank evaluates each loan individually. In 2009 and 2008, no loans were written down for impairment.

LHV Varahaldus provides fund management services to investment and pension funds. The management fees of funds are calculated in accordance with the issue prospectuses and LHV Varahaldus receives a monthly management fee which is transferred to the account of the management company by the management company as a result of which no material credit risk arises.

The legal title of the property leased by LHV Ilmarise Kinnisvaraportfelli OÜ under finance lease agreements remains with the Company until lease receivables have been collected in full. Therefore, the Company does not have any significant credit risk under the assumption that prices do not decrease significantly in the real estate market due to which the value of collateral would fall below the nominal value of all receivables. The prices in the real estate market which had significantly increased until now have by now fallen to the year 2004 level at which time according to the assessment reports, the collaterals were adequate for covering of finance lease receivables and there were no risks arising from the collateral.

The maximum credit risk exposure	**31.12.2009**	**31.12.2008**
Balances with banks and investment companies (Note 11)	420 065	21 854
Derivatives (Note 12)	3 003	96
Other financial assets designated at fair value (bonds) (Note 13)	83 042	18 720
Finance lease receivables (Note 16)	4 118	4 246
Loans and advances to clients (Note 14)	142 489	26 401
Receivables from customers (Note 15) *	4 173	3 292
Other assets (Note 17)	207	218
Totalassets	**657 097**	**74 827**
Off-balance sheet liabilities (Note 27)	25 623	0
Total maximum credit risk exposure	**682 720**	**74 827**

* As at 31.12.2009, other receivables include overdue receivables in the amount of EEK 75 thousand, incl. receivables from private persons in the amount of EEK 67 thousand and from legal entities in the amount EEK 8 thousand; no receivables have been written down. As at 31.12.2008, other receivables included overdue receivables in the amount of EEK 76 thousand, incl. from private persons in the amount of EEK 49 thousand and from legal entities in the amount of EEK 27 thousand. Receivables from private persons were written down in the amount of EEK 15 thousand. All receivables other than those overdue have been collected by the time of preparation of the annual report.

The credit risk exposure arising from cash and cash equivalents held with central bank, other banks and investment companies in essence is considered by the management to bear a minimal credit risk.

The following table provides an overview of the credit quality analysis (see also 2.22 for changes in presentation and Note 14):

	31.12.2009			**31.12.2008**		
(in thousand Estonian kroons)	Loans and advances to clients (Note 14)	Loans and advances to other banks (Note 11)	Total	Loans and advances to clients (Note 14)	Loans and advances to other banks (Note 11)	Total
Not due and not impaired	146 584	420 065	**566 649**	30 639	21 854	**52 493**
Past due but not impaired	23	0	**23**	8	0	**8**
Total	**146 607**	**420 065**	**566 672**	**30 647**	**21 854**	**52 501**

The majority of the loan portfolio of LHV Pank is backed by listed securities - share in collaterals forms 33%, shares of not listed entities as collateral form 17%, guarantees by KredEx and Maaelu Edendamise Sihtasutus (rural life development foundation) form 15%, pledged rights of claims 22% and deposit guarantee 10%.
According to the internal rating system developed by LHV Pank in 2009, the loan portfolio is distributed between the quality classes as at balance sheet date as follows:

(in thousand Estonian kroons)	**31.12.2009**	**31.12.2008**
Excellent	51 287	30 647
Good and very good	46 960	0
Satisfactory	41 552	0
Weak or doubtful	6 808	0
Total	**146 607**	**30 647**

In addition to the loans granted, loan contracts have been concluded and signed whereby the unused loan commitments was EEK 16 860 thousand as at 31.12.2009, see also Note 27 (as at 31.12.2008, there were no unused loan commitments). Therefore, the Group's maximum on-balance sheet credit risk exposure without accounting for any collateral would equal the carrying amount of these loans and finance lease receivables of EEK 146 607 thousand (31.12.2008: EEK 30 647 thousand), see also Notes 14 and 16, and the total credit risk exposure from loans and financial guarantees granted and commitments taken would be EEK 172 730 thousand.

3.2.2 Market risk

Market risk arises from LHV Pank's trading and investment activities in the financial markets from interest rate products, foreign exchange and stock markets as well as lending activities and taking in financial resources. Market risk is a potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. The VaR (Value at Risk) method is used to assess potential losses. The method calculates the maximum potential loss at a particular trade date from a particular portfolio with 99% probability. Options portfolios are limited to the open delta limit of the total portfolio. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures, the monitoring responsibility of which lies with the internal control department.

LHV Varahaldus invests over half of its capital in the units of investment funds managed by it. The management of LHV Varahaldus is responsible for assuming and monitoring of the market risk.

✓ ***Foreign currency risk***

Foreign currency risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. The custody and risk management department of LHV Pank is responsible for daily monitoring of open foreign currency positions. If the open currency position exceeds the limits set in regulatory acts, measures are immediately implemented to reduce such positions (hedging the risk with relevant instruments, like foreign currency forwards or futures).
Foreign currency rate risk is managed under the following limits:

- Open currency positions of OECD member states cannot exceed 15% of net own funds
- Open currency positions of any other currency (excl. euro, lats, litas) cannot exceed 5% of net own funds
- Open currency positions of the Estonian kroon, Latvian lats and Lithuanian litas are without limits, as the kroon and the litas are pegged to the Euro using a fixed exchange rate and the fluctuation of the lats is fixed at +/-1% to the Euro.

Information regarding assets and liabilities bearing currency risk is presented in the tables on the following pages. The main currencies, in which the Group has open currency exposures, are USD, SEK, LTL and LVL. Open currency exposures have not significantly differed throughout 2009 in comparison with the balance sheet date exposures.

<u>**Open currency exposures**</u>

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in EEK equivalent in respective columns, according to the exchange rate prevailing at the balance sheet date. Derivatives reported at fair value in the balance sheet have been included at contractual amounts under contingencies and commitments. Open currency exposure and the volume of financial assets and liabilities of the Group at the balance sheet date do not significantly differ from the average exposure during the year.

As at 31.12.2009	EEK	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk								
Balances with other banks and inv. companies	237 453	147 919	4 385	953	1 491	21 769	6 095	420 065
Financial assets at fair value through profit or loss	21 323	91 587	73	0	9	62	4	113 058
Loans granted	16 687	99 053	8 627	1 242	497	9 742	6 641	142 489
Receivables from customers	2 248	233	7	554	4	916	211	4 173
Finance lease receivables	4 118	0	0	0	0	0	0	4 118
Other assets	2 788	340	0	8	0	0	0	3 136
Total assets bearing currency risk *	**284 617**	**339 132**	**13 092**	**2 757**	**2 001**	**32 489**	**12 951**	**687 039**
Liabilities bearing currency risk								
Loans received and deposits from customers	274 443	205 316	8 313	834	1 785	34 982	2 107	527 780
Other financial liabilities	105	0	18	0	0	0	0	123
Accrued expenses and other liabilities	10 658	9 609	524	106	12	0	9	20 918
Deferred income	9	451	0	0	0	0	0	460
Finance lease liabilities	325	0	0	0	0	0	0	325
Bonds issued	4 190	0	0	0	0	0	0	4 190
Total liabilities bearing currency risk *	**289 730**	**215 376**	**8 855**	**940**	**1 797**	**34 982**	**2 116**	**553 796**
Contingencies at contractual amounts *	0	123 217	0	0	0	126 220	0	249 437
Commitments at contractual amounts *	0	123 217	0	0	0	123 217	0	246 434
Open foreign currency position	**-5 113**	**123 756**	**4 237**	**1 817**	**204**	**510**	**10 835**	**136 246**

* the balances of total assets and total liabilities bearing currency risk above don't include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts (see also Note 12).

As at 31.12.2008								
Assets bearing currency risk	**EEK**	**EUR**	**LTL**	**LVL**	**SEK**	**USD**	**Other**	**Total**
Balances with other banks	21 106	490	201	57	0	0	0	21 854
Financial assets at fair value through profit or loss	18 830	25 950	297	0	1	34	0	45 112
Loans granted	7 015	5 842	7 216	267	334	4 677	1 050	26 401
Receivables from customers	2 429	156	0	0	0	573	134	3 292
Finance lease receivables	4 246	0	0	0	0	0	0	4 246
Other assets	1 819	351	7	8	0	0	0	2 185
Total assets bearing currency risk *	**55 445**	**32 789**	**7 721**	**332**	**335**	**5 284**	**1 184**	**103 090**
Liabilities bearing currency risk								
Loans received	3 963	8 261	0	0	0	0	0	12 224
Financial liabilities at fair value through profit or loss	379	2	161	0	0	0	0	542
Accrued expenses and other liabilities	5 960	154	426	91	0	11	0	6 642
Finance lease liabilities	0	414	0	0	0	0	0	414
Bonds issued	4 342	0	0	0	0	0	0	4 342
Total liabilities bearing currency risk *	**14 644**	**8 831**	**587**	**91**	**0**	**11**	**0**	**24 164**
Contingencies at contractual amounts *	4 570	0	0	0	0	0	0	4 570
Commitments at contractual amounts *	0	0	0	0	572	3 902	0	4 474
Open foreign currency position	**45 371**	**23 958**	**7 134**	**241**	**-237**	**1 371**	**1 184**	**79 022**

* the balances of total assets and total liabilities bearing currency risk above don't include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts (see also Note 12).

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to open currency positions on the income statement, with the assumption of other conditions remaining constant.

Impact on statement of comprehensive income (th EEK)	Change	2009	Change	2008
USD exchange rate	10%	47	10%	-57
	-10%	-47	-10%	57
SEK exchange rate	5%	12	5%	-4
	-5%	-12	-5%	4

✓ ***Price risk***

Financial instruments bearing price risk in LHV Pank and LHV Varahaldus are securities held in trading portfolio (intermediating trades to the clients of the bank) and investment portfolio (investing liquid assets). The limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for bonds in investment portfolio. The internal control department monitors the compliance with limits.

Sensitivity analysis of the impact to net result from the risk exposures against reasonable possible change:

Impact on statement of comprehensive income (th EEK)	Change	2009	Change	2008
Shares	30%	224	10%	461
	-30%	-224	-10%	-461
Fund units	15%	32	10%	27
	-15%	-32	-10%	-27
Bonds	15%	12 455	20%	881
	-15%	-12 455	-20%	-881

The goal of the investment portfolio of LHV Varahaldus is to invest available funds similarly to how the assets of the funds managed by LHV Varahaldus are invested as a result of which LHV Varahaldus invests more than one half of capital in the funds managed by it. In order to ensure liquidity, the remaining available funds are invested in securities, including bonds and deposits.

Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 1% of the number of units in each of the mandatory pension fund managed by it. The investment portfolio of LHV Varahaldus consists of both pensions fund units as well as the units of investment funds managed by it. Management cannot reasonable certainty assess the price change of the units of funds managed by it over the following 12 months, as result of which the possible effect on the income statement is not presented here.

✓ ***Interest rate risk***

The goal of monitoring, measuring and managing interest rate risk is to evaluate the profitability of the bank's interest-bearing products, to forecast interest income and to set limits for risk management in order to prevent significant reduction of income through limitation of risks in two aspects:

- cash flow interest rate risk whereby in case of a 1% change in market interest rates, a change in annual net interest income is limited as compared to the estimated actual income based on the term structure of instruments currently in the balance sheet;
- fair value interest rate risk whereby in case of a 1% change in market interest rates, a change in the bank's intrinsic value is limited (fair value of assets and liabilities is determined by discounting the future cash flows at the market rate of interest).

To reduce the cash flow risk arising from possible change in interest rates, the Group primarily uses fixed interest rates for taking in deposits. The interest rates of the deposits from customers were in 2009 upto 7%. The interest rate on loans granted was between 7.5-20.5% in 2009, same in 2008. Interest rates for leveraging loans granted are changed once a month at most according to fluctuations in market interest rates. Interest rates on loans received in 2009 were at 1.5% (2008: 8%).

Since due to the launch of its operations as a bank, cash and cash equivalents represent the largest share in the bank's balance sheet and as liabilities have longer due dates, the decline in market rates of interest would have a negative effect on the bank's interest income. However, interest rate risk has been kept within limits. As at 31.12.2009, a 1% decline in interest rates would have an effect on Group´s yearly interest income by -351 thousand kroons (1% rise in interest rates would have and effect by +351 thousand kroons). In 2008, the portfolio of the loans received and granted was of short-term nature and the change in market rates of interest did not have a significant impact on the fair value of loans because the interest rates of products were continuously restated along with the market rates.

The finance lease receivables of LHV Ilmarise Kinnisvaraportfelli OÜ and issued bonds are with fixed interest rates of 6-8% and 5.8%, respectively. The redemption of bonds is performed in accordance with the scheduled collection of finance lease receivables. If customers wish to terminate finance lease agreements before the maturity date, the Group is entitled to redeem the issued bonds in the additionally collected amount. Due to this, the Group does not bear significant interest rate risk.

The structure of the interest-earning assets and interest-bearing liabilities of the Group according to the recalculation of interest due dates is presented in the following tables. Most of instruments represent fixed interest rate products in the case of which interest does not change during the contract period, and the leveraging loans are treated as a one-month product maturing at the next interest fixing date.

31.12.2009	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Assets						
Balances with other banks and inv. companies	323 225	96 840	0	0	0	**420 065**
Financial investments, incl. derivatives	110	12 049	21 632	49 251	33 019	**116 061**
Loans granted	61 235	34 390	41 061	5 803	0	**142 489**
Finance lease receivables	4 173	0	0	0	0	**4 173**
Receivables from customers	0	0	0	4 118	0	**4 118**
Other assets	0	0	0	0	207	**207**
Total financial assets	**388 743**	**143 279**	**62 693**	**59 172**	**33 226**	**687 113**
Liabilities						
Loans received and deposits from customers	303 010	182 022	20 098	22 650	0	**527 780**
Other financial liabilities	0	0	0	0	123	**123**
Bonds issued	0	0	0	4 190	0	**4 190**
Other liabilities	9	8 775	0	0	144	**8 928**
Total financial liabilities	**303 019**	**190 797**	**20 098**	**26 840**	**267**	**541 021**
Total interest repricing gap	**85 724**	**-47 518**	**42 595**	**32 332**	**-**	**146 092**

31.12.2008	Up to 3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets						
Balances with other banks and inv. companies	21 854	0	0	0	0	**21 854**
Financial investments, incl. derivatives	5 062	1 111	11 558	989	26 488	**45 208**
Loans granted	15 421	10 980	0	0	0	**26 401**
Receivables from customers	2 718	574	0	0	0	**3 292**
Finance lease receivables	0	0	0	4 246	0	**4 246**
Other assets	0	0	0	0	218	**218**
Total financial assets	**45 055**	**12 665**	**11 558**	**5 235**	**26 706**	**101 219**
Liabilities						
Loans received	7 247	4 977	0	0	0	**12 224**
Finance lease liabilities	22	67	325	0	0	**414**
Bonds issued	0	0	0	4 342	0	**4 342**
Other liabilities	0	0	0	0	542	**542**
Total financial liabilities	**7 269**	**5 044**	**325**	**4 342**	**0**	**16 980**
Total interest repricing gap	**37 786**	**7 621**	**11 233**	**893**	**-**	**84 239**

3.2.3 Liquidity risk

Liquidity risk relates to the solvency of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The finance department of LHV Pank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period, as well the concentration of bank's liabilities by maturities are monitored. As at 31.12.2009 and 31.12.2008, the Group does not have any debts past due.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and therefore, the tables do not reconcile to the positions in balance sheet. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows) rather than being included in a single bucket when the instrument matures.

Explanation of the fair value of these financial assets and liabilities is presented in Note 3.3. LHV Pank has sufficient supply of liquid resources to enable issuing standby loans. To enable covering unexpected monetary outflows, it is possible to sell security investments, which are held for a purpose to ensure liquidity.

31.12.2009	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates					
Loans received and deposits from customers	303 787	187 483	38 318	6 295	**535 883**
Other financial liabilities	123	0	0	0	**123**
Bonds issued	99	307	1 632	4 517	**6 555**
Other liabilities	9 596	12 366	500	0	**22 462**
Unused loan commitments	16 860	0	0	0	**16 860**
Financial guarantees by contractual amounts	8 763	0	0	0	**8 763**
Total liabilities	**339 228**	**200 156**	**40 450**	**10 812**	**590 646**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	323 346	100 234	0	0	**423 580**
Financial investments	1 297	15 373	38 063	58 751	**113 484**
Loans granted	70 212	25 667	46 256	3 731	**145 866**
Finance lease receivables	117	317	1 650	4 482	**6 566**
Receivables from customers	4 173	0	0	0	**4 173**
Total assets held for managing liquidity risk	**399 145**	**141 591**	**85 969**	**66 964**	**693 669**
Maturity gap from assets and liabilities	**59 917**	**-58 565**	**45 519**	**56 152**	**103 023**

31.12.2008	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates					
Loans received	1 115	11 603	0	0	**12 718**
Bonds issued	37	378	1631	4 915	**6 961**
Financial liabilities	542	0	0	0	**542**
Other liabilities	3 979	3 263	0	0	**7 242**
Total liabilities	**5 673**	**15 244**	**1 631**	**4 915**	**27 463**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	21 854	0	0	0	**21 854**
Financial investments	11 323	2 855	15 620	3 401	**33 198**
Loans granted	15 421	11 133	0	0	**26 554**
Finance lease receivables	39	383	1651	4 882	**6 955**
Receivables from customers	2 718	574	0	0	**3 292**
Total assets held for managing liquidity risk	**51 355**	**14 945**	**17 271**	**8 283**	**91 853**
Maturity gap from assets and liabilities	**45 682**	**-299**	**15 640**	**3 368**	**64 390**

3.2.4 Risk concentration

Distribution of assets and liabilities by geography is presented below:

As at 31.12.2009

Asset distribution by geography	Estonia	Latvia	Lithuania	Sweden	Finland	Denmark	USA	Other	Total
Balances with banks and inv. companies	159 473	106 564	7 900	626	69 711	29 080	29 799	16 912	**420 065**
Financial investments, incl. derivatives	45 766	0	17 890	15 194	13 328	0	6 630	17 253	**116 061**
Loans granted	130 070	2 476	9 922	0	0	0	0	21	**142 489**
Receivables from customers	3 065	81	181	18	0	0	9	819	**4 173**
Finance lease receivables	4 118	0	0	0	0	0	0	0	**4 118**
Other assets	3 002	82	52	0	0	0	0	0	**3 136**
Goodwill	16 332	0	0	0	0	0	0	0	**16 332**
Tangible and intangible assets	4 996	309	103	0	0	0	0	0	**5 408**
Total assets	**366 822**	**109 512**	**36 048**	**15 838**	**83 039**	**29 080**	**36 438**	**35 005**	**711 782**
Distribution of liabilities by geography									
Loans and deposits from customers	506 879	6 470	11 347	1	974	6	1 135	968	**527 780**
Other financial liabilities	109	0	14	0	0	0	0	0	**123**
Finance lease liabilities	325	0	0	0	0	0	0	0	**325**
Bonds issued	4 190	0	0	0	0	0	0	0	**4 190**
Other liabilities	12 459	115	1 104	15	0	0	9	8 776	**22 478**
Total liabilities	**523 962**	**6 585**	**12 465**	**16**	**974**	**6**	**1 144**	**9 744**	**554 896**

Unused loan commitments to Estonian residents amount to 16 860 thousand kroons (2008: nil).

As at 31.12.2008

Asset distribution by geography	Estonia	Latvia	Lithuania	Sweden	Finland	Denmark	USA	Other	Total
Balances with other banks	21 624	15	201	0	0	0	0	14	**21 854**
Financial investments, incl. derivatives	33 352	468	1 120	1 287	8 611	0	9	361	**45 208**
Loans granted	17 884	771	7 746	0	0	0	0	0	**26 401**
Receivables from customers	2 530	14	0	15	1	0	0	732	**3 292**
Finance lease receivables	4 246	0	0	0	0	0	0	0	**4 246**
Other assets	2 051	82	52	0	0	0	0	0	**2 185**
Goodwill	8 723	0	0	0	0	0	0	0	**8 723**
Tangble and intangible assets	6 767	570	307	0	0	0	0	0	**7 644**
Total assets	**97 177**	**1 920**	**9 426**	**1 302**	**8 612**	**0**	**9**	**1 107**	**119 553**
Distribution of liabilities by geography									
Loans received	11 832	392	0	0	0	0	0	0	**12 224**
Other financial liabilities	381	0	161	0	0	0	0	0	**542**
Finance lease liabilities	414	0	0	0	0	0	0	0	**414**
Bonds issued	4 342	0	0	0	0	0	0	0	**4 342**
Other liabilities	7 027	276	1 260	0	17	0	7	0	**8 587**
Total liabilities	**23 996**	**668**	**1 421**	**0**	**17**	**0**	**7**	**0**	**26 109**

Distribution of loans granted by industry

	31.12.2009	%	31.12.2008	%
Private individuals	25 691	18.03%	12 728	48.21%
Financial services	22 515	15.80%	4 232	16.03%
Wholesale and retail	16 913	11.87%	845	3.20%
Administration and support services	14 777	10.37%	4 342	16.45%
Construction	13 565	9.52%	21	0.08%
Manufacturing	7 496	5.26%	129	0.49%
Information and communication	6 758	4.74%	1 077	4.08%
Other services	4 959	3.48%	1 629	6.17%
Real estate	3 961	2.78%	160	0.61%
Other	25 854	18.14%	1 238	4.69%
Total	**142 489**	**100%**	**26 401**	**100%**

As at 31.12.2009, two loans granted qualify as large exposures, i.e. over 10% of the net own funds (NOF) of the Group. The receivables from the loans totalled 34 423 thousand kroons, i.e. 26% of NOF. As at 31.12.2008 the were no loans granted as large exposures.

3.3 Fair value of financial assets and financial liabilities

According to the management of the Group, the carrying values of assets and liabilities recognised at amortised cost in the consolidated balance sheet do not materially differ from their fair values as at 31.12.2009 and 31.12.2008.

Leveraged loans granted to customers are of sufficiently short-term nature and they have been issued at market terms, therefore the fair market rate of interest and also the fair value of loans do not change significantly during the loan term. The portfolio of other loans granted is still too small in volume due to the launch of the bank's operations, each customer is treated individually and interest rates vary as a result of the customer's risk level, therefore, a homogeneous and comparable interest rate based on similar transactions cannot be applied to discount the future cash flows of these loans. As the total loan portfolio was issued in the second half of 2009, the management of the bank estimates that the loans have been issued at market terms and their fair value as at 31.12.2009 does not materially differ from their carrying amount. See also the term structure of financial assets in Note 3.2.3. Liquidity.

Both finance lease receivables and bonds issued are of significantly longer maturity and the fair value of these expected cash flows at the current market rates might differ from the carrying amounts of the finance lease receivables and bonds issued. The lessees are entitled to terminate their agreement at any time during the lease period; therefore it would not be appropriate to consider these cash flows from current agreements as expected cash flows on the basis of schedules established in the agreements. Bonds have been redeemed in exactly the same volume as purchased finance lease agreements. Therefore, the Management Board has evaluated and concluded that the combined fair value of lease receivables and bonds issued does not significantly differ from their carrying amounts as at 31.12.2009 and 31.12.2008. During the period between the conclusion of finance lease agreements and the issue of bonds until the balance sheet date, the 6-month EURIBOR has moved from 2.971% to 0.994%, which gives an indication of the overall change in market interest rates during the period. All deposits from customers with fixed interest rates were also received in the second half of 2009. During this time period, the market yield curve has not significantly changed, as a result of which the fair value of deposits to be determined by discounting future interest income does not significantly differ from their carrying amount. See also the term structure of financial assets in Note 3.2.3. Liquidity.

Receivables from customers and accrued expenses and other liabilities have been generated/incurred during the ordinary course of business and are payable in the short-term, as a result of which the management estimates that their fair value does not significantly differ from their carrying amount. These receivables and liabilities are interest-free.

The following tables gives an overview of the hierarchy of valuation techniques used for valuation of financial asstets and liabilities measured at fair value:

	31.12.2009				31.12.2008			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss								
Trading portfolio								
shares	749	-	-	**749**	4 372	-	-	**4 372**
fund units	208	-	-	**208**	506	-	-	**506**
Investment portfolio								
bonds	74 937	-	8 105	**83 042**	2 230	-	16 490	**18 720**
fund units	29 059	-	-	**29 059**	21 514	-	-	**21 514**
Derivatives	-	3 003	-	**3 003**	-	96	-	**96**
Total financial assets	**104 953**	**3 003**	**8 105**	**116 061**	**28 622**	**96**	**16 490**	**45 208**
Financial liabilities at fair value through profit or loss								
Derivatives	123	-	-	**123**	540	2	-	**542**
Total financial liabilities	**123**	**0**	**0**	**123**	**540**	**2**	**0**	**542**

Levels used in hierarchy:

Level 1– quoted prices in active market

Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)

Level 3 – other valuation techniques (f.ex discounted cash flow method) with judgemental inputs

Debt instruments in Level 3 have been bought in 2009 for 6 838 thousand kroons and sold in total value of 14 633 thousand kroons and net loss (interest received less revaluation loss) recognised in statement of comprehensive income amounts to -590 thousand kroons, see also Note 8.

3.4 Operating risk

Operating risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the principle of duality is used in the Group's working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of the Group and to evaluate capital requirements. The analysis on cases collected into the database enables to identify the flaws in rules of procedures, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk manager of the bank is responsible for collecting information and the Management Board of LHV Pank is responsible for dealing with the analysis and implementing necessary measures.

Compliance control and internal audit have an important role in evaluating, monitoring and mitigating the operating risk. Pursuant to the Credit Institutions Act and Securities Market Act, the main task of Compliance Officer is to define non-compliance risks of the activities of the Group to legislation, recommended guidelines of the Financial Supervisory Authority and procedure rules of the Group, considering the nature, range and complexity of business and services rendered, and arrangement of mitigating or avoiding those risks. Internal audit is an independent and objective, assuring and consulting activity that is targeted at improving the Company's performance and adding value. Internal audit helps achieving the goals of the Group entities, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.5 Effects of the economic crisis

The managements has evaluated the effects of the global economic crisis on the Group´s business. Due to the current core business of the Group as a securities intermediary, the events occurring in the securities markets are an important factor impacting the Group's business. Despite the sharp decline in the global securities markets which started in 2008 and continued in the early spring of 2009, the fee and commission income of the Group has been maintained at the same level as in previous years and this trend is also expected to continue in 2010. As a result of the economic crisis which has hit the Baltic States, loan demand has decreased in the region as a whole. This has also had an effect on the lending activities of the Group in Estonia. However, the management estimates that once the macroeconomic situation improves in 2010, the loan demand can be expected to slightly pick up in the region. The management believes that all necessary measures have been taken into use to ensure the Group's entities´ sustainable operations and growth in a relatively difficult to forecast economic environment.

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the consolidated financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the balance sheet date, and the reported amounts of revenue and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates.
Management's estimates have been primarily applied to:

- recognition of impairment losses of loans, receivables and investments;
- in the absence of an active market, fair valuation of investments using valuation techniques (Note 13);
- assessment of provisions and contingent assets / liabilities;

Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances. Changes in management's estimates are reported in the statement of comprehensive income of the period in which the change occurred.

NOTE 5 Subsidiaries and associated company, goodwill

As at 31.12.2009, the Group's associate is a Finnish company Luottotalo Fenno OY (Fenno) which issues consumer loans. AS LHV Group made an investment in the amount of EEK 24 268 thousand into the shares of Fenno, thereby acquiring a 24,53% ownership interest in the entity. The acquisition was made with a goal that Finno would obtain the license of a credit institution, enabling it to raise deposits as a cheaper source of financing instead of issued bonds and the company's growth will continue. Considering the additional information which became available after the events after the balance sheet date (Note 29) and significant loan provisions made during the Company's audit review of the financial year, management has written down the investment in shares in full.

Financials of Luottotalo Fenno OY (audited)	31.12.2009
Assets	359 383
Liabilities	331 833
Equity	27 550
Revenue	119 965
Loan provisions	-67 834
Loss 2009	-68 727

For evaluating the gain/loss under the equity method, the financials of Fenno have been brought into compliance with the accounting policies of LHV Group and management estimates and as a result, the book value of the equity of Fenno is negative in the amount of EEK 14 911 thousand.

As at 31.12.2009, the Group's subsidiaries which have been consolidated in these financial statements, include:

- AS LHV Pank (ownership interest 100%)
- LHV Ilmarise Kinnisvaraportfelli OÜ (ownership interest 100%)
- AS LHV Varahaldus (ownership interest 81%)

As at 31.12.2008, AS LHV Group held 61,96% of the shares of AS LHV Varahaldus. At 15.06.2009, AS LHV Group entered into a contract with EBRD (European Bank for Reconstruction and Development), pursuant to which it acquired a 19.04% ownership interest in AS LHV Varahaldus which was previously held by EBRD. After the transaction, the ownership interest of AS LHV Group in AS LHV Varahaldus is 81%. In accordance with the contract, the share purchases will take place in four parts, with two payments made in 2009 and two will be made in 2010. Although AS LHV Group obtained the right of ownership to the shares after the conclusion of the contract, as at 31.12.2009, EBRD technically holds 9,52% of the shares. A monetary payment for the acquisition of the shares will be made in 2010 and the respective liability in the amount of EEK 8 775 thousand in recognised in the Group's balance sheet. Therefore, as at 31.12.2009, AS LHV Group holds 71,48% of the shares of AS LHV Varahaldus.

Acquisition of the shares of AS LHV Varahaldus for the price of EEK 14.50612 per share	15.06.2009
Cash and bank	21 600
Receivables and accrued income	1 356
Financial investments	34 701
Non-current assets	1 664
Liabilities	14 115
Equity	45 206

Acquired ownership interest	19,04%
Acquired net assets	8 606
Cost	**17 399**
Goodwill	8 793

As at 31.12.2008, the goodwill (EEK 8 723 thousand) carried in the consolidated balance sheet of AS LHV Group consisted of:

- Positive goodwill which had arisen on the acquisition of ownership interests in AS LHV Varahaldus in the amount of EEK 7 539 thousand
- Goodwill which had arisen on the acquisition of the subsidiary carried in the balance sheet of AS LHV Varahaldus (former management company AS Seesam Varahaldus) in the amount of EEK 1 184 thousand.

In 2009, an impairment test was performed to evaluate goodwill which arose on the acquisition of former Seesam Varahaldus. Three funds of former Seesam Varahaldus were considered to be the cash-generating units of goodwill. The revenue received from managing these funds and the related costs allocated to them were considered to be cash flows.

The following main assumptions were used to determine the value in use:

- In forecasting the cash flows for 2010-2014, management has used the assumptions that wages will start to grow again by 5% p.a. and the customer investments in the funds have been determined on the basis of this (assumption used in the test performed in 2008: wages will not increase)
- growth in the volume of funds is proportionately modest as compared to other funds managed by the management company (2008: the same)
- estimated rates on return of funds are 4-5% p.a. on average (2008: 2-3%)

- indirect costs are assumed to grow by 4% (2008: 7%)
- the discount rate of cash flows is 13% (2008: 12%)
- in using the key assumptions, management relied on the experience of previous periods and its best estimate in respect of most probable expectations.

Due to the low share of the revenue generated by the three funds tested to the entity's total revenue, and a higher cost base as a result of the share of costs allocated to them, the recoverable amount of goodwill determined in the test is lower than its carrying amount, as result of which, management has written down goodwill in full.

As at 31.12.2009, goodwill (EEK 16 332 thousand) in the consolidated balance sheet of AS LHV Group consists of:

- positive goodwill which had arisen on the acquisition of the ownership interests in AS LHV Varahaldus in the amount of EEK 7 539 thousand
- positive goodwill which had arisen after the conclusion of a purchase contract entered into in 2009 in the amount of EEK 8 793 thousand.

An impairment test was performed as at 31.12.2009. The cash generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

1) the cash flow forecast for the years 2010-2014 is based on the assumptions that after the halting of the state-made contributions to mandatory funded pension in 2009, over half of the customers of Varahaldus voluntarily continued to make their contributions to the 2nd pillar pension funds and future cash flows are generated according to scheme established by the state (2008: assumption that contributions to the 2nd pillar will not be made in 2010, in 2011, contributions will be half of the regular amount and from 2012,contributions will be restored to their regular level)
2) due to the economic environment, modest growth of 4% in operating is expected per annum (2008: 3%)
3) the discount rate used is (2008: 12%)

Based on the results of the impairment test, the recoverable amount of goodwill is higher than its carrying amount, as a result of which no impairment losses have been recognised.

NOTE 6 Net fee and commission income

Fee and commission income	**2009**	**2008**
Financial advisory services	210	284
Security brokerage and commissions	41 661	39 793
incl. related parties (Note 28)	*470*	*454*
Asset management and similar fees	20 010	19 717
incl. related parties (Note 28)	*13 265*	*11 894*
Total	**61 881**	**59 794**
Fee and commission expense		
Financial advisory and other similar services purchased	-15	0
Security brokerage and commissions paid	-8 070	-7 045
Total	**-8 085**	**-7 045**
Net fee and commission income	**53 796**	**52 749**

Fee and commission income by customer location:	**2009**	**2008**
Estonia	49 209	47 757
Latvia	3 124	3 774
Lithuania	9 548	8 263
Total	**61 881**	**59 794**

NOTE 7 Net interest income

Interest income	**2009**	**2008**
From balances with other banks and investment companies	6 013	3 060
From balances with central bank	57	0
Finance lease (Note 16)	261	270
Margin loans and lending of securities (Note 14)	5 711	6 456
Other loans (Note 14)	3 991	190
Total	**16 033**	**9 976**
Interest costs		
Bonds issued (Note 5, 21)	-244	-252
Loans received and deposits from customers (Note 19)	-7 494	-1 820
incl. loans from related parties (Note 28)	*0*	*-30*
Total	**-7 738**	**-2 072**
Net interest income	**8 295**	**7 904**

Interest income by customer location, excl other banks, investment companies and central bank:	**2009**	**2008**
Estonia	7 615	1 216
Latvia	235	475
Lithuania	2 113	5 225
Total	**9 963**	**6 916**

NOTE 8 Gain from financial assets

Gain/loss from financial assets	**2009**	**2008**
Related to changes in foreign exchange rates:	3 247	2 907
- translation gains less losses	*-423*	*-117*
- transactions gains less losses from customer trades	*3 670*	*3 024*
Net gain/loss on trading portfolio securities recognised at fair value	397	-6 706
Incl. revaluation gains/losses	*79*	*-6 967*
Incl. interest income on bonds	*318*	*261*
Dividend income from trading portfolio securities	*17*	1
Gain from investment portfolio securities designated at fair value	14 560	0
Incl. revaluation of fund units	*5 807*	*-10 039*
Incl. revaluation of bonds	*6 491*	*-1 735*
Incl. interest income on bonds	*2 262*	*2 442*
Net gain/loss from financial assets	**18 221**	**-13 130**

NOTE 9 Other income

	2009	2008
Other income from customers	1 494	474
Income from transactions with related parties (Note 28)	2 360	1 455
Income from transactions with other parties	592	402
Income related to release of provision (Note 22)	0	4 880
Total other income	**4 446**	**7 211**

NOTE 10 Operating expenses

Staff costs	**Note**	**2009**	**2008**
Wages, salaries and bonuses		24 467	19 801
Social security and other taxes		8 163	6 607
Total		**32 630**	**26 408**
Marketing expenses		17 249	9 318
Total services purchased		9 767	9 745
IT expenses		4 149	2 280
Information services and bank services		2 852	2 155
Office expenses		2 296	2 577
Transportation and communication costs		1 100	1 510
Training and travelling expenses of employees		935	1 704
Other administrative expenses		2 832	1 339
Operating lease payments	25	4 531	4 443
Depreciation	18	3 200	3 025
Impairment lof goodwill	5	1 184	0
Costs related to setting up provisions	22	500	600
Other operating expenses		387	332
Total operating expenses		**83 612**	**65 436**

A significant increase in marketing expenses in 2009 is related to more active sales activities targeted at attracting new customers to the funds managed by LHV Varahaldus. A total of 12 600 new customers invested in the 2nd pillar pension funds during the accession period at the beginning of 2010, thereby increasing the customer base by 40%. Due to developing of banking activities in LHV Bank the expenditure on IT has increased.

NOTE 11 Balances with central bank, other banks and investment companies

	31.12.2009	31.12.2008
Demand deposits *	195 962	21 854
Term deposits with original maturity less than 3 months *	54 117	0
Term deposits with maturity more than 3 months	80 000	0
Balances with central bank	88 507	0
Accrued interest	1 479	0
incl from central bank	*18*	*0*
Total	**420 065**	**21 854**
* cash and cash equivalents in statement of cash flows	250 079	21 854

Distribution of receivables by countries is presented in note 3.2.4. Balances with investment companies included in demand deposits amounts to 37 485 thousand kroons. All other demand and term deposits are held at credit institutions. Balances with central bank include the balance of mandatory banking reserve, which all Estonian banks, including LHV Pank, are required to hold in central bank at the level of 15% of all financial resources taken in (loans received and deposits from customers). Reserve requirement ist o be fulfilled as a monthly average in Estonian kroons or in the foreign securities preapproved by central bank.

The funds of the Group according to raitings given by Standard & Poor's or equivalent are held:

	31.12.2009	31.12.2008
AA- to AA+	77 915	0
A- to A+	139 701	21 854
Lower than A-	102 275	0
With no rating	100 174	0
Total	**420 065**	**21 854**

Majority of financial assets without raitings are held in central bank

NOTE 12 Foreign currency derivatives

Balance as at 31.12.2009	**Asset / liability (fair value)**	**Contingent assets (contractual amount)**	**Commitments (contractual amount)**
Foreign currency future contract (USD)	0	123 217	123 217
Foreign currency forward contracts (USD)	3 003	126 220	123 217
Total derivatives	**3 003**	**249 437**	**246 434**
Balance as at 31.12.2008			
Foreign currency future contract (USD)	0	3 902	3 902
Foreign currency forward contracts (SEK)	96	668	572
Total derivatives	**96**	**4 570**	**4 474**

The foreign currency forward contracts have been concluded for client service purposes in order to hedge USD currency exchange rate risk and the Group has again economically hedged that foreign currency exchange rate risk arising from forward contracts by entering opposite foreign currency future contracts. Both contracts are with 3 months maturity.

In 2008 the foreign currency forward contract had been concluded in Swedish kroons in order to economically hedge the foreign currency risk of fixed loans, receivables and securities. The foreign currency future was concluded in USD for the same purpose. The due dates of contracts are between 2 and 3 months from the balance sheet date.

A foreign currency future is traded on the stock exchange and daily gains or losses are immediately transferred to the Group's account as a result of which, the carrying amount of the contract is 0.

NOTE 13 Other financial assets and liabilities at fair value through profit or loss

Securities held for trading:	**31.12.2009**	**31.12.2008**
Shares	749	4 372
Fund units	208	506
Designated at inception:		
Fund units	29 059	21 514
incl. investments in managed pension funds	*20 673*	*14 766*
incl. investments in managed investment funds	*8 386*	*6 748*
Bonds	83 042	18 720
Total financial assets	**113 058**	**45 112**

The shares include the underlying assets purchased for hedging the risk of written options.

With regard to listed securities, the fair value of investments is their bid price. The discounted cash flow model has been used for bonds, the market price of which is difficult to determine. The valuation method considers the current condition and the expected rate of return at the date of valuation and may not accurately reflect market conditions before and after the valuation date.
The Group has adjusted its return expectations due to higher market interest rates and the risk level. All securities are reported at fair value in the financial statements. Of the total bond position, securities in the amount 104 953 thousand kroons (2008: 2 230 thousand kroons) are valued based on the quotes in an active market and bonds in the amount of 8 105 thousand kroons (2008: 16 490 thousand kroons) are valued using the discounted cash flow model are reported at the market price, see also Note 3.3. Debt securities have not been pledged as collateral for loans received or any other liabilities.

The bank's debt securities according to raitings given by Standard & Poor's or eqivalent:

	31.12.2009	**31.12.2008**
AA- to AA+	4 814	0
A- to A+	38 319	989
Lower than A-	31 984	1 241
With no rating	8 105	16 490
Total	**83 042**	**18 720**

Financial liabilities held for trading:	**31.12.2009**	**31.12.2008**
Options embedded in structured bonds	0	2
Written options	123	540
Total financial liabilities	**123**	**542**

LHV Pank underwrites options for the securities traded on Baltic stock exchanges. The Black & Scholes model is used to value options. If an underlying asset pays dividends, the Roll, Geske & Whaley model is used. The variables entered into the price formation include the price of the underlying asset, strike prices (future trade price), volatility, *smile, strike-smile, smile step*, interest, date of paying dividends and the amount of expected dividends. The price of the underlying asset is determined according to the market price, i.e. the price of a put option is calculated using the bid price and the price of a call option is calculated using the ask price of the underlying asset. In order to determine volatility, the function of the Bloomberg terminal is used and it is monitored that no arbitrage opportunities arise between various strike prices. Interest used for valuation depends on the value of money for LHV Pank and as at 31.12.2009, the interest rate used was 8% (2008: 8%).

NOTE 14 Loans granted

Loans to customers	**Loan balance 31.12.2009**	**Loan balance 31.12.2008**	**Interest rate**
Loans to entities	116 798	13 673	7%-18%
Loans to private persons	25 691	12 728	7%-18%
Total loans to customers	**142 489**	**26 401**	

The loans granted contain leveraged loans in the amount of 47 169 thousand kroons (31.12.2008: 26 400 thousand kroons) and loans to other unrelated entities in the amount of 95 320 thousand kroons (2008: 0). Deferred income includes deferred loan origination fees in the amount of 451 thousand kroons. They are recognised to interest income over the loan maturity period, of which the current part amounts to 301 thousand kroons and long-term part amounts to 150 thousand kroons. As at 31.12.2008 the deferred income included received prepaid interest on loans issued to customers in the amount of 1 336 thousand kroons. For interest income on loans granted, see Note 7.

Information about credit risk exposure and loan collateral information is presented in Note 3.2.1.
Distribution of loans granted by currency is presented in Note 3.2.2.
Distribution of loans granted by maturity is presented in Note 3.2.3.
Distribution of loans granted by geography is presented in Note 3.2.4.

Only leveraged loans backed with securities have been issued to the private individuals, where the interest rates are generally equal to their effective interest rates as no significant fees have been received at issuance.

NOTE 15 Receivables from customers

	31.12.2009	31.12.2008
Securities brokerage fees from intermediaries	749	752
Asset management fees from customers	1 838	1 181
Other fees for providing services to customers	1 051	1 374
incl. related parties (Note 28)	*1 564*	*1 520*
Payments in transit	535	0
Allowances for impairment of receivables	0	-15
Total	**4 173**	**3 292**

All fees are receivable within 12 months of the balance sheet date, and are considered current assets.

NOTE 16 Finance lease receivables

Net investment by due dates	**31.12.2009**	**31.12.2008**
Up to 1 year	183	161
Between 1 and 5 years	757	712
Over 5 years	3 178	3 373
Total net investment	**4 118**	**4 246**
Future interest income by due dates		
Up to 1 year	250	261
Between 1 and 5 years	893	939
Over 5 years	1 304	1 509
Total future interest income	**2 447**	**2 709**
Gross investment by due dates		
Up to 1 year	434	422
Between 1 and 5 years	1 650	1 650
Over 5 years	4 482	4 883
Total gross investment	**6 566**	**6 955**

At 21.01.2005, a subsidiary to the parent AS LHV Pank, LHV Ilmarise Kinnisvaraportfelli OÜ acquired from a third party OÜ Ilmarise Kvartal the portfolio of lease receivables arising from finance lease agreements against finance lessees concerning finance lease payments in the amount of 18 529 thousand kroons. The underlying currency of finance lease agreements is the Estonian kroon. The annual interest rates on the finance lease agreement are between 6% and 8%. Interest rates are fixed. In addition, OÜ Ilmarise Kvartal made an irrevocable payment of 141 thousand kroons to cover the credit risks associated with these lease receivables and the customers in these lease contracts. This is effectively accounted for as part of the acquisition cost of these lease receivables and deducted from the net investment (for interest cost, see Note 7).

These finance lease agreements cover the leasing of apartments by the lessees and upon payment of all lease payments according to the contract, the lessees will become owners of these apartments. Upon the early payment of the full amount of the net investment of the lease agreement, the lessees are entitled to acquire the apartment before the end of the lease term. In 2009, principal payments for apartments totalled 130 thousand kroons (2008: 128 thousand kroons). By the time of compiling this report, 8 apartments have not yet been purchased. All finance lease receivables have been pledged as collateral for the bonds issued.

Danske Bank A/S Estonia Branch acts as a guarantee agent and custodian of the pledged assets (see Note 21). For receivables past due, see the credit risk table in Note 3.2.1.

NOTE 17 Other assets

	31.12.2009	31.12.2008
Guarantee deposits of Baltic stock exchanges	207	218
Prepayment of marketing expenses	200	466
Prepayments to Financial Supervision Authority	1 322	743
Other prepayments *	1 407	758
Total	**3 136**	**2 185**

* Prepayments include office rent, insurance, communication services and periodicals.

Prepayments are expected to be received or used within 12 months of the balance sheet date, and are therefore considered current assets. Guarantee deposits on the Baltic stock exchanges are held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius, and should therefore be considered long-term assets.

NOTE 18 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2007			
Cost	7 147	562	7 709
Accumulated depreciation and amortisation	-1 324	-433	-1 757
Carrying amount	**5 823**	**129**	**5 952**
Changes occurred in 2008:			
Purchase of non-current assets	4 565	182	4 747
Proceeds from disposal of non-current assets at carrying amount	-29	0	-29
Depreciation/amortisation charge	-2 936	-89	-3 025
Balance as at 31.12.2008			
Cost	11 673	744	12 417
Accumulated depreciation and amortisation	-4 251	-522	-4 773
Carrying amount	**7 422**	**222**	**7 644**
Changes occurred in 2009:			
Purchase of non-current assets	476	488	964
Depreciation/amortisation charge	-3 064	-136	-3 200
Balance as at 31.12.2009			
Cost	12 149	1 232	13 381
Accumulated depreciation and amortisation	-7 315	-658	-7 973
Carrying amount	**4 834**	**574**	**5 408**

In 2009 and 2008, there was no indication of impairment of tangible and intangible assets.

NOTE 19 Loans received and deposits from customers

Loans received and due to customers	31.12.2009 Private individuals	Private legal entities	Public entities	Total	31.12.2008 Private individuals	Private legal entities	Total
Demand deposits	40 963	72 413	553	113 929	0	0	0
Term deposits	211 926	166 524	9 970	388 420	0	0	0
Structured bonds	0	0	0	0	709	101	810
Loans received *	0	0	22 650	22 650	705	10 625	11 330
Accrued interest liability	1 542	1 193	46	2 781	18	66	84
Total	**254 431**	**240 130**	**33 219**	**527 780**	**1 432**	**10 792**	**12 224**
Incl related parties (Note 28)	*8*	*996*	*0*	*1 004*	*0*	*0*	*0*

* Loans received from Maaelu Edendamise Sihtasutus (Rural Development Foundation) with intended purpose to finance loans to small enterprises operating in rural areas.

Distribution of loans received and deposits from customers by currency is presented in Note 3.2.2.
Distribution of loans received and deposits from customers by maturity is presented in Note 3.2.3.
Distribution of loans received and deposits from customers by geography is presented in Note 3.2.4.

The nominal interest rates of most loans received and deposits from customers equal their effective interest rates as no other significant fees have been paid.

Structured bonds are separated into two components, where the option component has been included at its fair value within the financial liabilities at fair value through profit or loss, see Note 13. Structured bonds were issued on 01.10.2008 with maturity of 1 year and the return of the bonds was dependent on return of the fund unit of LHV Persian Gulf Fund. The bonds have been redeemed by the balance sheet date.

NOTE 20 Accrued expenses and other liabilities

	31.12.2009	31.12.2008
Financial liabilities:		
Financial guarantee contracts issued	144	0
Liabilities for purchase of shares *(Note 5)*	8 775	0
Trade payables	2 941	1 536
Other liabilities:		
Tax liabilities	3 359	3 194
Payables to employees	4 576	1 912
Payments in transit	1 114	0
Other short-term liabilities	9	0
Total	**20 918**	**6 642**

Payables to employees consist of unpaid salaries; bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in number of employees during the year. Payments in transit are liabilities to clients arising from securities brokerage. All the liabilities, except for financial guarantees, are payable within 12 months and are therefore recognized as current liabilities.

NOTE 21 Bonds issued

The balance sheet line of bonds includes the bonds related to finance lease agreements.

Distribution of liabilities by maturities	**31.12.2009**	**31.12.2008**
Up to 1 year	225	226
Between 1 and 5 years	763	717
Over 5 years	3 202	3 399
Total issued bonds	**4 190**	**4 342**

At 19 January 2005, AS LHV Pank carried out a placement of securitised bonds backed by finance lease agreements in the total amount of 18 529 thousand kroons, see note 16. Interest on coupon bonds is 5.8% per annum. The redemption payments of bonds and interest payments to bond holders take place on a quarterly basis in the month following the end of the quarter.
During the reporting period bonds issued in amount of 150 thousand kroons (2008: 142 thousand kroons).

NOTE 22 Provisions

In the balance sheet, a provision has been recognised in the amount of 1 100 thousand kroons (2008: 600 thousand kroons), the respective expense is included within operating expenses (see Note 10). Provision in amount of 500 thousand kroons is recognized as a long-term liability and provision in amount of 600 thousand kroons is recognized as a short-term liability.

NOTE 23 Shareholders' equity in the public limited company

The sole shareholder of the Group is AS LHV Group. The ultimate controlling party of AS LHV Group is Rain Lõhmus with 54% of the voting rights. Andres Viisemann has significant influence with 19% of the voting rights.

	31.12.2009	**31.12.2008**
Share capital *(in thousand Estonian kroons)*	116 215	68 630
Number of shares (pcs)	1 162 150	686 300
Par value of a share *(in kroons)*	100	100

According to the Company's articles of association, , changed in 27 January 2009 the minimum share capital is 80 000 thousand and the maximum share capital is 320 000 thousand kroons. The share capital has been fully paid in cash.

In the beginning of 2009, the share capital was increased and the amount of new share capital is 116 215 thousand kroons. A total of 475 850 new shares with the nominal value of 100 kroons each were issued. The issue price was 200 kroons per share. The share capital was paid in cash and the total amount is 95 170 thousand kroons. In the Central Commercial Register the entry of the increase in share capital was made at 13.04.2009.

From 1 January 2008, the corporate income tax on net dividends payable out of retained earnings is 21/79. In accordance with the Commercial Code, it is possible to pay out that portion of net profit as dividends which exceeds the amount of the share capital of the parent and the reserves. Based on the financial results for 2008 and 2009, it is not possible to pay any dividends to the shareholders.

NOTE 24 Corporate income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Instead of taxing the net profit, the distribution of retained earnings is subject to taxation at the rate of 21/79. In 2009 or 2008, no dividend payments were made to the shareholders.

NOTE 25 Finance and operating lease

The Group leases cars, office space and computers under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period amounts to 14 957 thousand kroons (2008: 17 316 thousand kroons), the current portion of which amounts to 3 640 thousand kroons (2008: 3 928 thousand kroons) and the non-current portion which amounts to 11 317 thousand kroons (2008: 13 388 thousand kroons).

Operating lease payments recognised in operating expense:	**2009**	**2008**
Office space	4 443	4 298
Cars	88	106
Computers and other office equipment	0	39
Total (Note 10)	**4 531**	**4 443**

In addition, the Group leases one car under finance lease terms. Interest expenses in the amount of 21 thousand kroons (2008: 19 thousand kroons) which have arisen from the payment of finance lease principal payments have been included within interest expenses. Finance lease principal payments totalled 90 thousand kroons (2008: 119 thousand kroons) and they are reported as a reduction of the finance lease liability in the balance sheet. The due date of the finance lease agreement is 15.03.2013, the interest rate is 5.53% and the agreement is denominated in EUR.

NOTE 26 Assets under management from fiduciary activities

The Group, operating as an account manager for its customers, has custody of or intermediates the following customer assets:

	31.12.2009	**31.12.2008**
Cash balance of customers	**70 173**	**97 922**
incl. shareholders and related entities	0	100
Securities of customers	**1 873 069**	**1 421 885**
incl. members of management board and related entities	52 128	112 296
Total	**1 943 242**	**1 519 807**

Asset management fees for the management of these assets have been in the range of 0.015 – 0.025 % (for respective income, see Note 6).

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by LHV Pank, have been recognised as off-balance sheet assets. Due to the nature of the system, LHV Pank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by LHV Pank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. LHV Pank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the bank's balance sheet. LHV Pank has provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), whereas the primary collateral being the securities used as collateral for leveraged loans. In its current practice, no such losses in respect of which the guarantee provided by LHV Pank would apply have incurred and LHV Pank has not paid any compensation relating to the guarantee.

NOTE 27 Contingent liabilities

Irrevocable transactions	Financial guarantees	Unused loan limits	Total
Liability in contractual amount 31.12.2009	8 763	16 860	**25 623**

As at 31.12.2008 the Group did not have any contingent liabilities arising from irrevocable transactions.

Tax authorities have the right to review the Company's tax records for up to 6 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Company during 2008 - 2009. The Group's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on a Group company.

NOTE 28 Transactions with related parties

In preparing the consolidated financial statements of the Group, the following entities have been considered related parties:

- owners (parent company and owners of the parent);
- entities in the consolidation group (incl. fellow subsidiaries and associates);
- members of the management board, head of internal audit unit and legal entities controlled by them;
- close relatives of the persons mentioned above and the entities related to them;

Transactions	Note	2009	2008
Total service fee and commission income		**13 735**	**12 349**
Incl. managed funds	*6*	*13 265*	*11 894*
Incl. members of the management board and legal entities controlled by them		*0*	*455*
Incl. entities in the consolidation group	*6*	*470*	*0*
Total other income		**2 360**	**1 455**
Incl. members of the management board and legal entities controlled by them	*9*	*2 360*	*1 455*
Interest expenses	*7*	**0**	**-30**
Incl. members of the management board and legal entities controlled by them		*0*	*-30*

Balances	Note	31.12.2009	31.12.2008
Receivables as at the year-end		**1 564**	**1 520**
Incl. members of the management board and legal entities controlled by them	*15*	*258*	*662*
Incl. managed funds	*15*	*1 306*	*858*
Liabilities as at year-end		**1 005**	**0**
Incl. members of the management board and legal entities controlled by them		*67*	*0*
Incl. entities in the consolidation group	*19*	*938*	*0*

The receivables have arisen from the provision of services, they do not bear interest and have been collected by the time of preparation of the financial statements.Related party transactions are based on market prices and the interest rates of term deposits do not differ from the interest rates offered to other customers.

In 2009, the remuneration and other compensation paid to the managements of the subsidiaries of AS LHV Group totalled EEK 5 028 thousand (2008: EEK 4 703 thousand). As at 31.12.2009, the payable of the management consists of the remuneration for the month of December and accrued holiday pay in the amount of EEK 490 thousand (as at 31.12.2008: EEK 398 thousand) (Note 20). As at 31.12.2009 and 31.12.2008, the Group does not have any long-term obligations related to the members of the Management and Supervisory Boards (pension insurance, termination benefits, etc.). No remuneration was paid to the members of the Group's Supervisory Board in 2009 and in 2008.

Information on assets of related parties held by the Group as an account manager is presented in Note 26.

NOTE 29 Events after the balance sheet date

The Group's associate Luottotalo Fenno OY (Fenno), which offers consumer loans in Finland, applied for a banking license in Finland with the goal of raising cheaper sources of financing in the form of deposits, which until now used to finance its activities through bonds. Due to the unfavourable economic environment, Fenno's development did not meet expectations. Considering this and the additional capital requirements set for credit institutions, the entity withdrew its banking license application on 15 March 2010. Due to the fact that most of the entity's issued bonds expire will this year and it has no funds to redeem the bonds, AS LHV Pank has made an offer to purchase the portfolio of the entity's receivables, pursuant to which, its bonds can be redeemed. If the offer is accepted, AS LHV Pank plans to continue issuing consumer loans in Finland.

At the meeting of the Supervisory Board at 22 April, AS LHV Pank also decided to make another offer to purchase the portfolio of finance lease receivables of LHV Ilmarise Kinnisvaraportfelli OÜ, as a result of which the entity will prematurely redeem the bonds listed on a stock exchange, having reached a respective agreement with investors, and will terminate its operations.

The share capital of AS LHV Group was increased in February 2010 by EEK 1 281 thousand and the new amount of the share capital is EEK 117 496 thousand.

NOTE 30 Separate financial statements

In accordance with the Estonian Accounting Act, information on the separate primary financial statements of the parent of the consolidation group shall be disclosed in the notes to the financial statements.

Statement of comprehensive income of the parent
(in thousand Estonian kroons)

	2009	2008
Interest income	3 555	542
Interest expenses	-1 840	-37
Net interest income	**1 715**	**505**
Operating expenses	-186	-1 072
Profit of investment in accociate	-24 268	0
Loss for the financial year	**-22 739**	**-567**
Comprehensive income/loss for the year	**-22 739**	**-567**

Balance sheet of the parent
(in thousand Estonian kroons)

	31.12.2009	31.12.2008
Assets		
Balances with other banks and investment companies	15 688	823
Loans granted	9 936	12 837
Investment in subsidiary	143 330	61 891
Total assets	**168 954**	**75 551**
Liabilities		
Loans received	18 834	6 637
Other financial liabilities	8 775	0
Total liabilities	**27 609**	**6 637**
Shareholders' equity		
Share capital	116 215	68 630
Share premium	76 955	29 370
Statutory reserve capital	3 485	3 485
Accumulated deficit	-55 310	-32 571
Total shareholders' equity	**141 345**	**68 914**
Total shareholders' equity and liabilities	**168 954**	**75 551**

Cash flow statement of the parent

(in thousand Estonian kroons)

	2009	2008
Cash flows from operating activities		
Operating and other expenses	-186	-1 093
Interest received	3 555	222
Interest paid	-1 840	0
Change in loans granted	2 901	-12 517
Change in loans received	12 197	6 600
Change in other financial liabilities	8 775	0
Net cash flows from operating activities	**25 402**	**-6 788**
Cash flows from investing activities		
Acquisition of subsidiary and joint ventures	-105 707	0
Net cash flows from investing activities	**-105 707**	**0**
Cash flows from financing activities		
lPayment to share capital	95 170	3 345
Net cash flows from financing activities	**95 170**	**3 345**
Increase/decrease in cash and cash equivalents	**14 865**	**-3 443**
Cash and cash equivalents at beginning of the financial year	823	4 266
Cash and cash equivalents at the end of the financial year	**15 688**	**823**

Statement of changes in shareholders' equity
(in thousand Estonian kroons)

	Share capital	Share premium	Statutory reserve	Retained earnings	Total
Balance as at 01.01.2008	**66 400**	**28 255**	**2 830**	**-31 349**	**66 136**
Increase of share capital	2 230	1 115	0	0	3 345
Share premium	0	0	655	-655	0
Total comprehensive loss for 2008	0	0	0	-567	-567
Balance as at 31.12.2008	**68 630**	**29 370**	**3 485**	**-32 571**	**68 914**
Carrying amount of holdings under control and significant influence	0	0	0	-61 891	-61 891
Value of holdings under control and significant influence under equity method	0	0	0	69 476	69 476
Adjusted unconsolidated equity as at 31.12.2008	**68 630**	**29 370**	**3 485**	**-24 986**	**76 499**
Balance as at 01.01.2009	**68 630**	**29 370**	**3 485**	**-32 571**	**68 914**
Paid in share capital	47 585	47 585	0	0	95 170
Total comprehensive loss for 2009	0	0	0	-22 739	-22 739
Balance as at 31.12.2009	**116 215**	**76 955**	**3 485**	**-55 310**	**141 345**
Carrying amount of holdings under control and significant influence	0	0	0	-143 330	-143 330
Value of holdings under control and significant influence under equity method	0	0	0	151 229	151 229
Adjusted unconsolidated equity as at 31.12.2009	**116 215**	**76 955**	**3 485**	**-47 411**	**149 244**

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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS LHV Group

We have audited the accompanying consolidated financial statements of AS LHV Group and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2009 and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from 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 the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, 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 audit opinion.

PRICEWATERHOUSECOOPERS

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Tiit Raimla
AS PricewaterhouseCoopers

28 June 2010

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* *This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

Proposal for covering the loss

The Management Board of AS LHV Group proposes to the General Meeting of Shareholders to add the net loss for 2009 in the amount of 23 122 thousand kroons to retained earnings.

Signatures of the Management Board and the Supervisory Board to the consolidated annual report

The Management Board has prepared the management report and the consolidated financial statements of AS LHV Group for the financial year ended 31 December 2009.

The Supervisory Board has reviewed the annual report which consists of the management report and the financial statements, the auditor's report and the profit allocation proposal, and approved it for presentation at the General Meeting of Shareholders.

MANAGEMENT BOARD
30.06.2010

Member of the Management Board

Rain Lõhmus ....

SUPERVISORY BOARD
30.06.2010

Members of the Supervisory Board

Andres Viisemann ....

Tiina Mõis ....

Hannes Tamjärv ....

Heldur Meerits ....

Raivo Hein ....

Allocation of income according to EMTAK

EMTAK	Activity	2009	2008
66121	Security and commodity contracts brokerage	46 987	45 258
64191	Credit institutions (banks) (granting loans)	15 772	0
64929	Other credit granting (except pawnshops)	0	6 646
66301	Fund management	14 684	14 248
66191	Financial consultancy services	210	284
64911	Financial leasing	261	270
	Total income	**77 914**	**66 706**