AS LHV Group

Consolidated Annual Report 2011

(translation of the Estonian original)

Consolidated annual report **01.01.2011 – 31.12.2011**

Business name	AS LHV Group
Commercial Registry no.	11098261
Legal address	Tartu Road 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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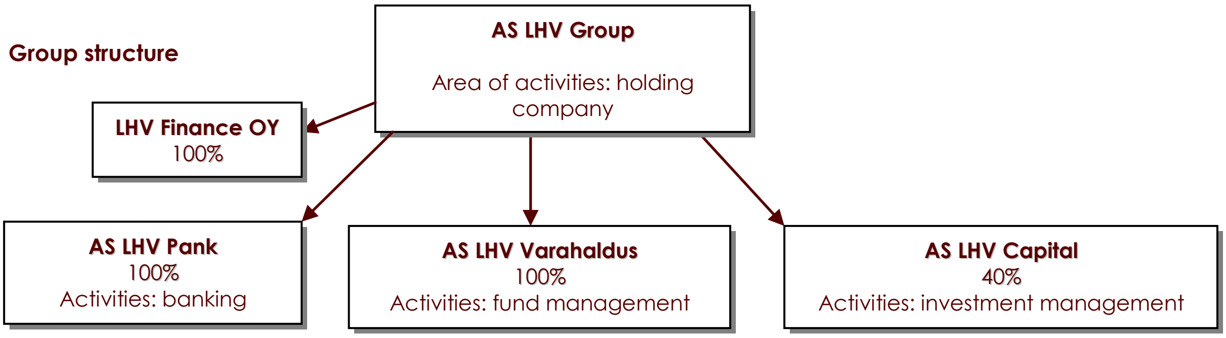
MANAGEMENT REPORT

Group structure



Key events in 2011 and at the beginning of 2012:

- **Changes in group structures**

In February 2011, AS LHV Group acquired 100% of the shares of AS LHV Varahaldus (previously owned 84% of the shares).

- **Changes in share capital**

In October 2011, the group's share capital was increased by EUR 5.1 million, the payment was EUR 12.8 million, including the share premium.

- **Issuing subordinated bonds**

In February 2011 subordinated bonds in the amount of EUR 1 million were issued. The due date of the bonds is 7 years.

- **New banking services**

In the summer of 2011, AS LHV Pank started to issue bank cards to its customers and on 10 May 2012 Tallinna Kaubamaja group's Partner Krediitkaart (credit card) was launched.

AS LHV Pank

The mission of LHV Pank is to foster Estonia's economy and social sustainability. The vision of LHV Pank is to be the primary and preferred bank of the new generation in Estonia. The key values of LHV Pank are direct communication 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 Pank is based on Estonian capital. The bank's customers are individuals, small and medium-sized companies and institutional investors. The branch offices of LHV Pank are located in Tallinn, Tartu, Riga, Vilnius and Helsinki. LHV Pank employs over 100 people. 20 000 private customers and 3900 corporate customers in Estonia, Latvia and Lithuania and 8 000 private customers in Finland use the bank's services. As compared to other banks, LHV Pank is more focused on increasing the assets of customers and managing their investments. LHV Pank is one of the largest brokers on NASDAQ OMX Baltic Stock Exchanges and the largest broker on international markets for the Baltic retail investors.

The goal of LHV Pank is to encourage people to invest their funds and teach customers to better understand the area of investments. For educating investors, the bank has launched an annual series of seminars "Investment School" and a virtual stock game "Börsihai" ("Stock Exchange Shark"). LHV Pank quarterly publish the largest investment magazine in Estonia, "Investeeri" ("Invest"), manages the weekly radio cast "Buum" ("Boom") and operates the most active portal of financial markets. In 2009, LHV Pank and Estonian Business School signed a collaboration agreement, laying down a foundation for earning a bachelor's degree in investment management.

In 2011, fast growth in business of LHV Pank and active development works to launch new products and services continued. After the adoption of the euro at the beginning of the year, a new online bank, home page and financial portal were launched in mid-January. In January, LHV Pank joined the national direct debit system which made it even easier for customers to conclude transactions. In June, the online bank was further improved and it became the sole provider of offering stock trading over the smartphone in Estonia.
In collaboration with Saxo Bank, a new trading platform LHV Broker was introduced to the market in June, primarily aimed at foreign currency and CFD trading, but it also provides access to key stock markets.

From 25 August, the Bank started to issue bank cards to its customers. Bank cards are equipped with the most modern and secure chip technology, and the number of the bank account related to the card is printed on its back side. At the year-end, almost 6,000 bank cards had been issued, over 90% of which were debit-credit cards. In cooperation of the Estonian Football Association and LHV Pank, a new football bank card was issued, the owners of which can support any Estonian football club of their choice or the national team with every purchase they make.

At 25 August, the new customer service office was opened on the ground floor of City Plaza, Tallinn and a marketing campaign for provision of daily banking services in Estonia was launched. After the launch of the marketing campaign, the number of new customers visiting the bank office increased more than four times in September as compared to previous months in 2011. Over the last months of the year, the number of payments by customers reached 20,000 per month and the bank gained monthly about 1,000 new customers.

In February, the Finnish Supervision Authority issued its approval for opening a bank branch in Finland. The branch was established and registered in the Commercial Register of Finland. The Finnish branch of LHV Pank officially launched its operations at 7 March, immediately followed a major marketing campaign introducing LHV trademarks and loan products. In September, a new office was opened in Helsinki and the next marketing campaign for issuing of loans was launched. Prior to this, all processes related to issuing and administration of loans as well as dealing with debtors, criteria for issuing loan and price lists were updated.

Business environment

In 2011, the Estonian economy grew at the fastest rate of the last couple of years and the gross domestic product for the year increased by 7.6% primarily due to strong exports of goods and services. In the second half of the year, the domestic demand also stated to pick up, primarily related to the fast growth of post-crisis capital expenditures made by companies for transport means, and machinery and equipment. Private consumption also started to recover in the second half of the year and companies increased their inventories of goods and raw materials.

In the first three quarters of the year, the exporting manufacturing sector made the largest contribution to economic growth. In the second half of the year, and especially in the 4th quarter, the contribution made by the processing industry to economic growth decreased. The additional value created by industries oriented towards the domestic market, such as the construction sector, information and communication, grew significantly.

The tensions arising from the high debt burden of Southern European countries, budget deficits and low competitiveness which escalated in the second half of 2011, have impacted the growth outlook for the whole Europe and the GDP growth in the euro area is forecast to be zero in 2012. Estonian economic growth is also significantly decelerating due to the cooling of the economies of its major export partners and lower economic confidence, and Estonian economic growth is expected to be only a few percentage points in 2012. Along with the escalation of tensions, long-term interest rates have also started to fall at the end of the year.

The contraction of loan volumes which started with the onset of the global financial crisis, continued in the Estonian economy in 2011 and the total balance of loans issued declined by 8.5% in a year. As compared to the peak reached in the third quarter of 2008, the balance of loans issued to businesses was 20.2% lower as at the year-end 2011. The decline in the loan balance of households continued at a slightly lower pace and at the year-end 2011, the balance of loans issued to households was 2.5% lower than a year ago.

Similarly to previous years, the volume of deposits continued to grow in 2011. The volume of deposits of corporate entities increased 10.2% and deposits of households increased 8.9% in a year. At the end of the year, the total volume of deposits of businesses and households in Estonian commercial banks was about EUR 10.1 billion.

The stock market turnover in the Baltics was the lowest in ten years, reaching only EUR 400 billion. The Tallinn Stock Exchange declined by 24% and the stock exchanges of Riga and Vilnius fell by 5% and 27%, respectively. The magnitude of the decline in European stock markets was also the same and Germany's DAX Index declined by 15% in a year. The U.S. stock markets remained unchanged during 2011. The price of crude oil (Brent) increased by 18% in euros in a year and reached a record level at the beginning of 2012.

Financial results

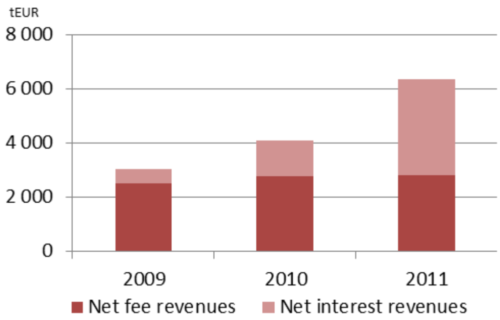
At the year-end, the balance sheet total of LHV Pank was EUR 230 million which is 81% higher than at the beginning of the year. The volume of deposits at the bank increased to EUR 209 million, which is 82% higher than a year ago. Of this amount, demand deposits totalled EUR 35 million and term deposits totalled EUR 173 million. The volume of the bank's loan portfolio reached EUR 67 million and that of the bond portfolio reached EUR 76, which is 75% and 345% higher than at the beginning of the year.

In 2011, LHV Pank's net fee and commission income totalled EUR 2.8 million, net interest income totalled 3.6 million and the financial loss totalled EUR 0.9 million. The bank's net income totalled EUR 5.5 million, expenses totalled EUR 9.4 million, loan provision totalled EUR 2.6 million and the loss totalled EUR 6.5 million.

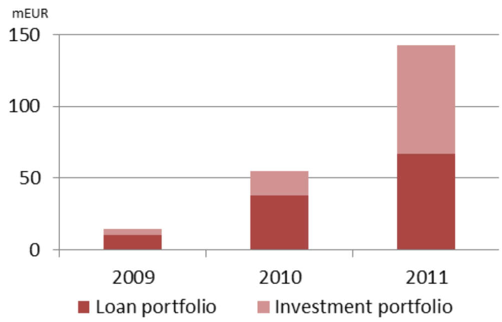
In 2011, the share capital of LHV Pank was increased three times, in April, July and October. In all cases, the bank's sole shareholder LHV Group made a monetary contribution of EUR 0.4 million, EUR 2.0 million and EUR 8.8 million, respectively, to share capital. The bank's share capital increased to EUR 17.7 million by the year-end 2011. Prior to the increase of the share capital of LHV Pank, the share capital of LHV Group was increased by EUR 12.9 million. During the issue of new shares, current and new investors subscribed for the share in the total amount of EUR 12.9 million, including all members of the Supervisory Board directly or through their holding companies in the amount of EUR 8.3 million, 9 investors in the amount of EUR 4.5 million and 20 employees in the amount of more than EUR 100 thousand. After the increase of share capital, the members of the Supervisory Board own 77%, investors own 21% and employees own 2% of the shares of LHV Group.

Net fee and commission income, and net interest income of LHV Pank (EUR million):

EUR million	**2011**	**2010**	**change**
net commission income	2.8	2.8	1%
net interest income	3.6	1.3	168%
net gain from financial assets	-0.9	0.3	-365%
total net operating revenues	5.5	4.4	24%
other income	0.1	0.2	-63%
operating expenses	-9.4	-5.5	70%
loan losses	-2.6	0	
net loss	-6.5	-0.9	



EUR million	**2011**	**2010**	**change**
loan portfolio	66.7	38.1	75%
bond portfolio	75.7	17.1	345%
deposits	209.4	114.8	82%
equity	10.4	5.7	82%
total assets	229.4	126.9	81%
number of customers holding assets in bank	23 979	16 275	47%
number of loan customers in Finland	8 264	7 877	5%
number of employees	144	102	41%



At the year end, the volume of margin loans backed by securities totalled EUR 7.4 million (annual decrease of 18%), the volume of loans issued to corporate entities totalled EUR 45.4 million (annual growth of 166%) and the volume of consumer loans was EUR 14.2 million (annual growth of 18%).

In 2011, the number of customers who have deposits at LHV Pank increased by 47% and at the year-end, the number of customers totalled 23 979. From the time of issuing bank cards at the end of August, the bank gained 600 new customers in August and 1 600 new customers in September. Over the last three months of the year, more than 3 000 new customers joined the bank. The volume of customer securities totalled EUR 187 million at the end of 2011.

AS LHV Varahaldus

AS LHV Varahaldus is a fund management company for investment funds.

In 2001, the main activity of the Company was the provision of the fund management service to five compulsory pension funds, one voluntary pension fund and three UCITSs investing in equities, one of which was liquidated at the end of the year.

The year 2011 was a weak year for the global stock markets. At the beginning of the year, the US Federal Reserve continued its money printing policy, which helped stimulate the economy, and boosted equity and commodity prices. This upward trend was temporarily interrupted by the earthquake which occurred in Japan in March and the nuclear disaster that followed it. However, the stock markets were hit the hardest in August when investors became worried about the sustainability of Italy's debt, the prices of Italian government bonds fell and the capital adequacy of European banks as well as the survival of the Eurozone became questionable. The stock markets fell sharply all over the world while the European stock markets were hit the hardest, dropping by over 20% in five days. In the last few months of the year, the stock markets recovered slightly and for the year, the European stock markets fell by 17%. LHV funds, which invest in the equity markets, ended the year with a negative return.

In 2011, the bond markets were characterized mainly by the escalation of problems in the euro area over the last months. However, the decline in the expected return of "risk-free" German and US bonds continued even before that – the return of 5-year German and US bonds declined by 2.05% and 2.2%, respectively, over the year from the level of 0.7%. On the other hand, the prices of bonds of the Southern European countries continued to decline, with the Italian 5-year bond ending the year at the return of 5.9%. This forced the European Central Bank to more actively intervene in the bond markets – the earlier increase in interest rates was reversed at the end of the year and, in addition, the banks of the euro area were offered a loan at an interest rate of 1% in an unlimited amount during two auctions (the second of the two auctions was held at the beginning of 2012). The latter measure, in particular, provided a significant support to the market of both government and corporate bonds. However, this could not compensate for a decline in the prices of corporate bonds in the autumn and therefore they yielded only a minimum positive return in the year. LHV pension funds, which invest only in bonds, ended the year with a positive return.

During the year, the volume of fund assets managed by the Company increased from EUR 84 million (at the end of 2010) to EUR 144 million (at the end of 2011). The number of active clients of compulsory pension funds also increased from 53 thousand to 84 thousand (market share of 13.6%).

In 2011, changes occurred in the set of LHV funds. One of the UCITSes investing in the equities managed by the Company - LHV Emerging Europe Alfa Fund - was liquidated due to the lack of interest among investors. The liquidation was decided by the Supervisory Board on 25 July and was completed on 22 December. The Company continues to manage two UCITSes – LHV World Equities Fund and LHV Persian Gulf Fund. Both funds are publicly offered in Estonia, Latvia and Lithuania; LHV Persian Gulf Fund is additionally also offered in Sweden, Finland and Norway.

The conditions of all funds changed for regulatory reasons several times: on1 January due to the adoption of the euro and on 30 June due to amendments to the legislation. The conditions of compulsory pension funds also changed on 1 August as a result of changes taking effect in the funded pension system. Since August, the investment limitations of conservative pension funds became stricter, i.e. assets of a conservative pension fund may be invested only in investment-grade bonds. In August, restrictions on change of mandatory pension funds also changed – payments can be directed to a new fund on an ongoing basis and the existing units can be transferred to another fund three times a year (in addition, units can be changed also partially).

The conditions of mandatory pension funds changed also at the beginning of 2012, when the strategy of LHV Pension Fund XL changed so that the Fund can invest, instead of 50% (so-called progressive strategy), up to 75% (so-called aggressive strategy) in the equity markets.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of comprehensive income

(in thousands of euros)

	Note	2011	2010
Fee and commission income	6	5 905	4 893
Fee and commission expense	6	-752	-711
Net fee and commission income		**5 153**	**4 182**
Interest income	7	7 636	3 028
Interest expense	7	-4119	-1 706
Net interest income		**3 517**	**1 322**
Net gain from financial assets designated at fair value	8	-1 168	-186
Foreign exchange rate gains	8	28	56
Net gains/losses from financial assets		**-1 140**	**-130**
Other income		117	239
Operating expenses	9	-13 530	-8 364
Operating loss		**-5 883**	**-2 751**
Change in investment in associate		33	-125
Loan losses		-2 607	0
Loss for the year		**- 8 457**	**-2 876**
Comprehensive loss for the year		**-8 457**	**-2 876**
Loss and comprehensive loss attributable to shareholders of the parent		**-8 457**	**-2 667**
Minority interest		**0**	**-209**

The notes on pages 12 to 51 are an integral part of these consolidated financial statements.

Consolidated balance sheet

(in thousands of euros)

	Note	31.12.2011	31.12.2010
Assets			
Balances with other banks	10	27 587	20 398
Balances with investment companies	10	4 915	2 934
Balances with central bank	10	52 556	45 431
Financial assets at fair value through profit or loss	12	49 051	20 487
Held-to-maturity financial investments	13	30 001	0
Loans granted	14	66 680	38 073
Receivables from customers	15	373	1 980
Other assets	16	937	855
Goodwill	5	1 044	1 044
Tangible assets	17	875	241
Intangible assets	17	528	215
Investment in subsidiary	5	43	10
Total assets		**234 590**	**131 668**
Liabilities			
Loans received and deposits from customers	18	213 705	116 352
Financial liabilities at fair value through profit or loss	12	441	0
Accrued expenses and other liabilities	19	1 805	1 328
Deferred income	14	389	185
Finance lease liabilities		0	14
Provisions	20	13	13
Subordinated loans	21	4 009	2 844
Total liabilities		**220 362**	**120 736**
Shareholders' equity			
Minority interest		0	391
Shareholders' equity attributable to shareholders of the parent			
Share capital	22	14 200	9 055
Share premium		13 419	5 702
Share options	21	210	210
Reserves		223	223
Accumulated deficit		-13 824	-4 648
Total shareholders' equity attributable to shareholders of the parent		**14 228**	**10 542**
Total shareholders' equity		**14 228**	**10 933**
Total liabilities and shareholders' equity		**234 590**	**131 668**

The notes on pages 12 to 51 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

(in thousands of euros)

	Note	2011	2010
Cash flows from operating activities			
Fee and commission income received		6 050	5 200
Fee and commission expense		-752	-711
Operating and other expenses paid		-13 294	-8 148
Interest received		7 636	2 711
Interest paid		-3 784	-1 712
Cash flows from operating activities before change in operating assets and liabilities		**-4 442**	**-2 660**
Change in operating assets			
Settlement of foreign currency forward contracts		0	192
Net acquisition/disposal of trading portfolio		-69	551
Loans granted and receivables from customers		-29 543	-30 680
Term deposits with other banks		-9 186	5 201
Mandatory reserve in central bank		5 240	-1 365
Stock exchange security deposit		-35	-576
Other receivables and prepayments		-238	-108
Change in operating liabilities			
Demand deposits of customers		17 211	10 464
Term deposits of customers		77 784	71 440
Loans received		2 505	748
Financial liabilities of trading portfolio		441	-8
Other liabilities and deferred income		789	143
Net cash generated from operating activities		**60 457**	**53 341**
Cash flows from investing activities			
Purchase of tangible assets	17	-1 195	-329
Tangible assets sold	17	11	0
Net cash handed over less proceeds from disposal of subsidiary	5	-1 110	-135
Change in investment portfolio		-59 664	-13 690
Net cash used in investing activities		**-61958**	**-14 154**
Cash flows from financing activities			
Paid in share capital	22	12 862	3 572
Issue of subordinated bonds		1 000	3 000
Finance lease payments made		-14	-6
Loans received	26	3 575	0
Repayment of loans received	26	-3 575	0
Net cash generated from financing activities		**13 848**	**6 566**
Net increase in cash and cash equivalents		**12 347**	**45 752**
Cash and cash equivalents at beginning of the year	10	61 736	15 983
Cash and cash equivalents at end of the year	**10**	**74 083**	**61 735**

The notes on pages 12 to 51 are an integral part of these consolidated financial statements.

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PricewaterhouseCoopers, Tallinn

Consolidated statement of changes in equity

(in thousands of euros)

	Share capital	Share premium	Share options	Reserves	Accumulated deficit	**Total**	Minority interest	**Total**
Balance as at 01.01.2010	**7 427**	**3 758**	**0**	**223**	**-1 869**	**9 539**	**488**	**10 027**
Paid in share capital	1 627	1 944	0	0	0	3 572	0	3 572
Issue of share options	0	0	210	0	0	210	0	210
Change in minority interest	0	0	0	0	-112	-112	112	0
Total comprehensive loss for 2010	0	0	0	0	-2 667	-2 667	- 209	-2 876
Balance as at 31.12.2010	**9 055**	**5 702**	**210**	**223**	**-4 648**	**10 542**	**391**	**10 933**
Balance as at 01.01.2011	**9 055**	**5 702**	**210**	**223**	**-4 648**	**10 542**	**391**	**10 933**
Paid in share capital	5 145	7 717	0	0	0	**12 862**	0	**12 862**
Change in minority interest	0	0	0	0	-719	-719	-391	**- 1 110**
Total comprehensive loss for 2011	0	0	0	0	-8 457	-8 457	0	**-8 457**
Balance as at 31.12.2011	**14 200**	**13 419**	**210**	**223**	**-13 824**	**14 228**	**0**	**14 228**

More detailed information is provided in Note 22.

The notes on pages 12 to 51 are an integral part of these consolidated financial statements.

Notes to the consolidated 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 Road 2, Tallinn. AS LHV Group is a holding company whose subsidiary AS LHV Pank provides banking, and securities brokerage services to Estonian, Latvian and Lithuanian customers. AS LHV Varahaldus provides fund management service.

These consolidated financial statements were authorized for issue by the Management Board at 24 May 2012.

The ultimate controlling parties of AS LHV Group are Rain Lõhmus with 46% of voting rights and Andres Viisemann with 13% of the voting rights (see Note 22). The financial statements approved by the Management Board shall be authorised for approval by the Supervisory Board and shareholders. The shareholders have the right not to approve the financial statements while the Supervisory Board does not have that right.

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 2011 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, except as disclosed in some of the accounting policies below, for example "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 2011 and ended at 31 December 2011. The financial figures of consolidated financial statements have been presented in thousands of euros 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 2011. 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) **Adoption of New or Revised Standards and Interpretations**

The following new or revised standards and interpretations became effective for the Group from 1 January 2011:

Improvements to International Financial Reporting Standards, issued in May 2010; (effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011) – The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations:

IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date, and not the amount obtained during the reporting period;
IAS 1 was amended to clarify the requirements for the presentation and content of the statement of changes in equity;

The above amendments resulted in additional or revised disclosures, but had no material impact on measurement or recognition of transactions and balances reported in these financial statements. The financial effect of collateral is disclosed in Note 3.2 of the financial statements.
There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2011 that would be expected to have a material impact to the Group.

b) New Accounting Pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2012, and which the Group has not early adopted.

Amendments to IFRS 7 - Disclosures—Offsetting Financial Assets and Financial Liabilities; (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

IFRS 9, Financial Instruments Part 1: Classification and Measurement (issued in November 2009 and effective for annual periods beginning on or after 1 January 2015) - IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets, and in December 2011 to change its effective date and add transition disclosures. Key features of the standard 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 payments of principal and interest only (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.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 10, Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2015; not yet adopted by the EU), replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the standard on its financial statements.

IFRS 12, Disclosure of Interest in Other Entities (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on share of non-controlling interests in group activities and cash flows, (iii) summarized financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the standard on its financial statements.
IFRS 13, Fair Value Measurement; (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU). The standard aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.
Amendments to IAS 32 - Offsetting Financial Assets and Financial Liabilities; (effective for annual periods beginning on or after 1 January 2014; not yet adopted by the EU). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Group is currently assessing the impact of the amendments on the Group and the timing of its adoption by the Group.
Disclosures—Transfers of Financial Assets – Amendments to IFRS 7; (effective for annual periods beginning on or after 1 January 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Group is currently assessing the impact of the amended standard on disclosures in its financial statements.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

2.2 Changes in presentation and accounting principles

Change in functional and presentation currency

As of 1 January 2011, the Republic of Estonia joined the euro area and adopted euro as a national currency, replacing the Estonian kroon. Therefore, since 1 January 2011 the functional currency of the Bank is euro. The change in the functional currency is applied prospectively. As at 1 January 2011 the Bank recalculated its accounting balances on the basis of exchange rate EUR 1 = EEK 15.6466.

The financial statements for the year 2011 are presented in euros. Comparative figures are recalculated from the Estonian kroon to euro at the exchange rate of EUR 1 = EEK 15.6466. As this exchange rate has also been the fixed exchange rate in the past, no currency translation differences arose.

2.3 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) and business operations. 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 recognized 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 recognized directly in the statement of comprehensive income.

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 unrealized gains on these transactions have been eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Minority interests in the comprehensive income 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's 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's statement of comprehensive income from the beginning of the financial year until the date of disposal.

The 2011 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank and AS LHV Varahaldus.

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 27), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

Non-controlling interest

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, which is attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity.

Transactions with non-controlling interests

As of 1 January 2010 the Group treats transactions with non-controlling interests as transactions with equity owners of the group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity. Until 31 December 2009 transactions with non-controlling interests were recorded similarly as transactions with third parties. Gains or losses on disposals to non-controlling interests were recorded in Group's statement of comprehensive income. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary was recorded as goodwill.

2.4 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 recognized 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. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized 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 2.8 are used as the basis.

2.5 Foreign currency translation

(a) Functional and presentation currency

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

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank (up to 31 December 2010: 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 euros based on the foreign currency exchange rates of the European Central Bank (up to 31 December 2010: 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 "Foreign exchange rate gains/losses". 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 in the statement of comprehensive income under the line "Foreign exchange rate gains/losses".

2.6 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.

2.7 Financial assets

Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss
- held-to-maturity financial investments
- loans and receivables

The classification depends on the purpose for which the financial assets were acquired. Management of the Group 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 recognized at the settlement date in the balance sheet. Financial instruments included in this category are initially recognized 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 recognized consistently, either as a profit or loss in the statement of comprehensive income of the accounting period under "Net gains from financial assets designated at fair value". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognized in the line "Dividend income" of the statement of comprehensive income when the right to receive dividends by the Group is established.

In case of listed securities (i.e. the securities which have an active market), the current 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.

Derivative financial instruments (futures, forward, swap and option contracts) are initially recognized in the balance sheet at the fair value net of transaction costs at the trade 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 the fair value. Otherwise, the valuation techniques are used to find the fair value. Profits and losses from derivatives are recognized as income or expense of the period in the statement of comprehensive income under "Net gains from financial assets designated at fair value". Derivative financial instruments are carried 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 the balance sheet are not netted. The Group does not use hedge accounting to account for its derivative financial instruments.

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 statement of comprehensive income.

Financial assets and financial liabilities are designated at fair value through profit or loss when 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) Held-to-maturity financial investments

Held-to-maturity financial investments are financial instruments quoted in an active market with a fixed due date and which the Management Board of the bank has an intention and opportunity to hold until their maturity. They do not include:

(a) investments designated as fair value through profit or loss upon their initial recognition;

(b) investments classified as available-for-sale assets; and

(c) investments which meet the criteria of loans and receivables.

These investments are initially recognised at fair value, net of all directly and indirectly attributable expenditures and they are subsequently measured at amortised cost using the effective interest rate method. Interest income on held-to-maturity investments is included within interest income in the statement of comprehensive income. Impairment losses are deducted from the carrying amount of the investments and the impairment charge is recorded in the line "Net profit/loss from financial assets" in the statement of comprehensive income.

(c) 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. After initial recognition, the Group recognizes loans and receivables at amortised cost (less principal repayments and any potential impairment losses, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest rate method.

Finance lease transactions are lease transactions under which all significant risks and rights from using the assets are immediately transferred from the Bank to the lessee. Legal ownership of assets is transferred to the customer at the end of the lease term. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of minimum lease payments (plus any unguaranteed residual value of the leased asset). Each lease payment received from the lessee is allocated between the receivable and finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. When there are service fees attributable to the conclusion of lease agreements, they are included in the calculation of the effective interest rate of the lease and calculation of a finance lease receivable. The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased asset and excess collateral, the financial position and reliability of the customer. Impairment of receivables is shown as a negative amount within the respective asset category in the balance sheet.

Loan receivables which have been acquired as a pool (portfolio of consumer loans of Finnish individuals) are recognized at fair value at the time of acquisition. When the nominal value of the acquired portfolio is higher than its fair value (i.e. the portfolio is acquired at a discount because some of the credit losses have already been incurred by the time of acquisition), the nominal amount and the respective impairment loss are recognized in the contra-asset account. The portfolio of receivables acquired as a pool is subsequently recognized on the portfolio basis, using the effective interest rate determined at the time of acquisition of the pool of assets. In case the actual cash flows earned on the portfolio differ from the estimated cash flows at the time of acquisition, the difference is discounted at the initial effective interest rate either as an impairment loss of the asset (actual cash flows are lower than estimated ones) or income (actual cash flows are higher than the estimated ones) in the statement of comprehensive income.

Trade receivables arise from provision of services to the customers and are initially recognized at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method (less repayments and a possible provision for impairment).

The impairment of loans and receivables is assessed in accordance with the principles described in clause 2.8.

2.8 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.

The Group assesses the risks conservatively, taking into consideration all known information about the solvency of the debtor and whether there are any objective circumstances indicating impairment (the buyer's financial difficulties, bankruptcy or inability to meet its obligations to the Group). The Group assesses individually whether there is any objective evidence of impairment of financial assets which are individually significant, and individually or jointly of those financial assets which are not individually significant.

Corporate loans are assessed individually, based on the financial position of the company, industry situation, reliability of the borrower, the competence of its management, timely fulfillment of obligations laid down in loan contracts and other factors. Margin loans backed by securities both to legal as well as physical persons are assessed individually, using primarily the market value of collateral as the basis. Consumer loans issued to individuals as borrowers are assessed as a group. Physical persons who are borrowers are assessed in terms of their timely fulfillment of obligations, solvency, the value of collateral, age, education, length of employment, savings habits and other factors impacting credit risk.

For the purpose of recognition of group-based impairment losses, financial assets are grouped on the basis of homogeneous credit risk features. Future cash flows of loan groups assessed as a group are assessed on the basis of contractual cash flows of assets and historical losses of these assets. Historical loan losses are adjusted on the basis of current observable data, to account for the effect of conditions at the time, which did not impact that period on which historical losses are based and to eliminate those effects of previous periods, which are currently absent. The Group regularly reviews future cash flow assessment methods and assumptions, in order to reduce potential differences between loss estimates and actual losses.

For assessment of loan losses, the probability of collecting the loan and interest payments over the coming periods (excluding future loan losses that have not been incurred), 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), which together help assess the amount of a loss incurred of the loan. In case estimating future cash flows cannot be conducted reliably, the market price indication of a comparable loan portfolio is used as an alternative method to assess loan losses. 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.

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 recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The reversal of the impairment loss is recognized as income in the line "Loan losses" in the statement of comprehensive income.

If the loan is uncollectible, it is written off against the respective impairment loss of the loan. Such loans are written off after implementation of all required procedures and determination of the loss amount. The loans, the due dates of which have been extended, are not considered to be past due loans, but regular ones.

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

2.9 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 recognized 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 recognized 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 during the financial period in which 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% p.a. or amortization throughout the rental period, depending on which is shorter. Depreciation is calculated starting from the month of acquisition until the carrying amount reaches the residual value of the asset. In case the residual value is greater than the carrying amount 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. The Group performs an impairment test when there are circumstances indicating impairment. 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 recognizing an impairment loss in the statement of comprehensive income 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 comprehensive income for the period.

2.10 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 is 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.

2.11 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.

2.12 Financial liabilities

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

Loans received, bonds issued and similar subordinated loans are initially recognized at fair value, less transaction costs (cash received less transaction costs). The subordinated loans are those liabilities, which in case of a termination of a credit institution or declaration of bankruptcy, are settled after the satisfaction of the justifiable claims of other creditors. Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognized at fair value.

Recognition a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.7. a). 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 expenses".

2.13 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 specific debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognized in the financial statements at fair value at the date the guarantee was given. Subsequent to initial recognition, the liabilities under such guarantees are recognized at the outstanding value of the guarantee stated as the higher of unamortised fees and a 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 recognized on a straight line basis over the life of the guarantee. The amounts to be disbursed to settle the guarantee obligation are recognized in the balance sheet as a provision at the date it becomes evident that it is probable that the guarantee is to be disbursed.

2.14 Payables to employees

Payables to employees include a 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 a 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 statement of comprehensive income.

Social tax includes payments to the state pension fund. The Group has no existing legal nor factual obligations to make pension or similar payments supplementary to social tax.

2.15 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 recognized as provisions in the balance sheet. The provisions are recognized based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognized 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 probable that a provision is will be realised 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 contingent or existing liabilities (guarantees, other than financial guarantees, and other commitments) the realisation of which is less probable than non-realisation or related 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).

2.16 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 recognized as current assets. Assets with expected inflows also after 12 months period after the balance sheet date are recognized 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 recognized 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 respective disclosure to these consolidated financial statements.

2.17 Revenues and expenses

Revenues and expenses are accounted for using the accrual basis of accounting. Revenue is recognized 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 recognized at the fair value of the fee received or receivable. Expenses are recognized when the company has received the goods or services.

Fee and commission income (incl. custody and portfolio management fees) are recognized on an 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 recognized as an adjustment to the effective interest rate on the loan. Commissions and fees arising from provision of advisory services to third parties (purchase or sale of businesses, acquisitions, etc.) are generally recognized upon completion of the underlying transaction or when a service is provided over a longer period of time, based on the stage of completion method. Portfolio management, other consultation fees and management fees related to investment funds are recognized according to the agreement, usually over the period during which the service is provided. The same principle is applied to 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 or based on the stage of completion. Other one-time service revenues and other revenues are recognized on an accrual basis at the moment of executing the respective transaction.

Fee and commission expenses are recognized after the service has been provided and when the liability has incurred.

Interest income and expense is recognised in the statement of comprehensive income for all financial instruments carried at amortised cost using the effective interest rate method or for bonds measured at fair value through profit or loss. Amortisation of transaction costs of bonds measured at fair value through profit or loss is not recognised as interest income.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and 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 flows 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 recognized when the legal right to receive dividends is established.

2.18 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.

2.19 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 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 and 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 primarily uses an operating lease for renting the premises. A rental expense is recognized in the statement of comprehensive income as "Operating expenses".

2.20 Taxation and deferred income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying amounts 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 the 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.

2.21 Offsetting

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

2.22 Statutory reserve

Statutory reserve capital is formed from annual net profit allocations to comply with the requirements of the Commercial Code. 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.

NOTE 3 Risk management

The principles of identification, management and control of risks at the Group are set out in the policies and procedures approved by the Supervisory Board and on daily basis risk management is carried out by the Management Board of the Group. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of the Group in order to ensure the reliability, stability and profitability of the entities of the Group. 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. The Group has to follow the capital requirements for covering the risks on separate and consolidated basis. The Group does not use internal rating based (IRB) models for calculating capital requirements.

(in thousands of euros)

Capital base	**31.12.2011**	**31.12.2010**
Paid-in share capital	14 200	9 055
Share premium	13 419	5 702
Reserves	223	223
Accumulated deficit	-5 367	-1 981
Net loss for accounting period	-8 457	-2 667
Intangible assets (subtracted)	-1 572	-1 259
Total Tier 1 capital	**12 446**	**9 073**
Subordinated loans	4 000	3 000
Total Tier 2 capital	**4 000**	**3 000**
Net own funds (NOF) for capital adequacy calculation	**16 446**	**12 073**
Capital requirements		
Central government and central banks with standardised approach	181	0
Credit institutions and investment companies with standardised approach	846	822
Companies under standard method	2 748	0
Retail claims under standard method	2 186	2 519
Overdue claims under standard method	450	0
Investment funds´s shares with standardised approach	243	257
Other assets with standardised approach	190	411
Total capital requirements for covering the credit risk and counterparty credit risk	**6 844**	**4 009**
Capital requirement against foreign currency risk	240	237
Capital requirement against interest position risk	1 112	461
Capital requirement against equity portfolio risks	6	9
Capital requirement for operational risk with standardised approach	642	612
Total capital requirements for adequacy calculation	**8 844**	**5 340**
Capital adequacy (%)	**18,60**	**22.61**
Tier 1 Capital Ratio (%)	**14,07**	**16.99**

The own funds of the LHV Bank as an credit institution at any time shall be equal to or exceed the minimum amount of share capital prescribed in the Credit Institutions Act (EUR 5 million). Capital adequacy level, i.e. the ratio of the bank's own funds to risk-weighted assets shall be at least 10%. LHV Pank maintains the capital adequacy level at 10%, to cover potential risks arising from fast growth. Each year, the Bank's Supervisory Board confirms the goals of capitalization and the target level of capital adequacy to cover potential risks arising from fast growth. Each year, an internal capital adequacy evaluation process is performed, the goal of which is to identify potential capital needs in addition to regulatory capital requirements.

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 (EUR 3 000). The net own funds of a fund manager, who is managing pension funds with the market value of over EUR 125 million, must be at least EUR 2.5 million and 1% of the market value of managed pension funds, which exceeds EUR 125 million.

3.2 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, bonds, 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.

3.2.1 Distribution of credit risks

The Group classifies the financial assets exposed to credit risk in the following key categories:

a) bonds
b) loans and advances to credit institutions and investment companies (referred to as "banks" in the tables)
c) leverage loans (margin loans backed by securities)
d) corporate loans
e) consumer loans with cash flows as collateral

a) Bonds

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

The Group's debt securities according to ratings given by Standard & Poor's or equivalent:

Rating	31.12.2011	31.12.2010
AAA	4 091	0
AA- to AA+	11 419	3 975
A- to A+	32 406	8 052
BBB- to BBB+	19 659	2 528
B- to BB+	4 418	3 317
Without a rating	4 611	0
Total (Note 12 and 13)	**76 604**	**17 872**

b) Loans and advances to banks

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating) are held as follows:

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Rating	31.12.2011	31.12.2010
Central bank	52 556	45 431
AA- toAA+	3 449	4 803
A- to A+	28 537	17 716
Lower than A-	0	0
Without a rating	516	813
Total (Note 10)	**85 058**	**68 763**

c) Leverage loans

LHV Pank gives margin loans backed by securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account, and on the general limit set by LHV Pank which is currently 100 thousand euros (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 Credit Committee. The list of acceptable marketable financial instruments and the levels of the required collateral are published on LHV Pank's 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. The Bank has set sufficiently conservative limits to the ratio of the loan and the collateral assets value. When the value of 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.

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.

d) Corporate loans

Since 2009, LHV Pank also issues corporate 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. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance. After issuing the loan, follow-up monitoring of each customer's financial position is performed at least once a quarter. Problem loans are monitored continuously.

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 amount of the loan principal and interest payments. Due to the small size of the bank's corporate loan portfolio, LHV Pank evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the residual value of the receivable and expected cash flows discounted at the effective interest rate. In 2011 and 2010, no impairment losses were recognised for corporate loans. Furthermore, as at 31.12.2011 as well as at 31.12.2010, there were no past due loan contracts, therefore the impact of financial collaterals on such loans has not been disclosed in more detail.

e) Consumer loans

At 28.06.2010, LHV Pank purchased a consumer loan portfolio of Finnish individuals with a 20% discount from its nominal value. The majority of the portfolio was past due and submitted to the bailiff for proceedings. Over the following months, LHV Pank upgraded the credit scoring model for issuing the loans of the acquired portfolio that had been in use previously, and started issuing new loans in September 2010. In addition to the customer's previous payment behaviour and income, the new credit scoring model also takes into account other statistical parameters, which have previously been collected by types of customer in order to evaluate potential disruptions in the payment behaviour of the scoring group. Different maximum limits for the loans to be issued have been set for various scoring groups. Consumer loans are issued only to individuals and using cash flows as collateral.

Consumer loans are homogeneous loans and they are not assessed individually, but they are provisioned on a group basis. For the purpose of recognition of group-based impairment losses, the receivables are grouped into subclasses on the basis of homogeneous credit risk features, considering customers' payment practice, past due time and the time passed from initiation of proceedings by the bailiff. For the receivables that have been grouped, the amount of the impairment loss is the multiple of the carrying amount of the receivables in the group and the group's percentage rate of impairment loss. The model for assessment of homogeneous receivables and setting up of provisions currently in use at the bank was developed in the second half of 2010 and renewed in 2011. As at 31.12.2011, the group-based impairment reserve makes up 19% of consumer loans and the related interest receivables (31.12.2010 18%). In 2010 and 2011, receivables, in respect of which the bailiff has sent a notice regarding the termination of the proceedings, have been written off the balance sheet against the impairment loss of the acquired portfolio.

The bank accounts for the acquired loan portfolio on a gross basis, i.e. showing contractual receivables from customers at nominal value, considering the actual effective interest rate of the contract and the impairment loss in the contra asset account.

3.2.2 Credit quality

Maximum credit risk exposure	**31.12.2011**	**31.12.2010**
Balances with banks and investment companies (Note 10)	85 058	68 763
Financial assets at fair value through profit or loss (bonds)(Note 12)	46 602	17 872
Held-to-maturity financial investments (Note 13)	30 001	0
Loans to customers (Note 14)	66 680	38 073
Other receivables from customers (Note 15)	373	1 980
Other assets (Note 16) *	624	590
Total assets	**229 322**	**127 277**
Off-balance sheet liabilities (Note 25)	7 338	3 517
Total maximum credit risk exposure	**236 660**	**130 795**

*excl. prepayments, that do not bear credit risk

Loans and advances to customers and banks as at 31.12.2011	Receivables not impaired and not past due	Receivables impaired and not past due	Receivables impaired and past due	**Total**	Impair-ment booked*	**Net**
Loans to legal entities						
Leverage loans	4 850	0	0	4 850	0	**4 850**
Corporate loans	45 690	0	0	45 690	0	**45 690**
Finance lease	46	0	0	46	0	**46**
Loans to individuals						
Leverage loans	3 230	0	0	3 230	0	**3 230**
Consumer loans	0	4 248	11 464	15 712	-3 042	**12 670**
Housing loans and finance lease	128	0	0	128	0	**128**
Credit card loans	66	0	0	66	0	**66**
Total loans and advances to customers	**54 010**	**4 248**	**11 464**	**69 722**	**-3 042**	**66 680**
Loans and advances to banks	85 058	0	0	85 058	0	**85 058**
Total (Note 8 and Note 12)	**139 068**	**4 248**	**11 464**	**154 780**	**-3 042**	**151 738**

* Impairment of a homogeneous portfolio, there are no receivables that have been impaired individually.

Distribution of loans and advances to customers as at 31.12.2011 by internal ratings	No past due payments, receivables not impaired	No past due payments, receivables impaired	Payments past due, receivables impaired
Excellent	8 078	0	0
Good and very good	11 582	4 248	0
Satisfactory	27 480	0	2 981
Weak or doubtful	6 870	0	8 483
Total	**54 010**	**4 248**	**11 464**

Loans and advances to customers and banks as at 31.12.2010	Receivables not impaired and not past due	Receivables impaired and not past due	Receivables impaired and past due	**Total**	Impair-ment booked	**Net**
Loans to legal person						
Leverage loans	5 024	0	0	5 024	0	**5 024**
Corporate loans	17 163	0	0	17 163	0	**17 163**
Finance lease	48	0	0	48	0	**48**
Loans to individuals						
Leverage loans	4 589	0	0	4 589	0	**4 589**
Consumer loans	0	2 813	10 740	13 553	-2 439	**11 113**
Housing loans and finance lease	135	0	0	135	0	**135**
Total loans and advances to customers	**26 960**	**2 813**	**10 740**	**40 513**	**-2 439**	**38 073**
Loans and advances to banks	68 763	0	0	68 763	0	68 763
Total (Note 8 and Note 12)	**95 723**	**2 813**	**10 740**	**109 276**	**-2 439**	**106 836**

* Impairment of a homogeneous portfolio, there are no receivables that have been impaired individually.

Distribution of loans and advances to customers as at 31.12.2010 by internal ratings	No past due payments, receivables not impaired	No past due payments, receivables impaired	Payments past due, receivables impaired
Excellent	9 614	0	0
Good and very good	1 948	2 813	0
Satisfactory	8 946	0	2 899
Weak or doubtful	6 452	0	7 841
Total	**26 960**	**2 813**	**10 740**

Distribution of internal ratings:

- Excellent – margin loans backed by securities and corporate loans with very low business risk.
- Good and very good – corporate loans with lower business risks and consumer loans, with no past due payments.
- Satisfactory – corporate loans with average business risk and consumer loans up to 60 days past due.
- Weak or doubtful – all remaining consumer loans (past due more than 60 days and portfolio in proceedings by the bailiff) and corporate loans carrying high business risk.

In addition to the loans granted, loan contracts have been concluded and signed whereby the unused loan commitment was EUR 4 911 thousand as at 31.12.2011 (as at 31.12.2010, EUR 2 828 thousand), see also Note 25. There are no restructured loans and receivables.

A portfolio of consumer loans of individuals makes up a quarter of the loan portfolio of LHV Pank, which is unsecured (issued for cash flows).

Structure of collateral of secured leveraged and corporate loans	2011	2010
Listed securities	12%	33%
Unlisted equity securities	10%	15%
Mortgages	24%	26%
Surety of KredEx and Rural Development Foundation	16%	11%
Pledges of rights of claim or deposit	11%	9%
Others	28%	6%

Loans, for which interest or principal payments had not been paid as at 31.12.2011, are divided to past due categories according to the past due time from the last scheduled payment as follows:

Structure of loans impaired according to past due time	31.12.2011	Impairment	Net
No past due payments	4 248	-45	4 203
Past due receivables	11 464	-2 997	8 467
1-30 days	*2 059*	*-56*	*2 003*
31-60 days	*922*	*-26*	*896*
61-90 days	*422*	*-39*	*383*
91-180 days	*615*	*-71*	*544*
181-360 days	*1 079*	*-129*	*950*
More than 360 days	*6 367*	*-2 676*	*3 691*
Total	**15 712**	**-3 042**	**12 670**

Loans, for which interest or principal payments had not been paid as at 31.12.2011, are divided to past due categories according to the past due time from the last scheduled payment as follows:

Structure of loans impaired according to past due time	31.12.2010	Impairment	Net
No past due payments	2 813	-21	2 792
Past due receivables	10 740	-2 418	8 321
1-30 days	1 245	-24	1 221
31-60 days	597	-18	579
61-90 days	276	-16	259
91-180 days	528	-53	475
181-360 days	1 447	-284	1 163
More than 360 days	6 647	-2 024	4 623
Total	**13 553**	**-2 439**	**11 113**

As at 31.12.2011 as well as at 31.12.2010, there were no other past due loans apart from consumer loans.

Credit quality of other receivables	31.12.2011	31.12.2010
Receivables not impaired and not past due	349	324
Receivables past due (not impaired)	8	5
incl. receivables from individuals	*8*	2
incl. receivables from legal persons	*0*	3
Impaired receivables acquired at net value	0	1 651
incl. receivables from individuals	*0*	1 651
Total (Note15)	**357**	**1 980**

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Credit quality of off-balance sheet liabilities	31.12.2011	31.12.2010
Excellent	0	0
Good and very good	2 125	1 675
Satisfactory	4 503	1 507
Weak or doubtful	710	336
Total (Note 23)	**7 338**	**3 517**

3.3 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. 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. The bank does not hold an active trading portfolio and the liquidity portfolio is very short-term, therefore, there is no major risk due to trading and the VaR method is primarily used for assessment of collateral value of margin loans.

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.

3.3.1 Foreign currency risk

Foreign currency risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. The 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, such as 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, Latvian lats, Lithuanian litas) cannot exceed 5% of net own funds
- Open currency positions of the Latvian lats and Lithuanian litas are without limits, as the litas is 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 LHV Pank has open currency exposures, are USD and SEK.

Open currency exposures

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in EUR 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.

31.12.2011	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk							
Balances with other banks and inv. companies	78 985	636	598	297	3 324	1 218	85 058
Securities	77 697	0	0	0	1 355	0	79 052
Loans granted	64 796	162	380	320	961	61	66 680
Receivables from customers	337	0	0	0	7	29	373
Other assets	341	0	0	0	595	1	937
Total assets bearing currency risk *	**222 156**	**798**	**978**	**617**	**6 242**	**1 309**	**232 100**
Liabilities bearing currency risk							
Loans received and deposits from customers	209 546	602	687	409	5 219	1 251	217 714
Deferred income	389	0	0	0	0	0	389
Accrued expenses and other liabilities	1 580	-2	9	193	21	445	2 246
Total liabilities bearing currency risk *	**211 515**	**600**	**696**	**602**	**5 240**	**1 696**	**220 349**
Off balance sheet contingencies at contractual amounts *	1 000	0	0	0	0	0	1 000
Off balance sheet commitments at contractual amounts *	0	0	0	0	1 000	0	1 000
Open foreign currency position *	**11 641**	**198**	**282**	**15**	**2**	**-387**	**11 751**

* the balances of total assets and total liabilities bearing currency risk above do not include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts as contingencies and commitments (see also Note 11); also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

31.12.2010	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk							
Balances with other banks and inv. companies	67 139	454	50	144	685	291	68 763
Securities	18 470	0	18	1	1 998	1	20 488
Loans granted	35 653	567	197	85	1 375	196	38 073
Receivables from customers	1 919	1	1	0	41	18	1 980
Other assets	278	0	1	0	576	0	855
Total assets bearing currency risk *	**123 459**	**1 022**	**267**	**229**	**4 675**	**506**	**130 158**
Liabilities bearing currency risk							
Loans received and deposits from customers	114 867	655	126	321	2 831	395	119 195
Deferred income	185	0	0	0	0	0	185
Accrued expenses and other liabilities	1 286	24	16	0	1	0	1 328
Total liabilities bearing currency risk *	**116 338**	**680**	**142**	**321**	**2 832**	**395**	**120 708**
Off balance sheet contingencies at contractual amounts *	1 875	0	0	0	0	0	1 875
Off balance sheet commitments at contractual amounts *	0	0	0	0	1 875	0	1 875
Open foreign currency position *	**8 996**	**343**	**125**	**-92**	**-32**	**111**	**9 450**

* the balances of total assets and total liabilities bearing currency risk above do not include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts as contingencies and commitments (see also Note 11); also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

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	Change	2011	Change	2010
USD exchange rate	10%	0	10%	3
	-10%	0	-10%	-3
SEK exchange rate	10%	2	5%	9
	-10%	-2	-5%	-9

3.3.2 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	Change	2011	Change	2010
Shares in trading portfolio	20%	1	20%	6
	-20%	-1	-20%	-6
Fund units in trading portfolio	15%	2	15%	2
	-15%	-2	-15%	-2
Bonds in investment portfolio	3.6%	1 678	5%	894
	3.6%	-1 678	-5%	-894

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 pension funds 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.

CBOE Nasdaq Index VIX, which measures the volatility of stock markets, has continued to fall as compared to previous years and fluctuates at around 15-20%, which has been used to test the effect of changes on the market value of equity positions. The bank does not hold significant amounts of shares and fund in its position, due to which the sensitivity to change in the market value of these positions is marginal. The bank's bond portfolio recognised at the market price is short-term and of high quality, therefore, the effect of the changes in market risk premiums on the market value of the bond portfolio should remain at around 3.6%.

3.3.3 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, LHV Pank primarily uses fixed interest rates for taking in deposits. The interest rates of the deposits from customers were up to 3.7% in 2011 (up to 4.5% in 2010). The interest rate on loans granted was between 3.2%-24% in 2011 (4.5-23% in 2010). The interest rates for leverage loans granted are changed at most once a month according to fluctuations in market interest rates. In 2011, the interest rate on loans received for specific purposes was 1.5% (2010: the same) and the effective interest rate of subordinated loans was 9% (2010: the same).

As at 31.12.2011, an increase of 1% in interest rates would affect the Bank's annual net interest income by EUR -31 thousand (2010: EUR +16 thousand). A 1% increase in market interest rates would lower the Bank's economical value by EUR -373 thousand (2010: EUR -191 thousand). The effect on the bank's economical value is negative due to the longer than average duration of interest-earning assets than the average duration of interest-bearing liabilities.

The table below shows the structure of the interest-earning assets and interest-bearing liabilities of the Group according to the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.

31.12.2011	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Assets					
Balances with other banks and inv. companies	75 866	9 000	0	0	**84 866**
Financial investments and securities	29 960	13 741	22 875	9 803	**76 379**
Loans granted	17 562	18 088	24 907	5 259	**65 816**
Total financial assets	**123 388**	**40 829**	**47 782**	**15 062**	**227 061**
Liabilities					
Loans received and deposits from customers	114 384	77 826	16 532	3 818	**212 560**
Subordinated loans *	0	2 790	1 000	0	**3 790**
Total financial liabilities	**114 384**	**80 616**	**17 532**	**3 818**	**216 350**
Total Interest pricing gap	**9 004**	**-39 787**	**30 250**	**11 244**	**10 711**

* The contractual term of subordinated loans is 7 years, but there will be interest rate changes.

31.12.2010	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Assets					
Balances with other banks and inv. companies	68 749	0	0	0	**68 749**
Financial investments and securities	0	786	11 543	4 475	**16 804**
Loans granted	13 263	8 778	12 569	2 960	**37 570**
Total financial assets	**82 011**	**9 564**	**24 111**	**7 435**	**123 122**
Liabilities					
Loans received and deposits from customers	64 376	43 061	6 417	1 761	115 615
Subordinated loans *	0	0	3 000	0	3 000
Total financial liabilities	**64 376**	**43 061**	**9 417**	**1 761**	**118 615**
Total Interest pricing gap	**17 635**	**-33 497**	**14 694**	**5 675**	**4 507**

3.4 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. The Group does not have any debts past due as at 31.12.2011 and 31.12.2010.

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).

Explanation of the fair value of these financial assets and liabilities is presented in Note 3.6. LHV Pank has a sufficient supply of liquid resources to enable issuing standby loans. To enable covering unexpected monetary outflows, it is possible to sell security investments, but the bank does not hold them for the purpose of ensuring liquidity, instead, they are held for investing purposes. Furthermore, the majority of the financial investments and securities in the Bank's bond portfolio can be used as collateral to raise a short-term loan from the central bank.

31.12.2011	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	115 484	81 341	19 129	4 285	**220 239**
Subordinated liabilities	40	190	1 501	4 594	**6 325**
Other liabilities	1 777	0	13	0	**1 790**
Unused loan commitments	1 533	3 078	300	0	**4 911**
Financial guarantees by contractual amounts	396	1 714	297	0	**2 407**
Interest rate swaps	0	441	0	0	**441**
Total liabilities	**119 230**	**86 764**	**21 240**	**8 879**	**236 113**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	75 954	9 187	0	0	**85 141**
Financial investments and securities	8 326	22 366	45 465	8 154	**84 311**
Loans granted	6 003	16 974	38 450	11 125	**72 552**
Receivables from customers	361	12	0	0	**373**
Total assets held for managing liquidity risk	**90 644**	**48 539**	**83 915**	**19 279**	**242 377**
Maturity gap from assets and liabilities	**-28 586**	**-38 225**	**62 675**	**10 400**	**6 264**

31.12.2010	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	69 857	39 506	7 780	589	117 731
Subordinated liabilities	0	150	961	3 330	4 441
Other liabilities	1 335	0	13	0	1 347
Unused loan commitments	2 828	0	0	0	2 828
Financial guarantees by contractual amounts	443	179	67	0	689
Total liabilities	**74 463**	**39 835**	**8 820**	**3 919**	**127 037**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	68 763	0	0	0	68 763
Financial investments and securities	301	1 527	13 215	6 160	21 204
Loans granted	11 768	10 301	14 742	5 271	42 082
Receivables from customers	742	413	825	0	1 980
Total assets held for managing liquidity risk	**81 574**	**12 241**	**28 782**	**11 431**	**134 029**
Maturity gap from assets and liabilities	7 111	-27 594	19 963	7 512	6 992

3.5 Risk concentration

Distribution of assets and liabilities by geography is presented below:

As at 31.12.2011	Estonia	Latvia	Lithuania	Sweden	Finland	Den-mark	USA	Other	Total
Asset distribution by geography									
Balances with banks and inv. companies	59 197	862	1 704	55	3 503	6 013	4 432	9 292	**85 058**
Financial investments, incl. derivatives	6 134	1 546	2 141	6 268	7 080	2 118	6 823	46 942	**79 052**
Loans granted	49 344	664	864	0	12 668	0	0	3 140	**66 680**
Receivables from customers	365	3	5	0	0	0	0	0	**373**
Other assets	314	5	3	0	0	0	615	0	**937**
Goodwill and associates	1 087	0	0	0	0	0	0	0	**1 087**
Tangible assets	1 138	1	0	0	264	0	0	0	**1 403**
Total assets	**117 546**	**3 081**	**4 717**	**6 323**	**23 515**	**8 131**	**11 870**	**59 374**	**234 557**
Distribution of liabilities by geography									
Loans and deposits from customers	203 825	1 151	1 209	22	502	0	74	6 922	**213 705**
Subordinated loans	4 009	0	0	0	0	0	0	0	**4 009**
Other liabilities	2 386	18	38	0	204	0	1	1	**2 648**
Total liabilities	**210 220**	**1 169**	**1 247**	**22**	**706**	**0**	**75**	**6 923**	**220 362**

Unused loan commitments to Estonian residents amount to EUR 4 911 thousand (2010: EUR 2 828 thousand).

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As at 31.12.2010	Estonia	Latvia	Lithuania	Sweden	Finland	Den-mark	USA	Other	Total
Asset distribution by geography									
Balances with banks and inv. companies	52 136	141	1 244	49	4 212	6 798	2 515	1 666	**68 763**
Financial investments, incl. derivatives	4 096	1 793	1 636	2 196	2 145	2 702	422	5 499	**20 488**
Loans granted	24 479	803	1 392	0	11 113	0	0	287	**38 073**
Receivables from customers	302	8	9	0	1 651	0	0	10	**1 980**
Other assets	270	5	3	0	0	0	576	0	**855**
Goodwill	1 054	0	0	0	0	0	0	0	**1 054**
Tangible and intangible assets	452	4	0	0	0	0	0	0	**456**
Total assets	**82 789**	**2 754**	**4 284**	**2 245**	**19 121**	**9 500**	**3 514**	**7 462**	**131 668**
Distribution of liabilities by geography									
Loans and deposits from customers	114 418	318	874	0	38	7	295	402	**116 352**
Subordinated loans	2 844	0	0	0	0	0	0	0	**2 844**
Other liabilities	1 375	18	64	0	83	0	0	0	**1 540**
Total liabilities	**118 637**	**336**	**938**	**0**	**121**	**7**	**295**	**402**	**120 735**

As at 31.12.2011, the loans issued to 3 customers had a large risk exposure (i.e. more than 10% of the net own funds (NOF) of the Group either individually or via group risk), totalling 40% of NOF. The Group has invested in the bonds of 7 issuers with a large risk exposure, totalling 84% of NOF. As at 31.12.2010, 7 loans issued with a large risk exposure totalled 59% of NOF. As at 31.12.2010, the group did not have a large risk exposure to the issuers of bonds.

Distribution of loans (corporate loans, consumer loans and leverage loans) granted by industry (gross):

	31.12.2011	%	31.12.2010	%
Private individuals	21 436	30.74%	18 277	45,11%
Financial services	6 584	9.44%	2 665	6,58%
Wholesale and retail	5 870	8.42%	3 149	7,77%
Administration and support services	3 415	4.90%	2 265	5,59%
Construction	2 818	4.04%	1 377	3,40%
Manufacturing	1 828	2.62%	4 569	11,28%
Information and communication	1 595	2.29%	849	2,10%
Other services	1 505	2.16%	356	0,88%
Real estate	1 018	1.46%	2 246	5,54%
Professional, scientific and technical activities	917	1.32%	1 982	4,89%
Health and social care	574	0.82%	1 292	3,19%
Accommodation and catering	1 241	1.78%	636	1,57%
Other areas of activities	20 921	30.01%	850	2,10%
Kokku	**69 722**	**100%**	**40 513**	**100%**

3.6 Fair value of financial assets and financial liabilities

The Management Board of the Group has assessed the fair value of assets and liabilities carried at amortised cost in the balance sheet. For identification of fair value, the future cash flows are discounted on the basis of the market interest yield curve.

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 corporate loans is too small due to the bank's early stage of business, each customer is reviewed separately and interest rates vary on the basis of customer's risk level, as a result of which a homogeneous interest rate based on similar transactions cannot be used for discounting the future cash flows of these loans. As the bank competes with other credit institutions when issuing loans and offers higher interest rates for customers than its competitors, the Management Board estimates that the loans have been issued at market conditions and their fair value is definitely not lower than their carrying amount as at 31.12.2011 and 31.12.2010. The effective interest rate of consumer loans issued is at the same level as the interest rate of the loan product offered in the market and it can be stated that the carrying amount of loans does not significantly differ from their fair value (at 31.12.2010, fair value was 2.37% lower).

As at 31.12.2011, the fair value of held-to-maturity financial investments was EUR 631 thousand lower than their carrying amount, taking into consideration the quoted market price for respective instruments. One month after the balance sheet date, the fair value of instruments did not differ from their carrying amount.

Trade receivables (other than the receivables related to consumer loans, which have been included within loans for assessment of fair value), and accrued expenses and other liabilities have been incurred in the course of ordinary business and are payable in the short-term, therefore, the management estimates that their fair value does not significantly differ from their carrying amount. These receivables and liabilities are interest-free.

Customer deposits with fixed interest rates are primarily short-term and market conditions are followed when pricing deposits. In 2011, the market yield curve did not change significantly; as a result, the fair value of deposits determined using the discounted future cash flows did not significantly differ from their carrying amount.

For the term structure of financial assets and financial liabilities, refer to Note 3.4.

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

	31.12.2011				31.12.2010			
	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	6	0	0	**6**	29	0	0	**29**
fund units	14	0	0	**14**	16	0	0	**16**
Investment portfolio								
bonds	46 602	0	0	**46 602**	17 872	0	0	**17 872**
fund units	2 429	0	0	**2 429**	2 571	0	0	**2 571**
Total financial assets	**49 051**	**0**	**0**	**49 051**	**20 488**	**0**	**0**	**20 488**
Financial liabilities at fair value through profit or loss								
Interest rate swaps	441	0	0	**441**	0	0	0	**0**
Total financial liabilities	441	0	0	**441**	**0**	**0**	**0**	**0**

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 (e.g discounted cash flow method) with judgemental inputs

3.7 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 minimize 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 Group is responsible for collecting information and the Management Boards of LHV Pank and LHV Varahaldus are 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.

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 applied to valuation of loans, receivables and investments (Notes 3.2, 10, 12, 13 and 14).

According to IAS 39, the Group classifies a portion of its bond portfolio as a held-to-maturity portfolio. When making investments, the Group evaluates the intention of holding the respective investment until maturity. When the Group is unable to hold the investment until maturity for any reason whatsoever, the total portfolio classified in this category shall be reclassified as a held-for-sale portfolio, investments shall be valued at fair value instead of amortised cost and the difference between the current carrying amount and fair value is recognised in the statement of comprehensive income.

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.

In 2011, the Group changed the presentation of the income statement. Interest income on bonds in the trading portfolio are now included in interest income, they had previously been included within finance income. Revenue from customers' foreign currency translation is now included within fee and commission income, previously they had been included in finance income. The comparatives for 2010 have been r accordingly. The changes have no effect on the results of the Group.

NOTE 5 Subsidiaries and associated companies, goodwill

As at 31.12.2011, the Group's subsidiaries which have been consolidated in these financial statements, include:

- AS LHV Pank (ownership interest 100%)
- AS LHV Varahaldus (ownership interest 83,72%)
- AS LHV Finance (ownership interest 100%)

In the autumn of 2010, AS LHV Capital was founded which the Group acquired a 40% ownership interest in. AS LHV Capital manages the investments in the portfolio previously based on the private capital of the bank's shareholders. At the beginning of 2011, LHV Ilmarise Kinnisvaraportfell OÜ, the subsidiary of the Group, was liquidated.

In February 2011, AS LHV Group acquired 100% ownership interest in AS LHV Varahaldus, when buying out the minority interest of 16% with the price of EUR 1 110 thousand. The minority interest was recognized in the balance sheet in the amount of EUR 391 thousand. The difference arising from the acquisition of the ownership in the amount of EUR 719 thousand is recognized in the equity as a reduction of the retained earnings, due to the changes in the IFRS adopted in 2010, after which goodwill is no longer allowed to be recognized as an intangible asset in the asset arising from transactions with the non-controlling party.

As at 31.12.2011, goodwill in amount EUR 1 044 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 EUR 482 thousand
- positive goodwill which had arisen after the conclusion of a purchase contract entered into in 2009 in the amount of EUR 562 thousand.

An impairment test was performed as at 31.12.2011. The cash generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

- due to the economic environment, modest growth of 4% in operating is expected per annum (2010: 4%)
- the discount rate used is 13% (2010: 13%)
- when using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations.

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 recognized.

NOTE 6 Net fee and commission income

Fee and commission income	**2011**	**2010**
Financial advisory services	60	31
Security brokerage and commissions	2 475	2 448
incl. related parties (Note 26)	1	0
Asset management and similar fees	2 962	2 005
incl. related parties (Note 26)	2 324	1 385
Other fee and commission income	408	139
Total	**5 905**	**4 622**
Fee and commission expense		
Financial advisory and other similar services purchased	-12	-1
Security brokerage and commissions paid	-497	-585
Collection costs	-243	-124
Total	**-752**	**-711**
Net fee and commission income	**5 153**	**3 912**

Fee and commission income by customer location:	**2011**	**2010**
Estonia	5 169	3 852
Finland	113	124
Latvia	149	176
Lithuania	473	471
Total	**5 905**	**4 622**

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NOTE 7 Net interest income

Interest income	2011	2010
From balances with other banks and investment companies	278	288
From balances with central bank	373	46
Bonds	1 739	377
incl. bonds held-to-maturity	*603*	*0*
incl. bonds at fair value through profit or loss	*1 136*	*377*
Finance lease	12	12
Margin loans and lending of securities (Note 14)	1 225	705
Customer loans (Note 14)	1 652	637
Other loans (Note 14)	2 357	963
Total	**7 636**	**3 028**
Interest costs		
Loans received and deposits from customers (Note 18)	- 4 119	-1 706
incl. loans from related parties (Note 26)	*-33*	*-26*
Total	**- 4 119**	**-1 706**
Net interest income	**3 517**	**946**

Interest income by customer location :	2011	2010
Estonia	3 256	1 473
Finland	1 652	637
Latvia	64	40
Lithuania	274	177
Total	**5 246**	**2 327**

NOTE 8 Gain/loss from financial assets

Gain/loss from financial assets	2011	2010
Net gain/loss on trading portfolio securities recognized at fair value	-5	-9
Gain from investment portfolio securities designated at fair value	-1 163	-177
Incl. revaluation of fund units	*-220*	*270*
Incl. revaluation of bonds	*-466*	*-447*
Incl. revaluation of interest rate swaps	*-477*	*318*
Gain/loss from revaluation of foreign exchange rates	28	56
Net gain/loss from financial assets	**-1 140**	**-130**

NOTE 9 Operating expenses

Staff costs	Note	2011	2010
Wages, salaries and bonuses		3 224	2 296
Social security and other taxes		1 001	733
Total		**4 225**	**3 029**
IT expenses		803	506
Information services and bank services		266	215
Marketing expenses		4 212	2 333
Office expenses		405	215
Transportation and communication costs		165	134
Training and travelling expenses of employees		247	138
Total services purchased		1 662	929
Other administrative expenses		538	255
Depreciation	17	236	219
Operating lease payments	23	696	376
Costs related to setting up provisions	20	0	-8
Other operating expenses		75	23
Total operating expenses		**13 530**	**8 365**

NOTE 10 Balances with central bank, other banks and investment companies

	31.12.2011	31.12.2010
Demand deposits *	17 186	15 019
Term deposits with original maturity less than 3 months *	6 125	8 309
Term deposits with maturity more than 3 months	9 000	0
Statutory reserve capital at central bank	1 784	7 014
Balances with central bank	50 772	38 408
Accrued interest	191	13
incl. from central bank	*0*	9
Total	**85 058**	**68 763**
* cash and cash equivalents in statement of cash flows	74 083	61 736

Distribution of receivables by countries is presented in note 3.5. Balances with investment companies included in demand deposits amounts to EUR 4 915 thousand (2010: EUR 2 934 thousand). All other demand and term deposits are held at credit institutions and in the central bank. LHV Pank is required to hold the reserve capital in the central bank at the level of 1% (31.12.2010: 2%) of all financial resources taken in (loans received and deposits from customers). Reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 11 Foreign currency derivatives

Balance as at 31.12.2011	Asset / liability (fair value)	Contingent assets (contractual amount)	Commitments (contractual amount)
Foreign currency future contract (USD)	0	1 000	1 000
Total derivatives	0	**1 000**	**1 000**
Balance as at 31.12.2010			
Foreign currency future contract (USD)	0	1 875	1 875
Total derivatives	**0**	**1 875**	**1 875**

A foreign currency future is traded on the stock exchange, and daily gains or losses are immediately transferred to LHV Pank's account as a result of which the carrying amount of the contract is 0. LHV Pank uses foreign currency futures for hedging the currency risk arising from open foreign currency exposures. All contracts are with 3 months maturity.

NOTE 12 Financial assets and liabilities at fair value through profit or loss

Securities held for trading:	**31.12.2011**	**31.12.2010**
Shares	6	29
Fund units	14	16
Bonds	46 602	0
Designated as at fair value through profit or loss upon initial recognition:		
Fund units	2 429	2 571
incl. investments in managed pension funds	*1 992*	1 939
incl. investments in managed investment funds	*437*	632
Bonds	0	17 872
Total financial assets	**49 051**	**20 488**
Interest rate swaps	441	0
Interest rate swaps	**441**	**0**

Bid price is the indication of fair value for quoted financial investments and securities. The information about revaluation gain/loss for such financial assets is presented in the Note 8.

NOTE 13 Held-to-maturity financial investments

In 2011, the bank set up a held-to-maturity bonds portfolio, which is carried at amortised cost in the balance sheet. The portfolio volume as at 31.12.2011 totalled EUR 30 001 thousand of which EUR 10 861 thousand had a floating coupon interest rate and EUR 19 140 thousand had a fixed coupon interest rate. Fair value estimates of these instruments are disclosed in Note 3.6.

NOTE 14 Loans granted

	Loan balance 31.12.2011	**Loan balance31.12.2010**
Loans to legal persons	**50 586**	**22 236**
incl. leveraged loans	4 850	5 024
incl. corporate loans	45 690	17 163
incl. finance lease	46	48
Loans to individuals	**19 136**	**18 277**
incl. leveraged loans	3 230	4 589
incl. consumer loans	*15 712*	13 553
incl. finance lease and housing loans	*128*	135
Incl. credit card loans	66	**0**
Total	**69 722**	**40 513**
Impairment loss	-3 042	-2 439
TOTAL	**66 680**	**38 073**

The impairment provision has been set up for the portfolio of consumer loans acquired with a discount and for newly issued consumer loans.

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Changes in impairments in 2011	Loans 31.12.2011	Other related receivables 31.12.2011
Balance as at January 1	-2 439	0
Impairment provisions set up during the year	-956	-1 651
Written off during the year	353	1 651
Balance as at December 31 (Note 15)	**-3 042**	**0**

In 2011, the average effective interest rate of consumer loans (excluding acquired loan portfolio of net value of EUR 5.3 EUR as at 31.12.2011) issued to individuals was between 20-24%. Interest income on the acquired portfolio is calculated on the basis of the effective interest rate of 10% which was the expected rate of return of the portfolio at the time of acquisition. Interest receivables from customers are accounted for using the effective interest rate calculated on the basis of the customer's contractual payments, and the difference between the customer's effective interest rate and the effective interest rate found upon acquisition is adjusted in the impairment account under assets. Interest income on new consumer loans issued is recognised in the income statement using their actual effective interest rate.

The contractual interest rate of leveraged loans issued to individuals is generally equal to their effective interest rate, because no other significant fees have been received upon their issue.

As at 31.12.2011 and 31.12.2010, no loans have been issued to related parties. Deferred income includes service fees of loans in the amount of EUR 389 thousand (2010: EUR 185 thousand), which are released to interest income over the loan term and the current portion of which totals EUR 110 thousand (2010: 107 thousand) and the non-current portion totals EUR 279 thousand (2010: EUR 78 thousand).

For interest income on loans granted, see Note 7.
For credit risk exposures and loan collateral, see Note 3.2.
Distribution of loans granted by currencies is disclosed in Note 3.3.
Distribution of loans granted by due dates is disclosed in Note 3.4.
The regional distribution of loans granted is disclosed in Note 3.5.

NOTE 15 Receivables from customers

	31.12.2011	31.12.2010
Securities brokerage fees from intermediaries	13	17
Asset management fees from customers	272	204
incl. related parties (Note 26)	*226*	*134*
Other fees for providing services to customers	71	108
incl. related parties (Note 26)	*0*	*17*
Payments in transit	17	0
Allowances for impairment of receivables	0	1 651
Total	**373**	**1 980**

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

NOTE 16 Other assets

	31.12.2011	31.12.2010
Guarantee deposits of Baltic stock exchanges	9	13
MasterCard guarantee deposits	615	576
Prepayments to Financial Supervision Authority	70	55
Other prepayments *	243	210
Total	**937**	**855**

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

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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 the deposit of MasterCard to guarantee credit card transactions, and should therefore both be considered non-current assets.

NOTE 17 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2009			
Cost	776	79	855
Accumulated depreciation and amortisation	-468	-42	-510
Carrying amount	**309**	**37**	**346**
Changes occurs in 2010:			
Purchase of non-current assets	132	197	329
Depreciation/amortisation charge	-200	-19	-219
Balance as at 31.12.2010			
Cost	908	276	1 184
Accumulated depreciation and amortisation	-667	-61	-728
Carrying amount	**241**	**215**	**456**
Changes occurs in 2011:			
Non-current assets sold at carrying amount	-11	0	-11
Purchase of non-current assets	824	371	1 195
Depreciation/amortisation charge	-179	-58	-237
Balance as at 31.12.2011			
Cost	1 721	647	2 368
Accumulated depreciation and amortisation	-846	-119	-965
Carrying amount	**875**	**528**	**1 403**

In 2011 and 2010, there was no indication of impairment of tangible and intangible assets.

NOTE 18 Loans received and deposits from customers

	Private individuals	Private legal entities	Public entities	**31.12.2011 Total**	Private individuals	Private legal entities	Public entities	**31.12.2010 Total**
Demand deposits	17 424	16 880	655	**34 959**	7 163	10 541	42	**17 746**
Term deposits	96 982	67 414	8 349	**172 745**	44 164	43 883	7 659	**95 706**
Loans received	0	172	4 347	**4 519**	0	243	1 920	**2 163**
Accrued interest liability	975	452	55	**1 482**	414	271	52	**737**
Total	**115 381**	**84 918**	**13 406**	**213 705**	51 741	54 937	9 674	**116 352**
Incl. related parties (Note 26)	*0*	*1 573*	*0*	*1 573*	*10*	*16*	*0*	*25*

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

Interest expense from loans received and deposits from clients is presented in Note 7.
Distribution of loans received and deposits from customers by currency is presented in Note 3.3.
Distribution of loans received and deposits from customers by maturity is presented in Note 3.4.
Distribution of loans received and deposits from customers by geography is presented in Note 3.5.

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.

NOTE 19 Accrued expenses and other liabilities

	31.12.2011	31.12.2010
Financial liabilities:		
Financial guarantee contracts issued	28	8
Trade payables	412	442
Other liabilities:		
Tax liabilities	418	270
Payables to employees	487	437
Payments in transit	460	171
Total	**1 805**	**1 328**

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 20 Provisions

In the balance sheet as of 31.12.2011, a provision has been recognized in the amount of EUR 13 thousand, the respective expense is included within operating expenses (see Note 9). Provision is recognized as a long-term liability. In 2010, some of the provisions were paid out and the amount of provisions was partially corrected by reducing it.

NOTE 21 Subordinated loans

In October 2010, the Group issued subordinated bonds in the amount of EUR 3 million. The due date of the bonds is 7 years and at the end of the second year investors have conversion option. The interest rate on subordinated bonds is 5% in the first two-year period and 7.5% + 12-month Euribor in the subsequent five-year period, with the due date at 15.10.2017. Investors' have the right to convert these bonds to share capital in October 2012. The bonds are recorded in balance sheet with internal rate of return of 9% p.a. Options in the amount of EUR 210 thousand are separated from bonds and are recorded in equity. Interest expenses on subordinated bonds in the amount of EUR 263 thousand are included within interest expenses in the income statement.

In February 2011, the Group issued additional subordinated bonds in the amount of EUR 1 million. The underlying currency of the bonds is euro and the interest rate for the first three years is 8% and 15% for the following four years. The bonds in the balance sheet are recognized with the internal interest rate of 11,65%. Interest expenses on subordinated bonds in the amount of EUR 105 thousand are included within interest expenses in the income statement.

NOTE 22 Shareholders' equity in the public limited company

Rain Lõhmus with 46% of the voting rights and Andres Viisemann with 13% of the voting rights hold the significant influence over the LHV Group.

	31.12.2011	31.12.2010
Share capital *(in thousands of euros)*	14 200	9 055
Number of shares (pcs)	14 199 778	9 054 836
Par value of a share	1 EUR	1 EUR

According to the Company's articles of association, the minimum share capital is EUR 5 million and the maximum share capital is EUR 20 million. The share capital has been fully paid in cash.

The share capital of AS LHV Group was increased in October 2011 by EUR 12 862 thousand. The share capital was paid in cash and was subscribed at premium: the issue price was EUR 1 per share with the nominal value of EUR 2.5.

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 exceed the amount of the share capital of the parent and the reserves. Based on the financial results for 2011 and 2010, it is not possible to pay any dividends to the shareholders.

NOTE 23 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 EUR 1 873 thousand (2010: EUR 1 488 thousand), the current portion of which amounts to EUR 673 thousand (2010: EUR 401 thousand) and the non-current portion which amounts to EUR 1 200 thousand (2010: 1 087 thousand). In 2011, the operating lease payments for office premises in the amount of EUR 677 thousand (2010: 362 thousand) and operating lease payments for cars in the amount of EUR 19 thousand (2010: EUR 14 thousand) are included within operating expenses.

In addition, the Group leased one car under finance lease terms. Interest expenses in the amount of EUR 1 thousand (2010: EUR 1 thousand) which have arisen from the payment of finance lease principal payments have been included within interest expenses. Finance lease principal payments totalled EUR 14 thousand (2010: EUR 6 thousand) and they are reported as a reduction of the finance lease liability in the balance sheet. The finance lease agreement was terminated with an agreement between both parties in July 2011.

NOTE 24 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:

	31.12.2011	**31.12.2010**
Cash balance of customers	**4 374**	**5 246**
Securities of customers	**159 724**	**178 544**
incl. members of the Management and Supervisory Board and legal entities controlled by them	6 987	6 425
Total	**164 098**	**183 790**

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 recognized 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 recognized 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 25 Contingent liabilities

Irrevocable transactions	**Unused loan commitments**	**Financial guarantees**	**Total**
Liability in contractual amount 31.12.2011	4 911	2 427	**7 338**
Liability in contractual amount 31.12.2010	2 828	689	**3 517**

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 2010 - 2011. 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 26 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	2011	2010
Total service fee and commission income	**6**	**2 330**	**1 385**
Incl. managed funds		*2 324*	1 385
Incl. members of the management board and legal entities controlled by them		*1*	0
Total other income		**0**	**17**
Incl. members of the management board and legal entities controlled by them		*0*	17
Interest expenses	*7*	**33**	**26**
Incl. members of the management board and legal entities controlled by them		33	26

Balances	Note	31.12.2011	31.12.2010
Receivables as at the year-end		**226**	**151**
Incl. members of the management board and legal entities controlled by them	*15*	0	17
Incl. managed funds	*15*	226	134
Liabilities as at year-end		**1 573**	**25**
Incl. members of the management board and legal entities controlled by them	*19*	1 573	25

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 2011, the remuneration and other compensation paid to the managements of the subsidiaries of AS LHV Group totaled EUR 366 thousand (2010: EUR 332 thousand). As at 31.12.2011, the payable of the management consists of the remuneration for the month of December and accrued holiday pay in the amount of EUR 74 thousand (as at 31.12.2010: EUR 98 thousand) (Note 19). As at 31.12.2011 and 31.12.2010, 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 2011 and in 2010.

Information on assets of related parties held by the Group as an account manager is presented in Note 24.

During the reporting period loans have been received from the members of the Management Board and legal entities controlled by them in the amount of EUR 2800 thousands and all the loans were repaid during the reporting period. The interest rates of loans were 4 % p.a.

NOTE 27 Separate financial statements of parent company

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 thousands of euros)

	2011	2010
Interest income	326	148
Interest expenses	-298	-105
Net interest income	**28**	**43**
Revaluation of investments	0	-762
Operating expenses	-20	-23
Impairment of investment in associate	0	-125
Income/loss for the financial year	**8**	**-867**
Comprehensive income/loss for the year	**8**	**-867**

Balance sheet of the parent

(in thousands of euros)

	31.12.2011	31.12.2010
Assets		
Balances with other banks and investment companies	131	587
Loans granted	3 181	4 061
Investment in subsidiary	24 440	10 140
Investment in associate	10	10
Total assets	**27 762**	**14 799**
Liabilities		
Other financial liabilities	0	7
Subordinated loans	2 944	2 844
Total liabilities	**2 944**	**2 850**
Shareholders' equity		
Share capital	14 200	9 055
Share premium	13 419	5 702
Share options	210	210
Statutory reserve capital	223	223
Accumulated deficit	-3 234	-3 241
Total shareholders' equity	**24 818**	**11 949**
Total shareholders' equity and liabilities	**27 762**	**14 799**

Cash flow statement of the parent

(in thousands of euros)

	2011	2010
Cash flows from operating activities		
Operating and other expenses	-20	-23
Interest received	326	148
Interest paid	-298	-105
Change in other receivables	-120	-26
Change in other financial liabilities	93	-501
Net cash flows from operating activities	**-19**	**-506**
Cash flows from investing activities		
Loans granted	0	-3 400
Repayments of loans granted	1 000	0
Acquisition of subsidiary and joint ventures	-14 299	-1 115
Change in investment portfolio	0	-762
Net cash flows from investing activities	**-13 299**	**-5 277**
Cash flows from financing activities		
Payment to share capital	12 862	3 572
Loans received	3 575	0
Repayment of loans received	-3 575	-1 204
Subordinated loans received	0	3 000
Net cash flows from financing activities	**12 862**	**5 368**
Increase/decrease in cash and cash equivalents	**-456**	**-415**
Cash and cash equivalents at beginning of the financial year	587	1 003
Cash and cash equivalents at the end of the financial year	**131**	**587**

Statement of changes in shareholders' equity
(in thousands of euros)

	Share capital	Share options	Share premium	Statutory reserve	Retained earnings	Total
Balance as at 01.01.2010	**7 427**	**4 919**	**0**	**223**	**-3 536**	**9 033**
Paid in share capital	1 627	1 944	0	0	0	3 572
Issuance of share options	0	0	210	0	0	210
Total comprehensive loss for 2010	0	0	0	0	-867	-867
Loss covered from share premium	0	-1 161	0	0	1 161	0
Balance as at 31.12.2010	**9 055**	**5 702**	**210**	**223**	**-3 242**	**11 948**
Carrying amount of holdings under control and significant influence	0	0	0	0	-10 140	-10 140
Value of holdings under control and significant influence under equity method	0	0	0	0	8 734	8 734
Adjusted unconsolidated equity as at 31.12.2010	**9 055**	**5 702**	**210**	**223**	**-4 648**	**10 542**
Balance as at 01.01.2011	**9 055**	**5 702**	**210**	**223**	**-3 242**	**11 948**
Paid in share capital	5 145	7 717	0	0	0	**12 862**
Total comprehensive income for 2011	0	0	0	0	8	**8**
Balance as at 31.12.2011	**14 200**	**13 419**	**210**	**223**	**-3 234**	**24 818**
Carrying amount of holdings under control and significant influence	0	0	0	0	-24 440	-24 440
Value of holdings under control and significant influence under equity method	0	0	0	0	13 850	13 850
Adjusted unconsolidated equity as at 31.12.2011	**14 200**	**13 419**	**210**	**223**	**-13 824**	**14 228**

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, which comprise the consolidated balance sheet as of 31 December 2011 and the consolidated statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

Management Board is responsible for the preparation, and true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 true and fair presentation of the consolidated 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 consolidated financial statements.

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

AS PricewaterhouseCoopers, Pärnu mnt 15, 10141 Tallinn, Estonia; Audit Company's Registration No.6
T: +372 614 1800, F: +372 614 1900, www.pwc.ee

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS LHV Group and its subsidiaries as of 31 December 2011, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

/signed/	/signed/
Tiit Raimla Auditor's Certificate No.287	Erki Mägi Auditor's Certificate No.523

24 May 2012

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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 2011 in the amount of EUR 8 457 thousand to accumulated losses.

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 2011.

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	SUPERVISORY BOARD
24.05.2012	**25.05.2012**
Member of the Management Board:	Members of the Supervisory Board
/signed/ **Rain Lõhmus**	/signed/ **Andres Viisemann** ....
	/signed/ **Tiina Mõis** ....
	/signed/ **Hannes Tamjärv** ....
	/signed/ **Heldur Meerits** ....
	/signed/ **Raivo Hein** ....

Allocation of income according to EMTAK

EMTAK	Activity	2011	2010
66121	Security and commodity contracts brokerage	3 468	3 159
64191	Credit institutions (banks) (granting loans)	7 624	2 639
66301	Fund management	2 377	1 433
66191	Financial consultancy services	60	31
64911	Financial leasing	12	12
	Total income	**13 541**	**7 274**