AS LHV Pank

Annual Report 2012

(translation of the Estonian original)

Annual Report 01.01.2012 – 31.12.2012

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Commercial Registry no.	10539549
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
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E-mail	lhv@lhv.ee
Main activities	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	Erki Kilu
	Kerli Lõhmus
	Jüri Heero
	Martti Singi
	Indrek Nuume
Supervisory Board	Rain Lõhmus
	Tiina Mõis
	Andres Viisemann
	Hannes Tamjärv
	Heldur Meerits
	Raivo Hein
Auditor	AS PricewaterhouseCoopers

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MANAGEMENT REPORT

The **mission** of LHV Pank is to help create Estonian capital. The **vision** of LHV Pank is Estonia where people and companies dare to think big, get things done and invest in the future. The **values** of LHV Pank are: simplicity, support, performance.

LHV Pank is based on Estonian capital. The Bank's clients include private 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 150 people. Approximately 50 000 clients use the Bank's services. In Estonia, LHV Pank is 7th largest in balance sheet total, 6th in volume of individual and corporate deposits and 5th by the number of issuing bank cards. The Bank has stronger investment and enterprise experience than other banks. LHV Pank is one of the largest brokers on NASDAQ OMX Baltic stock exchanges and the largest broker for Baltic retail investors in international markets.

Overview of the year 2012

Business activities

In 2012, the Bank significantly increased the volume of its loan portfolio and interest income. In November, the volume of the Bank's loan portfolio exceeded EUR 100 million for the first time. Volumes of both retail and corporate loan portfolios went up. For reducing interest expenses, interest rates of term deposits were significantly reduced during the year, but remained at an attractive level in comparison with main competitors and the volume of the Bank's term deposits continued to grow. From November, the Bank changed the method for calculating the interest rate of the bank account (abolishing the requirement for minimum monthly balance and starting daily calculation of interest) and lowered the interest rate of the bank account. For increasing the volume of demand deposits, settlement services were also developed further. In November, several further developments of corporate settlements were introduced in the Internet bank.

In January, the Bank won the Member of the Year 2011 Award at the Baltic Market Awards. The award included the possibility to participate at the closing bell ceremony on the NASDAQ OMX stock exchange in New York. The Bank's management rang the closing bell on July 17 and the event received extensive media coverage. In the US, Bank executives also met with the Bank's other partners including the executives of Auerbach & Grayson, a brokerage firm that is an important partner of the Bank.

In May, the Bank signed an agreement to sell the non-performing and off-balance sheet portion of the loan portfolio of its Finnish branch. The settlement date of the sales transaction was 1 February 2012 and the sales price complied with the balance sheet value of the portfolio. Only performing loans remained in the loan portfolio of the Finnish branch, the branch continued operations, conducting new sales in accordance with the approved annual budget and, since October, has been making a profit.

The annual brand awareness and image survey was conducted in October. In comparison with a year earlier, there were no significant changes in its findings – the LHV brand remained in fifth place by brand recogntion, but was rapidly reaching the brand recognition of foreign banks operating in Estonia.

With regard to loan provisions, the first individual impairment in the amount of EUR 26 thousand was set for one commercial loan. In August, the first provisions for credit cards were made and since December, the method for forming general provisions was taken into use in setting provisions for credit cards. In August, the rules of setting provisions for the Finnish loan portfolio were changed, establishing a provision rate for the performing portfolio, increasing provision rates for the portion of the portfolio that was past due in short term and reducing provision rates for the portion of the portfolio that was past due in long term. Since October, a new procedure for dealing with debtors took effect and renewed processes for dealing with debtors were implemented.

New services

In 2012, the Bank focused on the development and launch of three new services – LHV Partner Credit Card, leasing and the bank link.

In March, the cooperation contract for Partner Credit Card was signed with Tallinna Kaubamaja. The card was launched in May together with the renewed loyalty programme for the Partner Card. The new product was well received by customers and the Bank was receiving up to 100 card applications in a workday. The card launch was supported by marketing campaigns in Tallinna Kaubamaja and the Bank, and sales specialists in larger Selver stores. At the end of June, the Bank also launched a general marketing campaign for activating cards that lasted until the end of the year. In the fourth quarter, the Bank became the fifth bank in Estonia by the number of issued bank cards.

In March, the head of the leasing department started work and a cooperation agreement with United Partners was signed. In April, a leasing software contract was signed with Columbus IT Partner in Estonia and IIZI Kindlustusmaakler was chosen as the partner for insurance solutions. The first version of the software was implemented at the start of June, whereby the first leasing contracts were signed already in mid-June. In September, the Bank became more active in introducing leasing in the market and launched an advertising campaign for attracting customers. After the campaign launch, customer interest towards leasing increased notably, exceeding forecasts and targets. From October, car dealers have also been offering leasing. For selling leasing, cooperation contracts have been signed with most dealers of new and used cars in Tallinn, Tartu and Pärnu. In addition to leasing passenger cars, also leasing of heavy equipment that must be registered started at the end of the year.

In July, the Bank launched its bank link and started active sales work for integrating the bank link into different websites. By the end of the year, 40 bank links were operational and agreements had been signed for another 30. In case of several large enterprises, installation of a bank link required IT development that was postponed to the start of 2013.

Organizational structure

During the year, a number of important changes took place in the Bank's organizational structure.

In June, a new area of risk management was formed that started to consolidate different risk management functions that were previously decentralised in the Bank. Martti Singi started work in June as risk manager and a new member of the Management Board. In June, for providing faster service for corporate customers, Tartu commercial banking department was established and is headed by the Bank's current head of corporate banking in Tallinn. In August, it was decided to significantly change the structure of the IT development department and to increase the number of employees from 13 to 25 people by the end of the year in order to ensure faster implementation of development projects. In September, the new structure, work organization and personnel requirement of the IT administrative department, were also approved.

At the end of September, Erki Kert, the head of investment banking and member of the Management Board, left the Bank. To increase investment competence in LHV Asset Management, several analysts moved into LHV Asset Management. Retail brokerage was moved under retail banking and institutional brokerage moved under corporate banking. The department that specialised in corporate finance was closed already in February.

Since October, the Bank's Management Board again has five members. Every Management Board member was responsible for one area of activity which are retail banking, private and corporate banking, information technology, financial management and support services and risk management. During the year, the number of the Bank's employees increased only by 8 people to 152 people. At the beginning of the year, the Bank took into use the 22nd and 23rd floors of City Plaza, covering the need for office premises for upcoming years.

Raising capital

In June, the equity of LHV Group was successfully increased by EUR 8.6 million by issuing new shares. In the course of the issue, existing shareholders subscribed to EUR 3.4 million and new shareholders subscribed to EUR 5.2 million worth of new shares of LHV Group. As a result of the issue, 21 new investors and several employees became the shareholders of LHV Group. The Bank's share capital increased by EUR 6 million by issuing new shares to LHV Group.

In December, the Bank successfully held the issue of subordinated convertible bonds of LHV Group in the total volume of EUR 4.5 million. The issue was oversubscribed. EUR 4.3 million was subscribed by existing shareholders or persons related to them and only EUR 0.2 million was divided to entirely new investors. In December the proceeds were used to increase the Bank's equity by EUR 4 million, by issuing subordinated bonds to LHV Group. As a result of the increased equity, the Bank's maximum loan amount that can be issued increased to EUR 5 million.

Sponsorship

At the start of February, the Minister of Culture recognised LHV Pank as a culture-friendly enterprise in 2011. In February, the Bank sponsored the Ethical Essay contest held by the Enn Soosaar Foundation by providing a cash prize for the award, as well as supported the personal exhibition of Kaido Ole in KUMU and the publication of his book. In March, the Bank supported the organization of the Tallinn Music Week, in the course of which concerts were also held in the Bank's customer service office. In September, LHV Pank supported the Estonian Design Awards 2012 competition and the exhibition of the competition's final entries in the Bank's customer service office. In October, the Bank signed an annex to the cooperation contract with the Estonian Football Association, becoming the national team's main sponsor until 2014. In October, the Bank supported the organisation of the Tallinn Restaurant Week in which holders of the Partner Credit Card were able to book seats outside the queue. In November, the Bank supported the Entrepreneur of the Year 2012 competition, having sponsored it for most of the year. In December, the Bank sponsored the exhibition of historic Apple computers in the Bank's customer service office.

Management and the principles of remuneration

The Supervisory Board of LHV Pank has six members: Rain Lõhmus, Andres Viisemann, Tiina Mõis, Hannes Tamjärv, Heldur Meerits and Raivo Hein.

The Management Board of LHV Pank has five members: Erki Kilu, Kerli Lõhmus, Jüri Heero, Martti Singi and Indrek Nuume.

The employees of LHV Pank receive primarily fixed wages and salaries. Only a few employees are paid according to the sales-related performance fee scheme which depends on the fulfilment of the agreed goals. In 2012, incentive related remuneration was neither paid to the persons engaged in the Company's risk management nor to the members of the Management Board. The bank neither pays major termination benefits nor grants non-monetary compensations. The table below provides wages and salaries paid and the number of employees who received salaries and wages during the year (incl. trainees).

Calculated gross salaries and wages *(EUR thousand)*	**base salary**	**incentive salary**	**total**	**number of employees**
retail banking	1 370	50	1420	91
private and corporate banking	626	6	632	26
support services	736	0	736	50
infotechnology	512	0	512	37
total	**3 244**	**56**	**3 300**	**204**

Business environment

In 2012, against the backdrop of the negative development of the European Union economy, the growth of the Estonian economy slowed down significantly in comparison with the 7.6% growth in the previous year, but still remained stable at between 2.5 and 3.5% in every quarter.

Because of difficulties in the world economy and, in particular, in countries that are members of the Eurozone, Estonian export-oriented (approximately 70% of output is exported) industrial sector that had been driving the economic growth produced practically as much in 2012 as in 2011. Production still grew slightly in the first two months of last year, but from March until August, output volumes fell in annual comparison. As the volume of production of electronic equipment that has a major impact was restored since September, growth figures of the industrial production became also positive in the last months of the year.

In 2012, foreign environment favoured the producers of electronic equipment, beverages and agricultural produce. On the other hand, producers of metal products, chemicals, furniture and motor vehicles were affected the most.

Although during the year as a whole, the output of the industrial sector fell by 0.4%, export of industrial production still increased 4% from last year which explains why the total influence of the industrial sector on GDP remained positive at 0.1%. The change in external conditions was also reflected in a change in the geography of Estonian exports. The share of our neighbouring countries Latvia, Russia and Lithuania increased. The share of these countries in Estonian exports increased to 26% from 23% last year, while the share of the Eurozone and US shrank.

Last year the Estonian business climate was perhaps characterized best by the fact that by the end of the year, unemployment in Estonia fell to 9.3% which is 2.1% less than at the end of 2011. Since the fall in unemployment was accompanied by a 5.9% increase in average gross salaries and wages, the growth in domestic demand significantly offset the negative impact of the weakness of foreign demand on GDP.

In summary, in 2012 the economic growth was supported by moderately growing retail, transport and communication sectors. The biggest slowdown came from the decrease in value-added in agriculture, forestry and real estate development. The share of the industrial sector remained marginal in this respect.

Unlike in earlier years, the overall loan volume did not fall in 2012, whereas the balance of deposits continued to grow. By the end of the year, the loan balance totalled EUR 14.1 billion, the same as the year before, but the share of corporate loans had increased slightly and the volume of loans issued to households had fallen by EUR 0.15 billion. A total of EUR 3.16 billion was paid out in loans, which is 14% more than in 2011. Loans paid out to households increased by EUR 0.77 million, i.e. 12 %.

In 2012, deposits increased by EUR 1 billion to EUR 12.6 billion, the majority of which are corporate deposits. At the end of the year, households had EUR 4.7 billion in deposits which is 0.3 billion more than a year earlier.

Despite the fragile economic situation in the Eurozone, in 2013 the Estonian economy is forecast to continue growing at the level of last year, or slightly higher, but such a forecast can come true only if the external environment towards Estonia does not deteriorate.

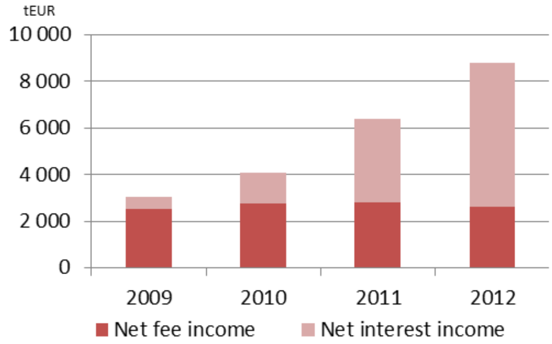
In the Baltic stock markets, the turnover of transactions continued to decline and in 2012 fell to EUR 282 million. At the same time local stock markets posted strong growth and the Tallinn stock market index increased 38% in a year, while Riga and Vilnius stock market indices gained 7% and 19%, respectively. Global stock markets also posted significant growth, whereas Germany's DAX Index was up as much as 29% and US S&P 500 Index increased 13.4%. The price of crude oil fell 7% last year.

Financial results

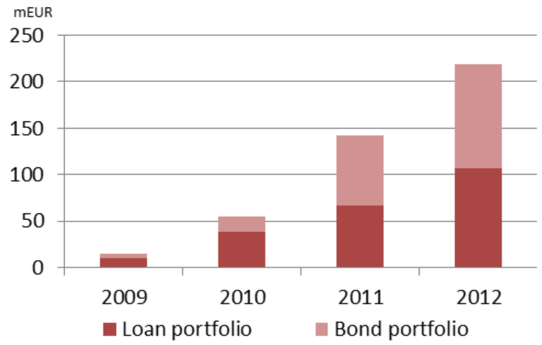
At year-end, the balance sheet total of LHV Pank was EUR 311 million which is 36% bigger than at the beginning of the year. The volume of deposits in the Bank increased to EUR 282 million, which is 35% more than at the start of the year. Of this amount, demand deposits totalled EUR 77 million and term deposits totalled EUR 205 million. The share of demand deposits reached 28% of all deposits. The volume of the Bank's loan portfolio reached EUR 106 million and that of the bond portfolio reached EUR 113 million, which is respectively 59% and 49% higher than at the beginning of the year.

In 2012, LHV Pank's net interest income totalled EUR 6.2 million, net fee and commission income totalled 2.6 million and financial income was EUR 0.4 million. The Bank's net income totalled EUR 9.3 million, expenses totalled EUR 9.9 million and loan provisions totalled EUR 1.07 million. The Bank's net income was 68% higher and expenses were 5% higher as compared to the previous year. The Bank's loss for the year was EUR 1.7 million which is 73% less than a year earlier.

EUR million	2012	2011	change
net fee and commission income	2.6	2.8	-7%
net interest income	6.2	3.6	74%
net gains from financial assets	0.4	-0.9	143%
total net operating revenues	9.2	5.5	65%
other income	0.1	0.1	0%
operating expenses	-9.9	-9.4	5%
loan losses	-1.1	-2.6	-59%
net loss	-1.7	-6.5	-73%



EUR million	2012	2011	change
loan portfolio	106.1	66.7	59%
bond portfolio	112.8	75.7	49%
deposits	282.0	209.4	35%
equity	14.7	10.4	41%
total assets	311.5	229.4	36%
number of customers holding assets in bank	37 953	23 979	58%
number of loan customers in Finland	10 537	8 264	28%
number of employees	152	144	6%



At the year-end, the volume of margin loans backed by securities totalled EUR 7.4 million (the portfolio volume has remained at the same level as the year before), the volume of loans issued to corporates totalled EUR 78.1 million (annual growth 72%) and the volume of consumer loans was EUR 12.6 million (annual decrease of 11% due to partial sale of the portfolio). Since September 2012, LHV Pank offers leasing to individuals and legal persons, the volume of the leasing portfolio totalled EUR 2.7 million at the end of the year.

In 2012, the number of customers holding assets in LHV Pank increased 58% and totalled 37 953 by the end of the year. The volume of customer securities totalled EUR 246 million at the end of 2012.

FINANCIAL STATEMENTS

Statement of comprehensive income

(in thousands of euros)

	Note	2012	2011
Interest income	5	10 938	7 590
Interest expense	5	-4 729	-4 013
Net interest income		**6 209**	**3 577**
Fee and commission income	6	3 480	3 541
Fee and commission expense	6	-889	-752
Net fee and commission income		**2 591**	**2 789**
Net gains/losses from financial assets measured at fair value	10	385	-915
Foreign exchange rate gains		-1	28
Net gains/losses from financial assets		**384**	**-887**
Other income		75	91
Operating expenses	7	-9 922	-9 444
Loss before loan losses		**-663**	**-3 874**
Loan losses	12	-1 074	- 2 607
Net loss for the year		**-1 737**	**-6 481**
Total comprehensive loss for the year		**-1 737**	**-6 481**

Notes on pages 13 to 47 are an integral part of the financial statements.

Balance sheet

(in thousands of euros)

	Note	31.12.2012	31.12.2011
Assets			
Balances with credit institutions	8	10 783	27 580
Balances with investment companies	8	1 547	4 915
Balances with central bank	8	77 965	52 556
Financial assets at fair value through profit or loss	10	44 853	45 716
Held-to-maturity financial investments	11	67 965	30 001
Loans granted	12	106 067	66 680
Receivables from customers	13	254	154
Other assets	14	946	813
Tangible assets	15	631	873
Intangible assets	15	441	503
Total assets		**311 452**	**229 791**
Liabilities			
Loans received and deposits from customers	16	286 163	213 874
Financial liabilities at fair value through profit or loss	10	656	441
Accrued expenses and other liabilities	17	2 009	1 500
Deferred income	12	590	389
Provisions	18	13	13
Subordinated loans	19	7 365	3 181
Total liabilities		**296 796**	**219 398**
Shareholders' equity			
Share capital	20	23 700	17 700
Retained earnings/accumulated deficit		-9 044	-7 307
Total shareholders' equity		**14 656**	**10 393**
Total liabilities and shareholders' equity		**311 452**	**229 791**

Notes on pages 13 to 47 are an integral part of the financial statements.

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Cash flow statement

(in thousands of euros)

	Note	2012	2011
Cash flows from operating activities			
Fee and commission income and other income received		3 554	3 660
Fee and commission expense		-889	-752
Operating and other expenses paid		-9 396	-9 213
Interest received		10 938	7 590
Interest paid		-4 729	-4 013
Cash flows from operating activities before change in operating assets and liabilities		**-522**	**-2 729**
Change in operating assets:			
Net acquisition/disposal of trading portfolio		0	24
Loans granted and receivables from customers		-40 561	-29 530
Term deposits with other credit institutions		9 189	-9 186
Mandatory reserve at central bank		-767	5 240
Security deposits		-90	-35
Other receivables and prepayments		-45	-20
Change in operating liabilities:			
Demand deposits of customers		41 672	16 761
Term deposits of customers		30 996	77 784
Loans received and repayments		-194	2 505
Financial liabilities for trading		216	441
Other liabilities and deferred income		710	657
Net cash generated from operating activities		**40 604**	**61 912**
Cash flows from investing activities			
Purchase of non-current assets	15	-222	-1 170
Change in investment portfolio		-36 716	- 59 586
Net cash used in investing activities		**-36 938**	**-60 756**
Cash flows from financing activities			
Paid in share capital	20	6 000	11 200
Subordinated loans received	19	4 000	0
Net cash generated from financing activities		**10 000**	**11 200**
Net increase in cash and cash equivalents		**13 666**	**12 356**
Cash and cash equivalents at the beginning of the year	8	74 076	61 720
Cash and cash equivalents at the end of the year	**8**	**87 742**	**74 076**

Notes on pages 13 to 47 are an integral part of the financial statements.

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Statement of changes in equity

(in thousands of euros)

	Share capital	Retained earnings/loss	Total
Balance as at 01.01.2011	**6 500**	**-826**	**5 674**
Paid in share capital	11 200	0	11 200
Total comprehensive loss for 2011	0	-6 481	-6 481
Balance as at 31.12.2011	**17 700**	**-7 307**	**10 393**
Balance as at 01.01.2012	**17 700**	**-7 307**	**10 393**
Paid in share capital	6 000	0	6 000
Total comprehensive loss for 2012	0	-1 737	-1 737
Balance as at 31.12.2012	**23 700**	**-9 044**	**14 656**

More detailed information is provided in Note 20.

Notes on pages 13 to 47 are an integral part of the financial statements.

Notes to the financial statements

NOTE 1 General information

AS LHV Pank (Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia, Latvia, Lithuania and Finland. There are offices for client servicing in Tallinn, Tartu, Riga, Vilnius and a branch office in Helsinki. LHV is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt. 2, Tallinn. As at 31.12.2012, LHV employed 152 people (as at 31.12.2011: 144 people).

These financial statements were approved by the Management Board on 08 April 2013. The financial statements will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus who owns 37% of the voting rights and Andres Viisemann who owns 11% of the voting rights (see also Note 20) have significant influence over the Company. 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 financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The financial statements of the Bank for the financial year 2012 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as: "financial assets and liabilities at fair value through profit or loss", including derivatives.

The preparation of 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 2012 and ended at 31 December 2012. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

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 financial statements which became mandatory for the Bank's accounting periods beginning on or after 1 January 2012. The overview of these standards and the Bank management's estimate of the potential impact of applying the new standards and interpretations are stated below.

a) Adoption of New or Revised Standards and Interpretations

No new or revised standards or interpretations that were effective for the first time for the financial year beginning on or after 1 January 2012 had material impact to the Bank.

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 2013, and which the Bank has not early adopted.

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

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 Bank is currently assessing the impact of the standard on 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 Bank.

2.3 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of the Bank is euro.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank (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 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".

2.4 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, demand deposits 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.

2.5 Financial assets

- The Bank 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 bank determines the classification of its financial assets at initial recognition.

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

Financial assets at fair value through profit or loss include

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

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

Regular purchases and sales of financial investments are recognised at the settlement date in the balance sheet. Financial instruments included in this category are initially recognised 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. Interest income is calculated based on financial assets' amortised cost using the effective interest rate method and is recorded within interest income in the statement of comprehensive income. Changes in fair values of these financial assets are recognised consistently, either as a profit or loss in the statement of comprehensive income of the accounting period under "Net gains/losses from financial assets measured 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 Bank. Dividend income on financial assets measured at fair value through profit or loss are recognised in the line "Dividend income" of the statement of comprehensive income when the right to receive dividends by the Bank 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 recognised 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 recognised as income or expense of the period in the statement of comprehensive income under "Net gains/losses from financial assets measured at fair value". Derivatives 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 Bank 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 recognised in the profit or loss of the reporting period 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 recognised in the balance sheet when the cash is paid to the customer and are initially recognised at fair value plus transaction costs, and are derecognised only when they are repaid or written-off. After initial recognition, the Bank recognises 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. Incase of credit cards the borrower's actual use of limit is recorded in the balance sheet.

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 recognised 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 recognised in the contra-asset account. The portfolio of receivables acquired as a pool is subsequently recognised 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. Loans restructured because of repayment problems are recognised as new loans when a new loan has been issued, incl. refinancing an existing loan or increasing an existing loan for payment of the loan principal, interest, overdue penalties or other fees related to it. Loans which include a change in other contractual terms as a result of deterioration of the customer's credit quality are recognised as earlier and a new loan is not issued.

Trade receivables arise from provision of services to the customers and are initially recognised 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 2.6.

2.6 Impairment of financial assets

The Bank 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 Bank 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 Bank). The Bank 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 and leases are assessed individually, based on the financial position of the company, collateral, industry situation, reliability of the borrower, the competence of its management, timely fulfilment 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. Specifically developed group-based discount model is used when assessing credit card loans. Physical persons who are borrowers are assessed in terms of their timely fulfilment of obligations, solvency, value of the 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 Bank 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 statement of comprehensive income line "Loan losses".

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The reversal of the impairment loss is recognised 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".

2.7 Tangible assets

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

2.8 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 Bank 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 recognised 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.

2.9 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 recognised in the statement of comprehensive income line "Interest expense" on the accrual basis.

Loans received, bonds issued and similar subordinated loans are initially recognised 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 recognised at fair value.

Recognition a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.5. 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".

2.10 Financial guarantees

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 recognised in the financial statements at fair value at the date the guarantee was given. Subsequent to initial recognition, the liabilities under such guarantees are recognised in balance sheet as the higher of linearly amortised guarantee fee in carrying value or 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 recognised on a straight line basis over the life of the guarantee. The amounts to be disbursed to settle the guarantee obligation are recognised in the balance sheet as a provision at the date it becomes evident that it is probable that the guarantee is to be disbursed.

2.10 Payables to employees

Payables to employees include unpaid salary accruals and 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. Bank has no existing legal nor factual obligations to make pension or similar payments supplementary to social tax.

2.11 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, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the balance sheet. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the balance sheet in the amount which according to the management is necessary as at the balance sheet date for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and an expense from the change in the carrying amount of provisions are 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).

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

Financial assets from which resources are expected to flow to the Bank within 12 months are recognised as current assets. The portion of financial assets with expected inflows later than 12 months after the balance sheet date is recognised as non-current assets.

Financial liabilities are classified as current when they are due within twelve months after the balance sheet date or if the Bank does not have an unconditional right to defer the payment for later than 12 months after the balance sheet date. Loans whose due date is within 12 months after the balance sheet date but which are refinanced as non-current after the balance sheet date but before the financial statements are authorised for issue are recognised as current. Loans that the lender has the right recall at the balance sheet date due to violation of contractual terms are also classified as current.

For all long-term financial assets and liabilities the long-term portion is separately disclosed in respective disclosure to these financial statements.

2.13 Revenue and expenses

Revenue and expenses are accounted for using the accrual basis of accounting. Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the Bank, the amount of the revenue can be measured reliably and services were rendered by the Bank. Revenue from services rendered in the ordinary course of business by the Bank is recognised at the fair value of the fee received or receivable. Expenses are recognised when the Bank has incurred an obligation for the respective expense and/or the Bank has received goods or services, and the latter occurs at an earlier data.

Fee and commission income (incl. custody and portfolio management fees) are recognised on an accrual basis when the service has been provided and the Company has a right of claim to the receivable. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commissions and fees arising from provision of advisory services to third parties (purchase or sale of businesses, acquisitions, etc.) are generally recognised 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 recognised 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 recognised when the performance criteria are fulfilled or based on the stage of completion. Other one-time service revenues and other revenues are recognised on an accrual basis at the moment of executing the respective transaction.

Fee and commission expenses are recognised 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 Bank 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 Bank 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 recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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

2.14 Asset management services

The Bank is engaged in providing asset management services. Such assets that have been given to the Bank to be managed by third parties and that the Bank 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 Bank.

2.15 Leases - Bank as the lessee

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

Finance leases are capitalised at the commencement of the lease at the lower of the fair value of the leased property 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 Company 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 Bank primarily uses an operating lease for renting the premises. A rental expense is recognised in the statement of comprehensive income as "Operating expenses".

2.16 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 the income tax payable on profits, the Estonian entities pay corporate income tax on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. From 1 January 2008, the tax rate is 21/79 on net dividends paid. The corporate income tax arising from the payment of dividends is recognised as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

As income tax is paid on dividends and not on profit, no temporary differences arise between the tax bases of assets and liabilities and the carrying amounts of assets and liabilities which may give rise to deferred income tax assets and liabilities. A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the balance sheet. The maximum amount of income tax payable, which would arise paying out the retained earnings as dividends, is disclosed in the Notes to the financial statements.

2.17 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 on a net basis.

2.18 Statutory reserve capital

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, measuring, reporting and control of risks at LHV Pank are set out in the policies and procedures approved by the Supervisory Board and daily risk management is organised by the Management Board. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of LHV Pank in order to ensure the bank´s reliability, stability and profitability. In LHV, risk management is based on three lines of defence. The first line of defence or business units are responsible for taking and managing risks. The second line of defence – which includes the risk management unit – is responsible for developing and maintenance of the risk management framework. The third line of defence or internal control department carries out independent control over risk management in the entire Bank. The rules and procedures of risk management are regularly reviewed at least once a year and updated in case of a need.

3.1 Capital management

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

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

Debt is managed according to internal rules and the Risk and Capital Committee (RCC) oversees capital management. The RCC 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 about the compliance with prudential and capital requirements for covering the risks are submitted monthly to supervision authorities. LHV Pank uses standard method for calculating capital requirements.

Capital adequacy

Capital base	**31.12.2012**	**31.12.2011**
Paid-in share capital	23 700	17 700
Accumulated deficit	-7 307	-826
Intangible assets (subtracted)	-441	-503
Net loss for accounting period	-1 737	- 6 481
Total Tier 1 capital	**14 215**	**9 892**
Subordinated loans	7 000	3 000
Subordinated loans and preference shares which exceed the limits	0	0
Total Tier 2 capital	**7 000**	**3 000**
Net own funds for capital adequacy calculation	**21 215**	**12 892**
Capital requirements		
Central government and central banks under standard method	232	181
Credit institutions and investment companies under standard method	686	846
Companies under standard method	5 674	2 748
Retail claims under standard method	2 814	2 186
Overdue claims under standard method	191	451
Other assets under standard method	211	177
Total capital requirements for covering the credit risk and counterparty credit risk	**9 808**	**6 588**
Capital requirement against foreign currency risk	84	57
Capital requirement against interest position risk	641	1 085
Capital requirement against equity portfolio risks	6	6
Capital requirement for operational risk under base method	690	530
Total capital requirements for adequacy calculation	**11 229**	**8 266**
Capital adequacy (%)	**18.89**	**15.60**
Tier 1 Capital Ratio (%)	**12.66**	**11.97**

The net capital of a 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%. 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.

3.2 Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet its obligations to the Bank. 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, given guarantees, other receivables and committed transactions. In order to hedge credit risk, LHV Pank 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

LHV Pank 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), incl. repo loans
d) corporate loans
e) consumer loans with cash flows as collateral
f) credit cards
g) leasing

a) Bonds

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

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

Rating	**31.12.2012**	**31.12.2011**
AAA	25 769	4 091
AA- to AA+	8 585	11 419
A- to A+	39 369	32 045
BBB- to BBB+	29 834	19 118
B- to BB+	3 246	4 418
Without a rating	5 999	4 611
Total (Note 10 and 11)	**112 802**	**75 702**

No principal and interest receivables arising from bonds are overdue.

b) Loans and advances to central bank, credit institutions and investment companies

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 LHV Pank according to ratings given by Standard & Poor's or equivalent (central bank without a rating) are held as follows:

Rating	31.12.2012	31.12.2011
Central bank	77 965	52 556
AA- to AA+	441	3 449
A- to A+	9 073	28 530
Without a rating	2 816	516
Total (Note 8)	**90 295**	**85 051**

No loans and advances to central bank, credit institutions and investments companies are overdue.

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. See Note 3.2.2. for more detailed information on the credit quality of loans.

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. As of 31.12.2012 LHV Pank has one leverage loan in the amount of 18 thousand euros with a collateral value of 0 and the loan has been fully impaired (31.12.2011: 0 thousand euros).

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 25% of net own funds. 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. See Note 3.2.2. for more detailed information on the credit quality of loans.

e) Consumer loans

The credit scoring model is being used to assess clients credit solvency in Finland. 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. 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 and 2012. The model is based on the classic method of calculating the probability of default (PD), loss given default (LGD) and exposure at default (EAD). As at 31.12.2012, the group-based impairment reserve makes up 7.8% of consumer loans and the related interest receivables (31.12.2011 19%). Loans and receivables, in respect of which the bailiff has sent a notice regarding the termination of the proceedings, have been written off the balance sheet. In 2012 the consumer loans portfolio purchasedt in 2010 was sold, see also Note 12.

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.

f) Credit cards

From 2011, LHV Pank issues credit cards and in spring 2012, started to issue Partner credit cards in cooperation with Tallinna Kaubamaja. Similarly with consumer loans, the credit card portfolio uses the credit scoring model to assess the customer's solvency. The scoring is made at the time the application is filed and is one of the criteria for issuing a loan. In December 2012, a group-based method for accounting credit card provisions was developed. The assessment of inputs that is the basis for impairment of the credit card portfolio using the statistical method generally requires extensive data about the counterparties and sufficiently extensive information about the defaulting counterparties. Since LHV Pank does not have sufficient statistical data because of a short history of its activities, the assessment criteria of the given model are based on expert opinion. Earlier, the need of credit card provisions was assessed individually. The model is based on PD, LGD and EAD indicators. EAD consists of two components: the amount of the existing receivable and the amount of use of an estimated additional limit. For calculating the latter, the model includes the credit conversion factor (CCF). As of 31 December 2012, the group-based impairment reserve amounted to 2.4% of credit card loans and related receivables (31 December 2011: 0%).

g) Leasing

In autumn 2012, LHV Pank started to offer leasing products for individuals and legal persons. The creditworthiness of customers is assessed by using scoring models. As of 31 December 2012, no impairements have been made for the leasing portfolio due to the fact that, because of the short history of activities, LHV Pank does not have sufficient statistical data and, as of 31 December 2012, there were no debtors.

3.2.2 Credit quality

Maximum credit risk exposure	31.12.2012	31.12.2011
Balances with banks and investment companies (Note 8)	90 295	85 051
Other financial assets at fair value (bonds) (Note 10)	44 837	45 700
Held-to-maturity financial investments (Note 11)	67 965	30 001
Loans and advances to customers (Note 12)	106 067	66 680
Other receivables from customers (Note 13)	254	154
Other assets (Note 14)	713	624
Total assets	**310 131**	**228 210**
Off-balance sheet liabilities (Note 23)	16 131	7 338
Total maximum credit risk exposure	**326 262**	**235 528**

Loans and receivables are divided into 4 groups in the table below:

1. Receivables not impaired and not past due
2. Receivables past due, not impaired
3. Receivables not past due, but impaired
4. Receivables past due and impaired

Loans and advances to customers and banks as at 31.12.2012	1	2	3	4	Total	Impair-ment booked *	Net
Loans to legal person							
Leverage loans	4 658	0	0	0	**4 658**	0	**4 658**
Corporate loans	77 135	1 330	0	132	**78 597**	-26	**78 571**
Finance lease	1 906	0	0	0	**1 906**	0	**1 906**
Loans to individuals							
Leverage loans	6 486	0	0	18	**6 504**	-18	**6 486**
Consumer loans	0	0	5 693	7 451	**13 144**	-1 029	**12 115**
Housing loans and finance lease	936	0	0	0	**936**	0	**936**
Credit card loans	0	0	1 332	96	**1 428**	-34	**1 394**
Total loans and advances to customers	**91 121**	**1 330**	**7 026**	**7 697**	**107 174**	**-1 107**	**106 067**
Loans and advances to banks	90 295	0	0	0	**90 295**	0	**90 295**
Total (Notes 8 and 12)	**181 416**	**1 330**	**7 026**	**7 697**	**197 469**	**-1 107**	**196 362**

* Corporate loans and leverage loans are assessed individually, consumer loans and credit card loans are assed homogeneously.

Loans and advances to customers and banks as at 31.12.2011	1	2	3	4	Total	Impair-ment booked *	Net
Loans to legal person							
Leverage loans	4 850	0	0	0	4 850	0	**4 850**
Corporate loans	45 690	0	0	0	45 690	0	**45 690**
Finance lease	46	0	0	0	46	0	**46**
Loans to individuals							
Leverage loans	3 230	0	0	0	3 230	0	**3 230**
Consumer loans	0	0	4 248	11 464	15 712	-3 042	**12 670**
Housing loans and finance lease	128	0	0	0	128	0	**128**
Credit card loans	66	0	0	0	66	0	**66**
Total loans and advances to customers	**54 010**	**0**	**4 248**	**11 464**	**69 722**	**-3 042**	**66 680**
Loans and advances to banks	85 051	0	0	0	85 051	0	**85 051**
Total (Notes 8 and 12)	**139 061**	**0**	**4 248**	**11 464**	**154 773**	**-3 042**	**151 731**

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

In 2012, the rules for managing credit risk were changed and the principles for rating corporate loans were specified. The rating scale used for evaluating the probability of insolvency of legal entities consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk. Ratings 1 and 2 are attributed only on the basis of average ratings of rating agencies Fitch, Moody's and Standard & Poor's, and are subject to the Bank's financial analysis as necessary. Thus, ratings 1 and 2 are attributed only to international enterprises, organisations, local governments and countries whose solvency has been confirmed by the rating agencies with their investment grade rating. Also rating classes 3 and 4 are partly based on the evaluation of rating agencies, although this category may also include strong and large Estonian enterprises that do not have an international rating.

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Distribution of internal ratings of corporate loans:

- 1 – minimum credit risk – highest investment grade. Rating is attributed only on the basis of ratings issued by rating agencies; average rating of rating agencies must be equivalent to at least AA- (Moody's Aa3).
- 2 - minimum credit risk - high investment grade. Rating is attributed only on the basis of ratings issued by rating agencies, average rating must be equivalent to at least A- (Moody's A3).
- 3 – low credit risk – high investment grade. Rating is attributed on the basis of an evaluation of rating agencies or LHV. Average rating of rating agencies must be equivalent to at least BBB (Moody's Baa2).
- 4 – relatively low credit risk – investment grade. Rating is attributed on the basis of an evaluation of rating agencies or LHV. Average rating of rating agencies must be equivalent to at least BBB- (Moody's Baa3).
- 5 – medium credit risk – investment grade. Rating is attributed on the basis of LHV evaluation.
- 6 – medium credit risk – investment grade. Rating is attributed on the basis of LHV evaluation.
- 7 – medium credit risk – investment grade. Rating is attributed on the basis of LHV evaluation.
- 8 – higher-than-medium credit risk- low investment grade. Rating is attributed on the basis of LHV evaluation.
- 9 – high credit risk – lowest investment grade rating. Rating is attributed on the basis of LHV evaluation.
- 10 – speculative rating - Rating is attributed on the basis of LHV evaluation.
- 11 – speculative rating - Rating is attributed on the basis of LHV evaluation
- 12 – non-satisfactory rating – non-satisfactory rating. In the opinion of a credit analyst, the financial situation of the legal entity is sufficiently weak and the entity probably becomes insolvent and falls into rating class 13.
- 13 – insolvent – the entity is insolvent. The entity is 90 days past due or is subject in a restructuring or bankruptcy procedure.

Distribution of loans and advances to customers as at 31.12.2012 by internal ratings	No past due payments, receivables not impaired	Payments past due, receivables not impaired	Payments past due, receivables impaired	**Total**
4 relatively low credit risk	2 600	0	0	**2 600**
5 medium credit risk	2 955	0	0	**2 955**
6 medium credit risk	8 037	0	0	**8 037**
7 medium credit risk	17 737	0	0	**17 737**
8 higher-than-medium credit risk	24 722	152	0	**24 722**
9 high credit risk	10 107	0	0	**10 107**
10 speculative rating	5 916	298	0	**5 916**
11 speculative rating	4 109	0	0	**4 109**
12 non-satisfactory rating	962	880	0	**1 832**
13 insolvent	0	0	132	**132**
Total	**77 135**	**1 330**	**132**	**78 597**

Same principles as in 2011 are used for determining ratings for other loans.

Distribution of internal ratings of credit card, leverage and consumer loans and leases:

- 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.

Changes from previous to current internal ratings of corporate loans have approximately been:

- Excellent -> new rating 1-4
- Good and very good -> new rating 5-8
- Satisfactory -> new rating 9-10
- Weak or doubtful -> new rating 11-13

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As of 31.12.2012, according to internal ratings the credit card, leverage and consumer loans and leases are divided as follows:

31.12.2012	No past due payments and not impaired	No past due payments, but impaired	Past due payments and impaired
Excellent	11 144	0	18
Good and very good	2 843	7 026	3 156
Satisfactory	0	0	1 353
Weak or doubtful	0	0	3 038
Total	**13 987**	**7 026**	**7 565**

In 2011, all loans had a mutual internal rating system.

	Corporate loans	Other loans	Other loans	Other loans
31.12.2011	No past due payments and not impaired	No past due payments and not impaired	No past due payments, but impaired	Past due payments and impaired
Excellent	0	8 078	0	0
Good and very good	11 340	242	4 248	0
Satisfactory	27 480	0	0	2 981
Weak or doubtful	6 870	0	0	8 483
Total	**45 690**	**8 320**	**4 248**	**11 464**

In addition to the loans granted, loan contracts have been concluded and signed whereby the unused loan commitment was EUR 13 578 thousand as at 31.12.2012 (as at 31.12.2011, EUR 4 911 thousand), see also Note 23. In 2012 and 2011, there have been restructuring for consumer loans, other loans have not been restructured.

Structure of collateral of loans	**2012**	**2011**
Listed securities	10%	12%
Unlisted equity securities	7%	10%
Mortgages	36%	24%
Surety of KredEx and Rural Development Foundation	10%	16%
Pledges of rights of claim or deposit	13%	11%
Leased assets	2%	0%
Others	7%	3%
Consumer loans and credit card loans without a collateral	14%	25%

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 2012, the Bank provisioned corporate loans in the total amount of EUR 26 thousand.

As of 31 December 2012, all leveraged loans and repurchase loans are oversecured, except one leveraged loan in the amount of EUR 18 thousand, which has been provisioned. Credit card and consumer loans are issued without collateral.

Loans, which have overdue interest or principal receivables and for which an impairment is recognised as at the balance sheet date, 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 as at 31.12.2012	Corporate loans	Consumer loans	Leverage loans	Credit cards	Impaire-ment	Net
No past due payments	0	5 694	0	1 332	-95	6 931
Past due receivables	1 462	7 451	18	86	-1 012	8 004
1-30 days	*152*	*3 060*	*0*	*53*	*-35*	*3 230*
31-60 days	*488*	*1 353*	*0*	*11*	*-141*	*1 711*
61-90 days	*0*	*497*	*0*	*7*	*-81*	*423*
91-180 days	*690*	*952*	*0*	*25*	*-240*	*1 427*
181-360 days	*132*	*1 290*	*0*	*0*	*-350*	*1 072*
more than 360 days	*0*	*299*	*18*	*0*	*-166*	*151*
Total	**1 462**	**13 145**	**18**	**1 428**	**-1 107**	**14 946**

As at 31.12.2012 a homogeneous provision is recognised for consumer and credit card loan portfolios.
An individual provision has been made for corporate and leverage loans.

Structure of loans impaired according to past due time as at 31.12.2011	Consumer loans	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**

As at 31.12.2011there were no other overdue loans apart from consumer loans.

Credit quality of other receivables	31.12.2012	31.12.2011
Receivables not impaired and not past due	183	146
Receivables past due (not impaired)	71	8
incl. receivables from individuals	39	8
incl. receivables from legal persons	32	0
Total (Note 13)	**254**	**154**

Credit quality of off-balance sheet liabilities	31.12.2012
4 relatively low credit risk	1 250
5 medium credit risk	67
6 medium credit risk	318
7 medium credit risk	8 643
8 higher-than-medium credit risk	2 667
9 high credit risk	1 372
10 speculative rating	568
12 non-satisfactory rating	1 246
Total (Note 23)	**16 131**

No provisions have been made for off-balance sheet liabilities because the value of collaterals exceeds the value of potential liabilities.

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

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. Internal judgement is used to assess potential losses. 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 risk management unit.

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 unit 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.

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

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in 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 bank at the balance sheet date do not significantly differ from the average exposure during the year.

31.12.2012	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk							
Balances with other banks and inv. companies	81 022	1 165	629	177	6 716	586	**90 295**
Securities	112 168	0	0	1	648	1	**112 818**
Loans granted	104 872	93	278	14	776	34	**106 067**
Receivables from customers	246	0	0	1	4	2	**254**
Other assets	130	0	0	0	584	0	**714**
Total assets bearing currency risk *	**298 439**	**1 258**	**907**	**193**	**8 729**	**624**	**310 148**
Liabilities bearing currency risk							
Loans received and deposits from customers	282 662	703	676	184	8 747	555	**293 528**
Interest rate swaps	656	0	0	0	0	0	**656**
Accrued expenses and other liabilities	1 960	14	9	16	9	0	**2 009**
Total liabilities bearing currency risk *	**285 278**	**717**	**685**	**199**	**8 756**	**555**	**296 193**
Open foreign currency position	**13 161**	**540**	**222**	**-7**	**-27**	**69**	**13 955**

31.12.2011	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk							
Balances with other banks and inv. companies	78 978	636	598	297	3 324	1 218	**85 051**
Securities	74 362	0	0	0	1 355	0	**75 717**
Loans granted	64 795	162	380	320	961	61	**66 680**
Receivables from customers	118	0	0	0	7	29	**154**
Other assets	9	0	0	0	615	0	**624**
Total assets bearing currency risk *	**218 261**	**798**	**978**	**618**	**6 262**	**1 308**	**228 226**
Liabilities bearing currency risk							
Loans received and deposits from customers	208 887	602	687	409	5 219	1 251	**217 055**
Interest rate swaps	441	0	0	0	0	0	**441**
Accrued expenses and other liabilities	1 297	-2	9	191	1	445	**1 941**
Total liabilities bearing currency risk *	**210 626**	**600**	**696**	**600**	**5 219**	**1 696**	**219 437**
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	**8 636**	**199**	**282**	**18**	**42**	**-388**	**8 789**

* the balances of total assets and total liabilities bearing currency risk above do not include currency futures at their fair value, but they are shown here at their full contractual cash flow amounts as contingencies and commitments (see also Note 9); 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 total comprehensive income, with the assumption of other conditions remaining constant.

Impact on comprehensive income	Change	2012	Change	2011
USD exchange rate	+/-10%	+/-2	+/-10%	+/-2
SEK exchange rate	+/-10%	+/-1	+/-10%	+/-2

3.3.2 Price risk

Financial instruments bearing price risk at LHV Pank are securities held in the trading portfolio and investment portfolio (Note 10). At the LHV Pank, the limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for bonds in the investment portfolio. The risk management unit monitors the compliance with limits.

Sensitivity analysis of the impact to comprehensive income from the risk exposures against reasonable possible change:

Impact on comprehensive income	Change	2012	Change	2011
Shares and fund units	+/-15%	+/-3	+/-15%	+/-2
Bonds	+/-1.9%	+/-830	+/-3.6%	+/-1 648

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 1.9% (2011: 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 economical 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 and invests mainly in assets with a floating interest rate. The interest rates of the deposits were up to 3.2% in the first half of 2012 (up to 3.7% in 2011). A significant fall in interest rates in the second half of 2012 reduced interest rates of the deposits and in the second half the interest rates were at 1.1-1.3%. The interest rates for leverage loans granted are changed at most once a month according to fluctuations in market interest rates. In 2012, the interest rate on loans received for specific purposes was 1.5% (2011: the same) and the effective interest rate of subordinated loans entered into in 2010 was 7.63% (2011: the same). The effective interest rate of the subordinated loan received in December 2012 is 7.38%. The information about contractual interest rates is provided in Note 19.

As at 31.12.2012, an increase of 1% in interest rates would affect the Bank's annual net interest income by EUR +158 thousand (2011: EUR -31 thousand). A 1% increase in market interest rates would raise the Bank's economical value by EUR 605 thousand (2011: EUR -373 thousand). In 2012, the effect on the Bank's economic value is negative due to the fact that the Bank has invested in current assets and, because of the nature of demand deposits, extended the duration of the liabilities. In 2011 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 LHV Pank 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.

31.12.2012	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest-earning assets					
Balances with other banks and inv. companies	90 294	0	0	0	**90 294**
Financial investments and securities	35 452	35 775	31 864	6 622	**109 713**
Loans granted	40 649	46 563	14 570	4 110	**106 072**
Total	**166 395**	**82 338**	**46 434**	**10 732**	**306 079**
Interest-bearing liabilities					
Loans received and deposits from customers	101 616	98 570	82 988	1 483	**284 657**
Subordinated loans *	0	3 000	4 000	0	**7 000**
Total	**101 616**	**101 570**	**86 988**	**1 483**	**291 657**
Interest pricing gap	**64 779**	**-19 232**	**-40 554**	**9 249**	**14 422**

* The contractual term of subordinated loans signed in 2010 is 7 years and the term of subordinated loans made in 2012 is 8 years. The interest rate of the loan signed in 2010 will be changed annually after two years, and for the loan signed in 2012, after three years.

31.12.2011	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest-earning assets					
Balances with other banks and inv. companies	75 859	9 000	0	0	**84 859**
Financial investments and securities	29 960	13 741	22 425	9 332	**75 458**
Loans granted	17 562	18 088	24 907	5 259	**65 816**
Total	**123 381**	**40 829**	**47 332**	**14 591**	**226 133**
Interest-bearing liabilities					
Loans received and deposits from customers	114 215	77 826	16 532	3 818	**212 391**
Subordinated loans *	0	3 000	0	0	**3 000**
Total	**114 215**	**80 826**	**16 532**	**3 818**	**215 391**
Interest pricing gap	**9 166**	**-39 997**	**30 800**	**10 773**	**10 742**

3.4 Liquidity risk

Liquidity risk relates to the solvency of LHV Pank to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The treasury 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, the concentration of bank's liabilities by maturities is also monitored. As at 31.12.2012 and 31.12.2011, the Bank does not have any debts past due.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and therefore, the tables do not reconcile to the positions in the 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.

31.12.2012	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	179 344	101 135	7 571	3 115	**291 165**
Subordinated loans	70	455	5 113	4 862	**10 500**
Other liabilities	1 920	0	13	0	**1 933**
Unused loan commitments	1 908	10 420	1 250	0	**13 578**
Financial guarantees by contractual amounts	553	1 293	722	0	**2 568**
Interest rate swaps	19	206	431	0	**656**
Total liabilities	**183 814**	**113 509**	**15 100**	**7 978**	**320 400**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with banks and inv. companies	90 295	0	0	0	**90 295**
Bonds in market price	12 995	20 482	11 824	197	**45 498**
Held-to-maturity bonds	4 259	11 825	50 250	7 014	**73 348**
Loans granted	15 073	30 201	57 499	12 259	**116 448**
Receivables from customers	254	0	0	0	**254**
Total assets held for managing liquidity risk	**122 877**	**62 507**	**119 574**	**19 470**	**325 843**
Maturity gap from assets and liabilities	**-60 937**	**-51 001**	**104 473**	**11 492**	**5 443**

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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	115 653	81 341	19 129	4 285	**220 408**
Subordinated loans	0	150	1 041	3 294	**4 485**
Other liabilities	1 472	0	13	0	**1 485**
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	**119 054**	**86 574**	**20 780**	**7 579**	**234 546**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	75 947	9 187	0	0	**85 134**
Financial investments and securities	8 309	22 339	44 849	7 616	**83 113**
Loans granted	6 003	16 974	38 450	11 125	**72 552**
Receivables from customers	154	0	0	0	**154**
Total assets held for managing liquidity risk	**90 413**	**48 500**	**83 299**	**18 741**	**240 953**
Maturity gap from assets and liabilities	**-28 641**	**-38 074**	**62 519**	**11 162**	**7 407**

3.5 Risk concentration

Distribution of assets and liabilities by geographic region is presented below:

31.12.2012	Estonia	Latvia	Lithuania	Finland	Nether-lands	Germany	EU	USA	Other	Total
Asset distribution by geography										
Balances with banks and inv. companies	81 517	473	2 029	283	68	159	4 284	1 370	112	90 295
Financial investments and securities	2 740	0	1 372	3 949	4 147	13 859	65 271	7 877	13 603	112 819
Loans granted	86 459	672	855	14 911	24	0	3 146	0	0	106 067
Receivables from customers	240	9	5	0	0	0	0	0	0	254
Other assets	233	5	3	0	0	0	0	705	0	946
Tangible and intangible assets	882	0	0	190	0	0	0	0	0	1 072
Total assets	**172 071**	**1 159**	**4 264**	**19 333**	**4 239**	**14 018**	**72 701**	**9 952**	**13 718**	**311 452**
Distribution of liabilities by geography										
Loans and deposits from customers	281 440	1 086	1 222	679	49	36	1 311	21	319	**286 163**
Subordinated loans	7 365	0	0	0	0	0	0	0	0	**7 365**
Other liabilities	3 081	15	43	115	0	0	10	4	0	**3 268**
Total liabilities	**291 886**	**1 101**	**1 265**	**794**	**49**	**36**	**1 321**	**25**	**319**	**296 796**

Unused loan commitments to Estonian residents amount to EUR 13 578 thousand (2011: EUR 4 911 thousand).

31.12.2011	Estonia	Latvia	Lithuania	Sweden	Finland	Denmark	USA	Other	Total
Asset distribution by geography									
Balances with banks and inv. companies	59 191	862	1 704	55	3 502	6 013	4 432	9 292	**85 051**
Financial investments, incl. derivatives	3 558	1 546	1 747	6 092	7 080	2 118	6 823	46 753	**75 717**
Loans granted	49 344	664	864	0	12 668	0	0	3 140	**66 680**
Receivables from customers	146	3	5	0	0	0	0	0	**154**
Other assets	189	5	3	0	0	0	615	0	**812**
Tangible and intangible assets	1 111	1	0	0	264	0	0	0	**1 376**
Total assets	**113 539**	**3 081**	**4 323**	**6 147**	**23 514**	**8 131**	**11 870**	**59 186**	**229 791**
Distribution of liabilities by geography									
Loans and deposits from customers	203 994	1 151	1 209	22	502	0	74	6 922	**213 874**
Subordinated loans	3 181	0	0	0	0	0	0	0	**3 181**
Other liabilities	2 081	18	38	0	204	0	1	1	**2 343**
Total liabilities	**209 256**	**1 169**	**1 247**	**22**	**706**	**0**	**75**	**6 923**	**219 398**

As at 31.12.2012, the loans issued to11 customers (2011: 8) had a large risk exposure, i.e. more than 10% of the net own funds (NOF) of LHV Pank either individually or via group risk, totalling 113% of NOF (2011: 103%). The bank has invested in the bonds of 15 issuers (2011: 10) with a large risk exposure, totalling 273% of NOF (2011: 139%).

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

	31.12.2012	%	31.12.2011	%
Individuals	22 012	20.54%	19 136	27.45%
Real estate	19 479	18.17%	11 429	16.39%
Financial services	19 244	17.96%	9 427	13.52%
Manufacturing	11 163	10.42%	8 131	11.66%
Agriculture	5 612	5.24%	4 056	5.82%
Professional, scientific and technical activities	7 482	6.98%	3 045	4.37%
Other servicing activities	4 491	4.19%	3 478	4.99%
Art and entertainment	786	0.73%	850	1.22%
Wholesale and retail	2 385	2.23%	2 091	3.00%
Education	2 410	2.25%	2 655	3.81%
Transport and logistics	2 048	1.91%	35	0.05%
Administrative activities	5 354	5.00%	1 305	1.87%
Information and communication	710	0.66%	415	0.60%
Public administration	540	0.50%	1 419	2.04%
Construction	0	0.00%	319	0.46%
Other areas at activities	13 458	3.23%	1 931	2.77%
Total	**107 174**	**100%**	**69 722**	**100%**

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3.6 Fair value of financial assets and financial liabilities

The Management Board of LHV Pank 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 not lower than their carrying amount as at 31.12.2012 and 31.12.2011. 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 31.12.2011: same).

As at 31.12.2012, the fair value of held-to-maturity financial investments was EUR 2 201 thousand higher than their carrying amount (31.12.2011: EUR 631 thousand lower), taking into consideration the quoted market price for respective instruments.

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; as a result, the fair value of deposits determined using the discounted future cash flows do 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:

	Level 1	Level 2	Level 3	31.12.2012	Level 1	Level 2	Level 3	31.12.2011
Financial assets at fair value through profit or loss								
shares	2	0	0	**2**	2	0	0	**2**
fund units	14	0	0	**14**	14	0	0	**14**
bonds	44 837	0	0	**44 837**	45 700	0	0	**45 700**
Total financial assets	**44 853**	**0**	**0**	**44 853**	**45 716**	**0**	**0**	**45 716**
Financial liabilities at fair value through profit or loss								
Interest rate swaps	656	0	0	**656**	441	0	0	**441**
Total financial liabilities	**656**	**0**	**0**	**656**	**441**	**0**	**0**	**441**

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 minimise potential losses and the principle of duality is used in LHV Pank'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 LHV Pank and to evaluate capital requirements. The analysis of cases collected into the database enables LHV Pank to identify the flaws in rules of procedure, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of the Bank is responsible for collecting information.

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 the risks of non-compliance of the activities of LHV Pank with legislation, recommended guidelines of the Financial Supervisory Authority and procedure rules of LHV Pank, 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 Bank's performance and adding value. Internal audit helps achieving the goals of the Bank, 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 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, 8, 10, 11 and 12).

According to IAS 39, the Bank classifies a portion of its bond portfolio as a held-to-maturity portfolio. When making investments, the Bank evaluates the intention of holding the respective investment until maturity. When the Bank 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. At the start of 2013, the Bank's management estimated that it does not intend to hold the investments until maturity and on the balance sheet date, the bond portfolio that was held-to-maturity was reclassified as held-for-sale portfolio (see also Note 24). As a result of the reclassification of the portfolio, the Bank's equity increases by EUR 2.2 million since the market value of the portfolio is higher than the adjusted acquisition cost recognised in the balance sheet until now.

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 prospectively in the statement of comprehensive income.

NOTE 5 Net interest income

Interest income	**2012**	**2011**
From balances with credit institutions and investment companies	110	277
From balances with central bank	96	373
From bonds	2 993	1 694
incl. bonds held-to-maturity	*1 763*	*603*
incl. bonds at fair value through profit or loss	*1 230*	*1 091*
Finance lease	28	12
Leverage loans and lending of securities (Note 12)	968	1 225
Consumer loans (Note 12)	2 282	1 652
Other loans (Note 12)	4 461	2 357
Total	**10 938**	**7 590**
Interest expense		
Loans received and deposits from customers (Note 16)	-4 729	-4 013
incl. loans from related parties (Note 25)	*-188*	*-299*
Total	**-4 729**	**-4 013**
Net interest income	**6 209**	**3 577**

Interest income of loans by customer location:	**2012**	**2011**
Estonia	5 285	3 256
Finland	2 282	1 652
Latvia	51	64
Lithuania	121	274
Total	**7 739**	**5 246**

LHV pank

NOTE 6 Net fee and commission income

Fee and commission income	2012	2011
Financial advisory services	5	60
Security brokerage and commissions	2 145	2 488
incl. related parties (Note 25))	*9*	*13*
Asset management and similar fees	549	585
Other fee and commission income	781	408
Total	**3 480**	**3 541**
Fee and commission expense		
Financial advisory and other similar services purchased	0	-12
Security brokerage and commissions paid	-528	-497
Collection costs	-361	-243
Total	**-889**	**-752**
Net fee and commission income	**2 591**	**2 789**

Fee and commission income by customer location:	2012	2011
Estonia	2 740	2 810
Finland	283	113
Latvia	143	145
Lithuania	314	473
Total	**3 480**	**3 541**

NOTE 7 Operating expenses

Staff costs	Note	2012	2011
Wages, salaries and bonuses		3 300	2 877
Social security and other taxes		1 090	889
Total		**4 390**	**3 766**
IT expenses		751	782
Information services and bank services		509	261
Marketing expenses		1 103	1 333
Office expenses		347	387
Transportation and communication costs		138	132
Training and travelling expenses of employees		164	230
Other outsourced services		483	1 125
Other administrative expenses		729	504
Depreciation	15	526	230
Operating lease payments	21	718	629
Other operating expenses		64	65
Total operating expenses		**9 922**	**9 444**

NOTE 8 Balances with central bank, credit institutions and investment companies

	31.12.2012	31.12.2011
Demand deposits *	12 328	17 179
Term deposits with original maturity less than 3 months *	0	6 125
Term deposits with maturity more than 3 months	0	9 000
Statutory reserve capital at central bank	2 551	1 784
Other receivables from central bank *	75 414	50 772
Accrued interest	2	191
Total	**90 295**	**85 051**
* cash and cash equivalents in the statement of cash flows	87 742	74 076

Distribution of receivables by countries is presented in Note 3.5. Balances with investment companies amounting to EUR 1 547 thousand (2011: EUR 4 915 thousand) are included under demand deposits. All other demand and term deposits are held at credit institutions or the central bank. Mandatory banking reserve as at 31.12.2012 was 1% (2011: 1%) of all financial resources taken in (loans received and deposits from customers). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 9 Currency derivatives

Balance as at 31.12.2012	Asset / liability (fair value)	Contractual amount as off-balance sheet asset	Contractual amount as off-balance sheet liability
Foreign currency future contract (USD)	0	0	0
Total derivatives	**0**	**0**	**0**
Balance as at 31.12.2011			
Foreign currency future contract (USD)	0	1 000	1 000
Total derivatives	**0**	**1 000**	**1 000**

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 maturity of 3 months.

NOTE 10 Financial assets and liabilities at fair value through profit or loss

Securities held for trading:	31.12.2012	31.12.2011
Shares	2	2
Fund units	14	14
Bonds	44 837	45 700
Total financial assets	**44 853**	**45 716**
Interest rate swaps	656	441
Total financial liabilities	**656**	**441**

Bid price is the indication of fair value for quoted financial investments and securities.

In 2012, financial gain of EUR 734 thousand (2011: loss of EUR 433 thousand) resulted from revaluation of bonds and EUR 343 thousand (2011: EUR 477 thousand) of financial loss from revaluation of interest rate swaps. Interest income from bonds is recorded as interest income in statement of comprehensive income.

NOTE 11 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 31.12.2012 totalled EUR 67 965 thousand (2011: EUR 30 001 thousand) of which EUR 17 584 thousand (2011: EUR 10 861 thousand) had a floating coupon interest rate and EUR 50 381 thousand (2011: EUR 19 140 thousand) had a fixed coupon interest rate. Fair value estimates of these instruments are disclosed in Note 3.6.

NOTE 12 Loans granted

	31.12.2012	31.12.2011
Loans to legal persons	**85 162**	**50 586**
incl. leveraged loans	*4 658*	4 850
incl. corporate loans	*78 597*	45 690
incl. housing loans and finance lease	1 906	46
Loans to individuals	**22 012**	**19 136**
incl. leveraged loans	*6 504*	*3 230*
incl. consumer loans	*13 144*	*15 712*
incl. housing loans and finance lease	936	*128*
incl. credit card loans	*1 428*	66
Total	**107 174**	**69 722**
Impairment loss	- 1 107	-3 042
Total	**106 067**	**66 680**

Net and gross investments on finance leases

	31.12.2012	31.12.2011
Net investment according to remaining maturity		
up to 1 year	512	0
1-5 years	2 064	0
over 5 years	18	0
Total net investment	**2 594**	**0**
Unearned future interest income according to remaining maturity		
up to 1 year	79	0
1-5 years	156	0
over 5 years	1	0
Total unearned future interest income	**236**	**0**
Gross investment according to remaining maturity		
up to 1 year	591	0
1-5 years	2 220	0
over 5 years	19	0
Total gross investment	**2 830**	**0**

Net investments on finance leases is recorded above under housing loans and finance lease.

Impairment loss includes homogeneous provision of consumer and credit card loan portfolios and individual provisions of corporate and leverage loans.

Changes in impairments	**Loans 31.12.2012**	**Loans 31.12.2011**	**Other related receivables 31.12.2011**
Balance as at January 1	-3 042	-2 439	0
Impairment provisions set up during the year	-1 074	-956	-1 651
Written off during the year	3 009	353	1 651
Balance as at December 31 (Note 13)	**-1 107**	**-3 042**	**0**

In 2012, the average effective interest rate of new consumer loans issued to individuals was between 20-28% (2011: 20-24%). The portfolio of consumer loans that was acquired in 2012 and in which interest income was calculated on the basis of effective interest rate of 10%, was sold in 2012 with the balance sheet net value of EUR 4.3 million.

Receivables in the amount of EUR 6.8 million and impairments in the amount of EUR 2.5 million related to these receivables were written off.

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 31.12.2012 loans have been issued to related parties in the amount of EUR 49 thousand and the loans have been issued on market terms (as at 31.12.2011 no loans were issued to related parties).

Deferred income includes service fees of loans in the amount of EUR 590 thousand (2011: EUR 389 thousand), which are released to interest income over the loan term and the current portion of which totals EUR 251 thousand (2011: 110 thousand) and the non-current portion totals EUR 339 thousand (2011: EUR 279 thousand).

For interest income on loans granted, see Note 5.
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 13 Receivables from customers

	31.12.2012	31.12.2011
Securities brokerage fees from intermediaries	29	13
Asset management fees from customers	46	46
Other fees for providing services to customers	79	78
incl. related parties (Note 25)	*19*	*19*
Payments in transit	65	17
Other receivables related to collection of receivables	35	0
Total	**254**	**154**

All fees, other than other receivables related to collection of receivables, are receivable within 12 months of the balance sheet date, and are considered as current assets. In 2011 other receivables related to collection of receivables have been assessed as uncollectable and therefore have been written off the balance sheet in the amount of EUR 1 927 thosuand.

NOTE 14 Other assets

	31.12.2012	31.12.2011
Guarantee deposits of Baltic stock exchanges	9	9
Guarantee deposit of MasterCard	704	615
Prepayments to Financial Supervision Authority	85	70
Other prepayments *	148	118
Total	**946**	**812**

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

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 15 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2010			
Cost	857	275	1 132
Accumulated depreciation and amortisation	-636	-60	-696
Carrying amount	**221**	**215**	**436**
Changes occurred in 2011:			
Purchase of non-current assets	824	346	1 170
Depreciation/amortisation charge	-172	-58	-230
Balance as at 31.12.2011			
Cost	1 681	621	2 302
Accumulated depreciation and amortisation	-808	-118	-926
Carrying amount	**873**	**503**	**1 376**
Changes occurred in 2012:			
Purchase of non-current assets	73	149	222
Write-off of non-current assets	-66	-25	-91
Depreciation/amortisation charge	-315	-211	-526
Balance as at 31.12.2012			
Cost	1 688	745	2 433
Accumulated depreciation and amortisation	-1 057	-304	-1 361
Carrying amount	**631**	**441**	**1 072**

In 2012 and 2011, there was no indication of impairment of tangible and intangible assets.

NOTE 16 Loans received and deposits from customers

	Individuals	Legal entities	Public sector	**31.12.2012 total**	Individuals	Legal entities	Public sector	**31.12.2011 total**
Demand deposits	34 951	41 628	220	76 799	17 424	17 049	655	**35 128**
Term deposits	106 493	87 112	10 112	203 717	96 982	67 414	8 349	**172 745**
Loans received	0	0	4 141	4 141	0	172	4 347	**4 519**
Accrued interest liability	1 075	401	30	1 506	975	452	55	**1 482**
Total	**142 519**	**129 141**	**14 503**	**286 163**	**115 381**	**85 087**	**13 406**	**213 874**
incl. related parties (Note 25)	*81*	*55*	*0*	*136*	*57*	*50*	*0*	*107*

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

Distribution of loans received and deposits from customers by currency is presented in Note 3.3.
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 17 Accrued expenses and other liabilities

	31.12.2012	31.12.2011
Trade payables	500	203
Tax liabilities	240	363
Payables to employees	433	446
Financial guarantee contracts issued	89	28
Payments in transit	264	460
Other short-term liabilities	483	0
Total	**2 009**	**1 500**

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 the number of employees during the year. Payments in transit consist of foreign payments and payables to customers related to intermediation of securities transactions. All liabilities, except for financial guarantees, are payable within 12 months and are therefore recognised as current liabilities.

NOTE 18 Provisions

In the balance sheet, a provision has been recognised in the amount of EUR 13 thousand (2011: EUR 13 thousand), the cost of which is included within operating expenses. Provision is recognised as a long-term liability.

NOTE 19 Subordinated loans

As at 31.12.2011, subordinated loans include bonds issued in the amount of EUR 7 000 thousand (31.12.2011: EUR 3 000 thousand). The parent LHV Group purchased these securities, having issued subordinated bonds itself and deposited the proceeds received from the issue to the bank under the same conditions with the goal of including subordinated bonds within the bank's net own funds.

In 2010, subordinated bonds were issued in the amount of EUR 3 000 thousand at the interest rate of 5% in the first two-year period and 7.5% + 12 months EURIBOR in the subsequent five-year period with the due date at 15 October 2017. After two years, the issuer used its right to prematurely redeem the bonds in March 2013 and deposited the same amount in the Bank's share capital.

In December 2012, subordinated bonds were issued in the amount of EUR 4 000 thousand. The due date of the bonds is 20 December 2020 and the interest rate is 7% during the first three-year period and 7% + 3 months EURIBOR onwards. After three years, the issuer has the right to prematurely redeem the bonds.

Interest expenses on subordinated bonds in the amount of EUR 184 thousand (2011: EUR 299 thousand) are included within interest expenses in the income statement. As of 31 December 2012, the accrued interest liability of subordinated liabilities was EUR 365 thousand (31 December 2011: EUR 181 thousand). Interest liabilities are accounted in the balance sheet using the effective interest rate.

NOTE 20 Shareholders' equity in the public limited company

The sole shareholder of the Bank is a company registered in Estonia, AS LHV Group. Rain Lõhmus who owns 37% of the voting rights and Andres Viisemann who owns 11% of the voting rights in AS LHV Group have significant influence over the company.

	31.12.2012	31.12.2011
Share capital *(in EUR thousand)*	23 700	17 700
Number of shares (pcs)	23 700 000	17 700 000
Par value of a share	1 EUR	1 EUR

According to the Company's articles of association, the minimum share capital is EUR 10 million and the maximum share capital is EUR 40 million. The share capital has been fully paid in for. The share capital of AS LHV Pank was increased in June 2012. The bank's sole shareholder LHV Group made a monetary contribution of EUR 6 million to share capital. The bank's share capital increased to EUR 23.7 million by the year-end 2012.

As at 31.12.2012, the accumulated deficit of the Bank totalled EUR 9 044 thousand (31.12.2011: accumulated deficit EUR 7 307 thousand). Thus, it is not possible to pay dividends to the shareholders.

NOTE 21 Operating lease

LHV Pank leases office premises 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 1 618 thousand (2011: EUR 2 021 thousand), the current portion of which amounts to EUR 758 thousand (2011: EUR 503 thousand) and the non-current portion amounts to EUR 859 thousand (2011: EUR 1 518 thousand). In 2012, the operating lease payments for office premises in the amount of EUR 718 thousand (2011: EUR 629 thousand) are included within operating expenses.

NOTE 22 Assets under management

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

	31.12.2012	**31.12.2012**
Cash balance of customers	6 234	4 374
Securities of customers	240 206	182 534
incl. parent company	*27 713*	*22 810*
incl. shareholders of the parent company and related entities	*11 647*	*5 198*
Kokku	**246 440**	**186 908**

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

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by LHV Pank, have been recognised as off-balance sheet assets. Due to the nature of the system, LHV Pank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by LHV Pank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. LHV Pank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the bank's balance sheet. LHV Pank has provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), with 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 23 Contingent assets and liabilities

Irrevocable transactions	**Unused loan commitments**	**Financial guarantees**	**Total**
Liability in contractual amount 31.12.2012	13 578	2 553	**16 131**
Liability in contractual amount 31.12.2011	4 911	2 427	**7 338**

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 2011 - 2012. The Company's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on the Company.

Due to the losses of earlier periods of the Finnish branch, the Bank has EUR 750 thousand in potential contingent income tax assets. The management has estimated that the probability of reducing the income tax liability of future periods at the expense of contingent income tax asset cannot be estimated sufficiently reliably and has decided to recognise the income tax asset as off-balance sheet asset.

NOTE 24 Events after the balance sheet date

After the end of the financial year, the following significant events have occurred at AS LHV Pank which do not have an effect on the positions of the Bank's assets and liabilities as at 31 December 2012.

On 8 March 2013, LHV Pank redeemed bonds subscribed by its parent LHV Group in the total amount of EUR 3 million and, simultaneously, LHV Group increased the share capital of LHV Pank by EUR 3 million, as a result of which the share capital of LHV Pank is EUR 26.7 million.

In March, the Bank reclassified its held-to-maturity bond portfolio as available-for-sale portfolio that increased the Bank's equity by EUR 2.2 million.

From May 2013, LHV Pank will be offering instalment service for merchants. To this aim, in January 2013, LHV Pank established LHV Finance, a subsidiary in which it has a 65% holding.

NOTE 25 Transactions with related parties

In preparing the financial statements of AS LHV Pank, 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 (together referred to as management);
- members of the supervisory board
- close relatives of the persons mentioned above and the entities related to them;

Transactions	Note	2012	2011
Interest expenses	**6**	**188**	**299**
incl. management		*4*	*0*
incl. parent company		*184*	*299*
Fee and commission income	**5**	**9**	**3**
incl. ultimate controlling party and related entities		*8*	*3*
incl. management		1	0
Other income		**28**	**68**
incl. ultimate controlling party and related entities		*28*	*68*

Balances	Note	31.12.2012	31.12.2011
Receivables as at the year-end		**19**	**19**
incl. ultimate controlling party and related entities	*13*	*19*	*19*
Loans received as at the year-end		**7 365**	**3 288**
incl. management		*0*	*107*
incl. parent company		*7 365*	*3 181*

Receivables have originated from rendering services, they do not bear interest and have been received by the time of compiling the annual report.

The term deposits due to management as at 31.12.2012 are with maturities in January to August 2013 and with interest rates 1.0-2.6% (31.12.2011 with maturities March to December 2012 and with interest rates 1.5 - 3.0%). The subordinated loans received during 2010 have the interest rate of 5% during the first two years and 12 months EURIBOR + 7.5% onwards. The subordinated loan received in December 2012 has the interest rate of 7% during the first three years and 3 months EURIBOR + 7% since 16 December 2015. The interest rate of all subordinated loans is the same as the parent is paying on its own subordinated loan received from a third party, and it deposited the funds at the Bank.

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PricewaterhouseCoopers, Tallinn

In 2012, salaries and other compensations paid to the management of LHV totalled EUR 366 thousand (2011: EUR 280 thousand). The Management Board of the Bank had 5 members in 2012 (6 members in the middle of 2012) and 5 members in 2011. As at 31.12.2012, remuneration for December and accrued holiday pay in the amount of EUR 63 thousand (as at 31.12.2011: EUR 64 thousand) is reported as a payable to management (Note 17). The Company did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2012 and 31.12.2011 (pension liabilities, termination benefits, etc). In 2012, the remuneration paid to the members of the Supervisory Board totalled EUR 27 thousand (2011: EUR 11 thousand).

Information on assets of related parties held as an account manager is presented in Note 22.

SIGNATURES OF THE MANAGEMENT BOARD TO THE ANNUAL REPORT

The Management Board has prepared the management report and the financial statements of AS LHV Pank for the financial year ended on 31 December 2012. The financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

08.04.2013

Chairman of the Management Board

Erki Kilu / signed /

Members of the Management Board:

Kerli Lõhmus	/ signed /	**Indrek Nuume**	/ signed /
Jüri Heero	/ signed /	**Martti Singi**	/ signed /

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of AS LHV Pank

We have audited the accompanying financial statements of AS LHV Pank (the Company), which comprise the balance sheet as of 31 December 2012 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

/signed/

Tiit Raimla
Auditor's Certificate No.287

/signed/

Erki Mägi
Auditor's Certificate No.523

8 April 2013

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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 OF LOSS

The Management Board of LHV Pank proposes to the General Meeting of Shareholders to add the loss for reporting period in the amount of EUR 1 737 thousand to the accumulated deficit.

SIGNATURES OF THE SUPERVISORY BOARD TO THE ANNUAL REPORTt

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

24.04.2013

Rain Lõhmus	/ signed /	**Andres Viisemann**	/ signed /
Tiina Mõis	/ signed /	**Hannes Tamjärv**	/ signed /
Raivo Hein	/ signed /	**Heldur Meerits**	/ signed /

ALLOCATION OF INCOME ACCORDING TO EMTA CLASSIFICATORS

EMTAK	Activity	2012	2011
66121	Security and commodity contracts brokerage	2 694	3 073
64191	Credit institutions (banks) (granting loans)	11 691	7 986
66191	Financial consultancy services	5	60
64911	Finance lease	28	12
	Total income	**14 418**	**11 131**