AS LHV Pank

Consolidated Annual Report 2013

(translation of the Estonian original)

Consolidated Annual Report **01.01.2013 – 31.12.2013**

Legal name	AS LHV Pank
Commercial Registry no.	10539549
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
Fax	(372) 6800410
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
	Andres Kitter
Supervisory Board	Rain Lõhmus
	Erkki Raasuke
	Tiina Mõis
	Andres Viisemann
	Hannes Tamjärv
	Heldur Meerits
	Raivo Hein
Auditor	AS PricewaterhouseCoopers

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MANAGEMENT REPORT

AS 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 180 people. More than 50 000 clients use the Bank's services. 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. In January, the Bank founded a subsidiary AS LHV Finance that started to provide hire-purchase service to retailers. The results of the subsidiary are consolidated with the Bank. The Bank owns 65% of the subsidiary.

Overview of the year 2013

Business activities

Business volumes

In 2013, the Bank's volume of deposits and loans increased significantly: the volume of deposits increased 26% to EUR 356 million and the volume of loans grew by 94% to EUR 205 million.

Amongst deposits, the volume of demand deposits increased 114% to EUR 164 million. The volume of term deposits decreased 6% to EUR 192 million.

By volume of loan portfolios, most of the growth came from corporate loans that increased 70% to EUR 133 million, whereas the leasing portfolio reached EUR 15 million and the hire-purchase portfolio reached EUR 5 million. In addition, during the year, the loans of Lithuanian financing enterprise Mokilizingas that belongs to parent company LHV Group were refinanced in the amount of EUR 24 million.

Profitability

The profit for the financial year totaled EUR 2.3 million. Significant growth in the volume of loans created good preconditions for faster growth of interest income and profitability. In addition, in March it was decided to reclassify the bond portfolio held to maturity date to portfolio recognized in market value and sell most of it.

During the year, a model for setting collective provisions was established for corporate loans, leasing and hire-purchase. In addition, the level of provisions of Finnish loans was analyzed and updated, and a decision was made to simplify the provisioning model, as a result of which provisions of Finnish loans increased.

Starting from June, the interest rates of Finnish loans and contract fees were renewed to ensure compliance with the new requirement in the Finnish legislation on maximum percentage rate of charge. Also, it was decided to significantly reduce maximum amounts for Finnish loans. In the third quarter, EUR 1.7 million of non-performing loans of the Finnish branch were sold. These were loan contracts that were being administered by bailiffs and the bank was no longer actively involved with. The centralization of daily functions of debt administration from Finland to Estonia was started.

Capitalization

During the year, equity of LHV Group increased, as a result of which the Bank's own funds and capitalization increased significantly.

In March, EUR 3 million in subordinated convertible bonds of LHV Group were converted into equity. After that, LHV Group converted EUR 3 million of the bank's subordinated bonds to equity.

In June, LHV Group successfully issued new shares for the employees of LHV in the amount of EUR 0.6 million, exchanged subordinated convertible bonds into equity in the amount of EUR 1.3 million and issued new subordinated bonds in the volume of EUR 5.4 million. As a result, the Bank's share capital went up by EUR 1.8 million and subordinated bonds in the amount of EUR 3 million were issued.

In December, subordinated bonds of LHV Group were issued in the amount of EUR 10.05 million. After that, the Bank's share capital was increased by EUR 5 million and the Bank's subordinated bonds were issued in the amount of EUR 3 million. As a result of the increase of own funds, the maximum loan amounts of the Bank increased to EUR 9 million.

Development

During the year, several new retail banking products and services were completed. In April, the hire-purchase product and information systems necessary for issuing and administration of hire-purchase products were completed. In May, the Bank launched hire-purchase in all Euronics stores and, starting from June, in other stores. Multiple account card and Partner Bank Card were launched in October and mobile bank app for iPhone in November. Work began in developing a mobile bank app for Android.

Other developments completed during the year included further developments for the Internet Bank settlement services, SEPA payments, e-invoice via a standing order, overdraft for corporate and private customers and the first part of new loan administration software. In April, a cooperation agreement was signed with KredEx Credit Insurance and in June, leasing of heavy machinery was started.

In the beginning of the year, the Bank won the Member of the Year 2012 Award at the Baltic Market Awards for the second year running. With the aim of becoming more active in preparing Baltic analyses for retail customers, the analyst of institutional brokerage moved into retail banking in February. The current work process and the structure and outlook of analyses were renewed.

In April, LHV Pro was renamed to Baltic Analyses and an updated analyses environment was launched in the financial portal. In June, Harju Elekter and Siauliu Bankas were included in the analyses as new enterprises. In July, the Bank joined the Marketmaking Program of Baltic Bourses and became a marketmaker for three stocks listed on the Tallinn Stock Exchange. Starting from January 2014, the Bank also became a marketmaker for one stock listed on the Vilnius Stock Exchange. In May, the Bank started to manage the Bond Portfolio offered through unit-linked life insurance of Compensa Life.

Organization

By the end of the year, the Bank's organizational structure had reached certain maturity and no major changes took place during the year. The Bank's organization was divided between five largest divisions: Retail Banking, Private and Business Banking, IT, Finance Management and Operations, and Risk Management.

At the start of the year, the activities of the asset and liability managing committee, securities' assessment committee and the investment committee were terminated. They were replaced by the risk and capital committee. During the year, the number of employees increased by 34 people to 186, which includes 13 new jobs created at the Bank and 8 in LHV Finance.

In September, Erkki Raasuke started his term as the Chairman of the Bank's Supervisory Board. Andres Kitter became head of retail banking in November and, starting from January 2014, an additional member of the Management Board.

Sponsorship

The Bank's main sponsorship partners remained the same. During the year, the Bank supported the Estonian Optimist Class Association to acquire 40 new sails, Estonian Football Association as the main sponsor of the national team, organization of the Tallinn Restaurant Week, the Ethical Essay contest held by the Enn Soosaar Foundation by providing a cash prize for the award and the Entrepreneur of the Year 2013 competition.

As a new project, a cooperation agreement was signed with the Education Information Technology Foundation for issuing an LHV scholarship in three consecutive years. The scholarship commends for bachelor's degree thesis in the framework of the IT Academy program that contribute to promoting the financial sector in Estonia. In addition, the

Bank supported holding the EKA EXPO exhibition introducing cooperation possibilities of the Academy of Art and entrepreneurs in the Bank's client service office. The Minister of Culture recognized the Bank as a culture-friendly enterprise for the second consecutive year.

Management and the principles of remuneration

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

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

The employees of LHV Pank and LHV Finance receive primarily fixed wages and salaries. The parent company AS LHV Group is planning to implement incentive fees and share options for the members of the Management Board, heads of departments and employees equivalent to them. The precondition for receiving a share option will be based on financial performance that will be assessed by the Management Board and the Supervisory Board of AS LHV Group. The level of share options will depend on the successful fulfillment of corporate and individual targets. Issuing of share options will be decided in the general meeting of shareholders. The Bank has made no major severance payments nor significant non-cash 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	1 662	28	1 690	99
private and corporate banking	621	32	653	26
support services	825	0	825	46
infotechnology	693	0	693	48
total	**3 801**	**60**	**3 861**	**219**

Business environment

In the backdrop of the overall negative performance of world economy, Estonia's economic growth slowed down in 2013 and practically came to a standstill in the fourth quarter, with the GDP growing only 0.7% from the last quarter of 2012.

The main sectors that came under pressure included export-oriented manufacturing industry and transport as well as the construction sector. On the other hand, economic growth was supported by the upswing in domestic consumption and tourism sector, supported by growing income and lower unemployment. The economy was also favorably influenced by historically low levels of interest rates and relatively stable and low price of fuels.

With the slowdown of economic growth, also the growth of inflation decreased to annual average of 2.8%, whereas in December the prices were 0.1% higher than in November and were only 1.4% higher than the prices in December 2012.

In addition to unfavorable external environment, the Estonian economic climate is increasingly being affected by the worsening situation on the labor market due to the demographic development and growing migration. In spite of the 8.7% unemployment rate, employers are finding it difficult to hire suitable workforce even for existing businesses, to say nothing of finding personnel for new enterprises.

Last year, corporate and household deposits increased by EUR 1 billion amounting to EUR 13.6 billion, which included EUR 9.1 billion in demand deposits. Deposit growth came from the increase in household deposits that went up from EUR 4.7 billion to 5.5 billion in a year.

Weak economic growth was reflected also in the modest EUR 0.3 billion growth of the loan volume, whereas the volume of loans issued to households increased only marginally, by EUR 0.02 billion, in a year.

In the Baltic stock markets, the turnover of transactions totaled EUR 301,5 million. The fragility of the total economic environment was reflected in stock market indices: Tallinn stock market index increased 11,4%, while Riga and Vilnius stock market indices were up 16,2% and 18,7%, respectively. In global stock markets, there were clear differences between leading developed and developing markets. US S&P Index gained 29,6%, DAX 25,5% and FTSE 14,4% whereas China's SSE Composite decreased 6,7%, Brazil's Bovespa 15,5% and Russia's RTS 5,5%.

Financial results

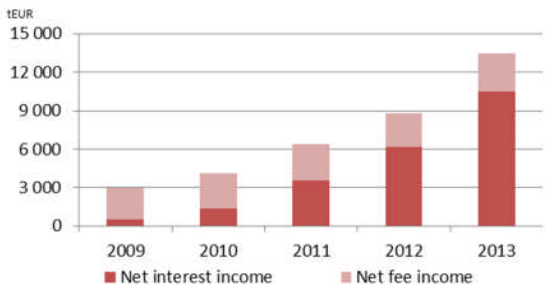
At year-end, the balance sheet total of the consolidation group (further: the Group) was EUR 401 million which is 29% bigger than at the beginning of the year. The volume of deposits in the Group increased to EUR 356 million, which is 26% more than at the start of the year. Of this amount, demand deposits totalled EUR 164 million and term deposits totalled EUR 192 million. The share of demand deposits reached 46% of all deposits. The volume of the Group's loan portfolio reached EUR 206 million and that of the bond portfolio was EUR 43 million, which is respectively 94% higher and 62% lower than at the beginning of the year.

In 2013, the Group's net interest income totalled EUR 10.5 million, net fee and commission income totalled 3.0 million and financial income was EUR 2.3 million. The Group's net income totalled EUR 15.8 million, expenses totalled EUR 11.0 million and loan provisions totalled EUR 2.6 million. The Group's profit for the year was EUR 2.3 million.

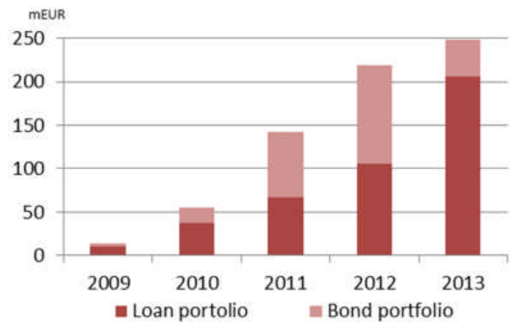
At the year-end, the volume of loans issued to corporates totalled 133 million euros, the volume of margin loans secured by debt or equity securities totalled 10 million, the volume of consumer loans was 16 million, the volume of leasing was over 15 million and the volume of hire-purchase loans was almost 5 million.

In 2013, the number of customers holding assets in LHV Pank increased 29% and totalled 48 863 by the end of the year. The volume of customer securities totalled EUR 362 million at the end of 2013.

EUR million	2013	2012	change
net interest income	10.5	6.2	69%
net fee and commission income	3.0	2.6	15%
net gains from financial assets	2.3	0.4	510%
total net operating revenues	15.8	9.2	72%
other income	0.1	0.1	-15%
operating expenses	-11.0	-9.9	11%
loan losses	-2.6	-1.1	144%
net income	2.3	-1.7	231%



EUR million	2013	2012	change
loan portfolio	204.6	106.1	93%
bond portfolio	42.7	112.8	-62%
deposits	356.3	282.0	26%
equity	26.9	14.7	83%
total assets	400.5	311.5	29%
number of customers holding assets in bank	48 863	37 953	29%
number of loan customers in Finland	9 066	6 878	32%
number of employees	186	152	22%



CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of Comprehensive Income

(in thousands of euros)

	Note	2013	2012
Interest income	5	13 297	10 938
Interest expense	5	-2 802	-4 729
Net interest income		**10 495**	**6 209**
Fee and commission income	6	4 009	3 480
Fee and commission expense	6	-1 028	-889
Net fee and commission income		**2 981**	**2 591**
Net gains from financial assets measured at fair value	9,10	2 354	385
Foreign exchange rate losses		-12	-1
Net gains from financial assets		**2 342**	**384**
Other income		64	75
Operating expenses	7	-10 995	-9 922
Impairment losses on loans and advances	12	-2 619	-1 074
Net profit/loss for the year		**2 268**	**-1 737**
Other comprehensive income/loss			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Revaluation of available-for-sale financial assets		-27	0
Total comprehensive income/loss for the year		**2 241**	**-1 737**
Profit/loss attributable to:			
Owners of the parent		2 366	-1 737
Non-controlling interest		-98	0
Total profit/loss for the year		**2 268**	**-1 737**
Total comprehensive income/loss attributable to:			
Owners of the parent		2 339	-1 737
Non-controlling interest		-98	0
Total comprehensive income/loss for the year		**2 241**	**-1 737**

Notes on pages 12 to 52 are an integral part of the consolidated financial statements.

Consolidated Statement of Financial Position

(in thousands of euros)

	Note	31.12.2013	31.12.2012
Assets			
Balances with central bank	8	133 839	77 965
Due from credit institutions	8	15 300	10 783
Due from investment companies	8	1 456	1 547
Available-for-sale financial assets	9	11 903	0
Other financial assets at fair value through profit or loss	10	30 816	44 853
Held-to-maturity financial investments	11	0	67 965
Loans and advances to customers	12	204 563	106 067
Receivables from customers	13	719	254
Other assets	14	939	946
Tangible assets	15	416	631
Intangible assets	15	533	441
Total assets		**400 484**	**311 452**
Liabilities			
Deposits from customers and loans received	16	359 837	286 163
Financial liabilities at fair value through profit or loss	10	433	656
Accrued expenses and other liabilities	17	3 317	2 009
Deferred income	12	0	590
Provisions	18	0	13
Subordinated loans	19	10 025	7 365
Total liabilities		**373 612**	**296 796**
Equity			
Non-controlling interest		77	0
Equity attributable to owners of the parent			
Share capital	20	33 500	23 700
Other reserves	9	-27	0
Accumulated deficit		-6 678	-9 044
Total equity attributable to owners of the parent		**26 795**	**14 656**
Total equity		**26 795**	**14 656**
Total liabilities and equity		**400 484**	**311 452**

Notes on pages 12 to 52 are an integral part of the consolidated financial statements.

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Consolidated statement of Cash Flows

(in thousands of euros)

	Note	2013	2012
Cash flows from operating activities			
Interest received		12 795	10 938
Interest paid		-4 069	-4 729
Fees and commissions received		3 997	3 479
Fees and commissions paid		-1 028	-889
Other operating income received		64	75
Staff costs paid		-5 005	-4 390
Administrative and other operating expenses paid		-5 318	-5 006
Cash flows from/used in operating activities before change in operating assets and liabilities		**1 436**	**-522**
Net increase/decrease in operating assets:			
Net acquisition/disposal of trading portfolio		-4	0
Loans and advances to customers		-101 693	-40 561
Term deposits with other credit institutions		2	9 189
Mandatory reserve at central bank		-846	-767
Security deposits		64	-90
Other assets		-43	-45
Net increase/decrease in operating liabilities:			
Demand deposits of customers		87 354	41 672
Term deposits of customers		-12 128	30 996
Loans received and repayments		-612	-194
Financial liabilities held for trading at fair value through profit or loss		-223	216
Other liabilities		1 158	710
Net cash used in / generated from operating activities		**-25 535**	**40 604**
Cash flows from investing activities			
Purchase of non-current assets	15	-414	-222
Acquisition of investment securities held to maturity		-2 790	-45 988
Proceeds from disposal and redemption of investment securities available for sale (previously held to maturity)		61 130	8 295
Net changes of investment securities at fair value through profit or loss		14 090	977
Net cash from / used in investing activities		**72 016**	**-36 938**
Cash flows from financing activities			
Paid in share capital	20	9 800	6 000
Non-controlling interest contribution to subsidiary´s share capital		175	0
Subordinated loans received	19	3 000	4 000
Net cash from financing activities		**12 975**	**10 000**
Net increase in cash and cash equivalents		**59 456**	**13 666**
Cash and cash equivalents at the beginning of the year	8	87 742	74 076
Cash and cash equivalents at the end of the year	**8**	**147 198**	**87 742**

Notes on pages 12 to 52 are an integral part of the consolidated financial statements.

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Consolidated statement of Changes in Equity

(in thousands of euros)

	Attributable to owners of the parent					
	Share capital	**Other reserves**	**Accumulated deficit**	**Total**	**Non-controlling interest**	**Total equity**
Balance as at 01.01.2012	**17 700**	**0**	**-7 307**	**10 393**	**0**	**10 393**
Paid in share capital	6 000	0	0	6 000	0	6 000
Total comprehensive loss for 2012	0	0	-1 737	-1 737	0	-1 737
Balance as at 31.12.2012	**23 700**	**0**	**-9 044**	**14 656**	**0**	**14 656**
Balance as at 01.01.2013	**23 700**	**0**	**-9 044**	**14 656**	**0**	**14 656**
Paid in share capital	9 800	0	0	9 800	0	**9 800**
Non-controlling interest contribution to subsidiary´s share capital	0	0	0	0	175	**175**
Profit for the year	*0*	*0*	2 366	2 366	-98	**2 268**
Other comprehensive income	*0*	*-27*	*0*	*-27*	*0*	**-27**
Total comprehensive income for 2013	0	-27	2 366	2 339	-98	**2 241**
Balance as at 31.12.2013	**33 500**	**-27**	**-6 678**	**26 795**	**77**	**26 872**

More detailed information is provided in Note 20.

Notes on pages 12 to 52 are an integral part of the consolidated financial statements.

Notes to the consolidated financial statements

NOTE 1 General information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2013 for AS LHV Pank (the "Bank") and its subsidiary AS LHV Finance (the "Group"). AS LHV Pank holds 65% interest in AS LHV Finance. AS LHV Finance was incorporated January 23, 2013.

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 31.12.2013, the Group employed 186 people (as at 31.12.2012: 152 people). LHV Finance offers hire-purchase services to merchants.

The consolidated annual report (incl. financial statements) was approved by the Management Board on 31 March 2014. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 34.5% of the voting rights and Andres Viisemann, who owns 10.3% of the voting rights (see also Note 20), have significant influence over AS LHV Group. The consolidated annual report 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 consolidated annual report while the Supervisory Board does not have that right.

NOTE 2 Summary of significant accounting policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2013 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 and assets available for sale.

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

The financial year started at 1 January 2013 and ended at 31 December 2013. 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 Group's accounting periods beginning on or after 1 January 2013. The overview of these standards and the Group management's estimate of the potential impact of applying the new standards and interpretations are stated below.

In 2013 financial statements, management has made a change in presentation of information in Statement of Cash Flows. Investing activities cash flows from investment securities held to maturity and investment securities available for sale are disclosed in gross, as in 2012 financial statements information was provided on net basis.

a) Adoption of New or Revised Standards and Interpretations

The following new or revised standards and interpretations became effective for the Group from 1 January 2013.

IFRS 13, Fair Value Measurement; (effective for annual periods beginning on or after 1 January 2013). 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 application of the standard have not changed measurement of fair value of financial assets and financial liabilities, as the quoted market price used for financial assets is the current bid price; the quoted market price for financial liabilities is the current asking price and the Group used the same measurement basis before 1 January 2013. The Standard also resulted in additional disclosures in these consolidated financial statements. Refer to Note 3.6.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2013 that would be expected to have a material impact to the Group.

b) New accounting pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2014, and which the Group has not early adopted.

IFRS 9, Financial Instruments (not yet adopted by the EU) - 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 instrument 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.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

The amendments made to IFRS 9 in November 2013 removed its mandatory effective date, thus making application of the standard voluntary. The Group does not intend to adopt the existing version of IFRS 9.

IFRS 12, Disclosure of Interest in Other Entities (effective for annual periods beginning on or after 1 January 2014). The standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 sets out the required disclosures for entities reporting under the two new standards: IFRS 10, Consolidated financial statements, and IFRS 11, Joint arrangements, and replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on share of non-controlling interests in group activities and cash flows, (iii) summarised financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the the principles of the standard, the impact of this standard on the Group and the timing of its adoption by the Group.

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

2.2 Consolidation

The 2013 consolidated financial statements include the financial statements of AS LHV Pank (parent company) and its subsidiary AS LHV Finance.

A subsidiary is an entity controlled by the parent company. Control is presumed to exist when the parent company owns, directly or indirectly through its subsidiaries, more than 50% of the voting power of the subsidiary or otherwise has power to govern the financial and operating policies of the subsidiary. The acquisition method of accounting is used to account for the acquisition of subsidiaries (except for acquisitions among enterprises under common control) and business operations. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed.

According to the acquisition method, the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary are recognized at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Group measures non-controlling interest that represents present ownership interest and entitles the holder to a proportionate share of net assets in the event of liquidation on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree. Non-controlling interests that are not present ownership interests are measured at fair value.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed, and reviews appropriateness of their measurement.

Intercompany transactions balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered.

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

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

In the parent separate primary financial statements, disclosed to these consolidated financial statements (see Note 25, the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

Non-controlling interest

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, which is attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separaate component of the Group's equity. Non-controlling interests in the comprehensive income is included within equity in the consolidated statement of financial position separately from the equity attributable to the shareholders of the parent company and is disclosed below the consolidated statement of comprehensive income.

2.3 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of entities in the Group 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 and which are subject to an insignificant risk of changes in value.

2.5 Financial assets

The Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss
- held-to-maturity financial investments
- available-for-sale financial assets
- loans and advances

The classification depends on the purpose for which the financial assets were acquired. Management of the Group determines the classification of its financial assets at initial recognition. Refer to note 4 for information about reclassification of held-to-maturity financial investments to available-for-sale assets.

	IAS 39 category	Class (applied by the Group)	
Financial assets	Loans and advances	Loans and advances to credit institutions and investment companies	
		Loans and advances to customers	Corporate loans
			Loans to individuals
	Financial assets at fair value through profit or loss	Securities held for trading	Equity securities
			Listed debt securities
			Derivatives
	Available-for-sale financial assets	Investment securities	Listed debt securities
	Held-to-maturity financial investments	Investment securities	Listed debt securities

(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 way 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 profit or loss. 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 Group. 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 Group is established.

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

Derivative financial instruments (futures, forward, swap and option contracts) are initially 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 Group does not use hedge accounting to account for its derivative financial instruments.

Financial assets designated at fair value through profit or loss at inception - securities are classified into this group, if the Group 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.

Refer to Note 3.6 for fair value of financial assets.

(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, plus all directly attributable transaction costs incremental to their acquisities 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) Available-for-sale financial assets

Available-for-sale financial assets are financial instruments which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Investment securities available-for-sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. Other changes in fair values of these financial assets are recognised in other comprehensive income.

(d) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates, and has no intention of trading the receivable. Loans and advances are initially recognised at fair value plus transaction costs, and are derecognised only when they are repaid or written-off. After initial recognition, the Group recognises loans and advances 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. In case 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 Group 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.

Loans restructured because of significant changes in contract terms 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 advances is assessed in accordance with the principles described in clause 2.6.

2.6 Impairment of financial assets carried at amortised cost

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment.

The Group assesses the risks conservatively, taking into consideration all known information about the solvency of the debtor and whether there are any objective circumstances indicating impairment (the buyer's financial difficulties, bankruptcy or inability to meet its obligations to the Group).

Corporate loans and leases are assessed individually, primarily based on the overdue status of loan and relisable of related collateral, if any. Other criteria used to determine whether there is objective evidence that an impairment loss has occurred are financial position of the company, industry situation, reliability of the borrower, the competence of its management and other factors. Margin loans secured by debt or equity securities both to legal as well as private individuals are assessed individually, using primarily the market value of collateral as the basis. Consumer loans, credit card loans and hire-purchase loans are assessed as a group. Private individuals 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 purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows in a group of financial assets that are collectively evaluated for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently. The Group regularly reviews future cash flow assessment methods and assumptions, in order to reduce potential differences between loss estimates and actual losses.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. Any impairment losses are charged to statement of comprehensive income line "Impairment losses on loans and advances".

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 through profit or loss for the year. The reversal of the impairment loss is recognised as income in the line "Impairment losses on loans and advances" in the statement of comprehensive income.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

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

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

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if that has become appropriate, at each balance sheet date. The Group performs an impairment test when there are circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell and its value in use), it is written down immediately to its recoverable amount 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 Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is 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 guarantees

The Group issues financial guarantees and commitments to provide loans. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

2.10 Financial liabilities

The Group classifies financial liabilities to 2 categories:

a) financial liabilities measured at fair value through profit or loss
b) financial liabilities measured at amortised cost

Recognition of 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".

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, debt securities 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 less transaction costs.

2.11 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 constructive obligations to make pension or similar payments supplementary to social tax.

2.12 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 Group's current operating practice (legal or constructive obligation) that require the outflow of resources , 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 operating losses.

When it is probable that a provision 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 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 on a portfolio basis. If it becomes probable that an outflow of future economic benefits will be required for an item or portfolio of items 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).

2.13 Distinction between short- and long-term assets and liabilities

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

Liabilities are classified as current when they are due within twelve months after the balance sheet date or if the Group does not have an unconditional right to defer the payment for later than 12 months after the balance sheet date. Loans with due date within 12 months after the balance sheet date 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 (Note 3.4).

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

2.14 Revenues and expenses

Revenues and expenses are recorded on an accrual basis. Revenue is recognised when it is probable that the economic benefits associated with the transaction are received by the Group, the amount of the revenue can be measured reliably and services were rendered by the Group. Revenue from services rendered in the ordinary course of business is recognised at fair value of the fee received or receivable. Expenses are recognised when the Group has obligation to pay for the expense and/or the Group has received goods or services, and the latter occurs at an earlier date.

Fee and commission income (incl. custody and portfolio management fees) are recognised on an accrual basis when the service has been provided and the Group has a right of claim to the receivable. Loan commitment fees that are directly related with the undrawn portion of the loan commitment and which changes based on the portion of the unused commitment are recognised as fee income during the period when draw down is available. 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 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 received 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 debt securities measured at fair value through profit or loss. Amortisation of transaction costs of debt securities measured at fair value through profit or loss is not recognised as interest income.

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

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

2.15 Asset management services

The Group is engaged in providing asset management services (Note 22). Such assets have been given to the Group to be managed by third parties and these assets are recorded off-balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

2.16 Leases - Group as the lessee

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

Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the lease term. The Group primarily uses an operating lease for renting the premises. A rental expense is recognised in the statement of comprehensive income as "Operating expenses".

2.17 Taxation and deferred income tax

Corporate income tax in Estonia

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. 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.

Corporate income tax in other countries

In accordance with the local income tax laws, the net profit of companies located in Latvia, Lithuania and Finland that has been adjusted for the permanent and temporary differences as stipulated by law is subject to corporate income tax.

Corporate income tax rates	2013	2012
Latvia	15%	15%
Lithuania	15%	15%
Finland	24.5%	26%

Deferred income tax is provided using the liability method. Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the consolidated balance sheet. The main temporary differences arise from depreciation and tax loss carry-forwards. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry-forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry-forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

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 Note 20 to the financial statements.

2.18 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. The Group has not used offsetting in financial year or previous year.

2.19 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 purpose of risk management is to identify, assess, manage and control all risks related to the activities of LHV Pank and its subsidiary. 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 Risk management unit. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of the Group in order to ensure the Group´s reliability, stability and profitability. In the Group, 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 group. 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 Group's capital management is to:

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

The amount of capital that the Group managed as of 31.12.2013 was 36 366 thousand euros (31.12.2012: 21 215 thousand euros). Capital is managed according to internal rules. Risk and Capital Committee (RCC) oversees capital management in the Group. 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 Group's further development and to comply at any given time with the prudential requirements established for credit institutions.

Capital adequacy

Capital base	**31.12.2013**	**31.12.2012**
Paid-in share capital	33 500	23 700
Accumulated deficit	-9 044	-7 307
Intangible assets (subtracted)	-533	-441
Net profit/loss for accounting period	2 366	-1 737
Non-controlling interests	77	0
Total Tier 1 capital	**26 366**	**14 215**
Subordinated loans	10 000	7 000
Total Tier 2 capital	**10 000**	**7 000**
Net own funds for capital adequacy calculation	**36 366**	**21 215**
Capital requirements		
Central government and central banks under standard method	0	232
Credit institutions and investment companies under standard method	339	686
Companies under standard method	10 702	5 674
Retail claims under standard method	5 597	2 814
Overdue claims under standard method	177	191
Other assets under standard method	145	211
Total capital requirements for covering the credit risk and counterparty credit risk	**16 960**	**9 808**
Capital requirement against foreign currency risk	22	84
Capital requirement against interest position risk	312	641
Capital requirement against equity portfolio risks	6	6
Capital requirement for operational risk under base method	975	690
Total capital requirements for adequacy calculation	**18 275**	**11 229**
Capital adequacy (%)	**19.90**	**18.89**
Tier 1 Capital Ratio (%)	**14.43**	**12.66**

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 Group's own funds

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PricewaterhouseCoopers, Tallinn

to risk-weighted assets shall be at least 10%. According to the new capital standards (CRR/CRD IV) the minimum capital adequacy ratio will be increased to 12,5% starting from 2014. 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 assessment process (ICAAP) is performed, the goal of which is to identify potential capital needs in addition to regulatory capital requirements.

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 regularly to supervision authorities. The Group consolidated basis and LHV Pank as standalone uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement. The Bank has complied with all capital requirements during the financial year and in previous year.

3.2 Credit risk

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

3.2.1 Distribution of credit risks

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

a) debt securities
b) loans and advances to credit institutions and investment companies (referred to as "banks" in the tables)
c) leverage loans (margin loans secured by debt or equity securities), incl. repo loans
d) corporate loans
e) consumer loans without collateral
f) credit cards
g) leasing
h) hire-purchase
i) mortgage loans

a) Debt securities

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

The Group´s debt securities at fair value through profit or loss (FVTPL), available-for-sale (AFS) and held-to-maturity (HTM) according to ratings given by Standard & Poor's or equivalent:

Rating	FVTPL	AFS	Total 31.12.2013	FVTPL	HTM	Total 31.12.2012
AAA	15 462	9 198	24 660	25 769	0	25 769
AA- to AA+	2 842	189	3 031	5 395	3 190	8 585
A- to A+	6 602	599	7 201	16 877	22 492	39 369
BBB- to BBB+	5 577	1 917	7 494	12 126	17 708	29 834
B- to BB+	313	0	313	2 592	654	3 246
Non-rated	0	0	0	5 206	793	5 999
Total (Note 9, 10 and 11)	**30 796**	**11 903**	**42 699**	**67 965**	**44 837**	**112 802**

No principal and accrued interest receivables arising from debt securities are overdue. During 2013 debt securities portfolio decreased from 112,8 mil EUR to 42,7 mil EUR mainly due to the fact that the Group reclassified its held to maturity portfolio to available-for-sale portfolio and sold most of it.

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

Rating	Credit institutions	Inv. companies	Total 31.12.2013	Credit institutions	Inv. companies	Total 31.12.2012
Central bank	133 839	0	133 839	77 965	0	77 965
AA- to AA+	1 140	0	1 140	441	0	441
A- to A+	11 881	1 359	13 240	9 073	0	9 073
BBB to BBB+	454	0	454	0	0	0
Non-rated	1 815	107	1 922	1 269	1 547	2 816
Total (Note 8)	**149 129**	**1 466**	**150 595**	**88 748**	**1 547**	**90 295**

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

c) Leverage loans

LHV Pank gives margin loans secured by debt or equity 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 risks arising from financial leverage are mitigated by constant monitoring of the market values of the financial instruments required as collateral. The Group 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 31.12.2013 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 (31.12.2012:18 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. Each customer is assigned to credit rating (1-13). 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 Group'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. 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 behaviour in Finland. In addition to the customer's previous payment behaviour and income, the credit scoring model also takes into account other statistical parameters, which have previously been collected by types of customer. Consumer loans are issued only to individuals and using cash flows as collateral.

As consumer loans are homogeneous loans, provisions for potential credit loss level is calculated based on historical performance of these homogeneous loans and applied to current portfolio at the balance sheet date. 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 framework is based on the classic method of calculating the probability of default (PD), loss given default (LGD) and exposure at default (EAD). As at 31.12.2013, the group-based impairment reserve makes up 9,4% of consumer loans and the related interest receivables (31.12.2012: 7,8%). 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.

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 credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a loan.

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework 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 2013, the group-based impairment reserve amounted to 3,6% of credit card loans and related receivables (31 December 2012: 2,4%).

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, which mainly consists of characteristics described for consumer loans. Similarly to other homogenous portfolios provisions are made based on the same framework as consumer loans. As of 31 Decembrer 2013, the group-based impairment reserve amounted to 1,0% of leasing portfolio (31.12.2012: 0%).

h) Hire-purchase

In 2013 subsidiary LHV Finance started to offer hire-purchase services for merchants. The creditworthiness of customers is assessed by using scoring models, which mainly consist of characteristics described for consumer loans. Similarly to other homogenous portfolios provisions are made based on the same framework as consumer loans. As of 31 Decembrer 2013, the group-based impairment reserve amounted to 1,4% of hire-purchase.

i) Mortgage loans

In 2013 the Group started to offer mortgage loans to customers. This line of business is relatively small and no provisions have been made for those loans.

3.2.2 Credit quality

Maximum credit risk exposure	31.12.2013	31.12.2012
Balances with banks and investment companies (Note 8)	150 595	90 295
Other financial assets at fair value (bonds) (Note 9,10)	42 699	44 837
Held-to-maturity financial investments (Note 11)	0	67 965
Loans and advances to customers (Note 12)	204 563	106 067
Other receivables from customers (Note 13)	719	254
Other assets (Note 14)	650	713
Total assets	**399 226**	**310 131**
Off-balance sheet obligations (Note 23)	39 185	16 131
Total maximum credit risk exposure	**438 411**	**326 262**

Loans and advances to customers and banks as at 31.12.2013	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total	Collective impairment	Individual impairment	Net
Loans to legal persons							
Loans to other subsidiaries of the parent company	24 075	0	0	**24 075**	0	0	**24 075**
Corporate loans	125 067	0	3 752	**128 819**	-632	-238	**127 949**
Overdraft	3 918	0	0	**3 918**	0	0	**3 918**
Leverage loans	4 218	0	0	**4 218**	0	0	**4 218**
Leasing	11 299	0	1 280	**12 579**	-102	-18	**12 459**
Mortgage loans	43	0	0	**43**	0	0	**43**
Credit card loans	47	0	0	**47**	-2	0	**45**
Loans to individuals							
Consumer loans	7 906	0	7 976	**15 882**	-496	-999	**14 387**
Hire-purchase	4 714	0	169	**4 883**	-56	-13	**4 814**
Leverage loans	5 721	0	18	**5 739**	0	-18	**5 721**
Leasing	2 566	0	234	**2 799**	-23	-4	**2 772**
Mortgage loans	1 948	0	0	**1 948**	0	0	**1 948**
Credit card loans	2 083	0	168	**2 251**	-53	-28	**2 170**
Overdraft	29	0	0	**29**	0	0	**29**
Other loans to individuals	0	15	0	**15**	0	0	**15**
Total loans and advances to customers	**193 633**	**15**	**13 597**	**207 245**	**-1 363**	**-1 319**	**204 563**
Loans and advances to banks	150 595	0	0	**150 595**	0	0	**150 595**
Total (Notes 8 and 12)	**344 228**	**15**	**13 597**	**357 840**	**-1 363**	**-1 319**	**355 158**

Loans are individually impaired from the first day of payment delay.

As part of risk analysis the Group is performing regularly stress tests and sensitivity analysis regarding credit risk and its components (such as probability of default (PD), loss given default (LGD)). In credit impairment assessment the Group is basing on potential loss calculation. The Group has performed stress test in cases when PD and LGD estimations will both increase 10 percent (for example, from 1,0% to 1,1%). The impact of the described stress test to impairments is aggregated in the table below.

Impact to impairment as at 31.12.2013 (in case PD and LGD levels will increase by 10%)	Balance as at 31.12.13	Impairment with increased PDs and LGDs	Impact to impairment booked
Loans to legal persons			
Corporate loans	128 819	-933	-63
Leasing	12 579	-133	-13
Loans to individuals			
Consumer loans	15 882	-1 734	-239
Hire-purchase	4 883	-76	-7
Leasing	2 799	-29	-2
Credit card loans	2 251	-97	-14
Total	**167 213**	**-3 061**	**-337**

Loans and advances to customers and banks as at 31.12.2012	Neither past due nor impaired	Past due, but not impaired	Indi-vidually impaired	Total	Col-lective iImpair-ment	Indi-vidual impair-ment	Net
Loans to legal person							
Leverage loans	4 658	0	0	**4 658**	0	0	**4 658**
Corporate loans	77 135	1 330	132	**78 597**	0	-26	**78 571**
Leasing	1 906	0	0	**1 906**	0	0	**1 906**
Loans to individuals							
Leverage loans	6 486	0	18	**6 504**	0	-18	**6 486**
Consumer loans	5 693	0	7 451	**13 144**	-63	-966	**12 115**
Leasing and mortgage loans	936	0	0	**936**	0	0	**936**
Credit card loans	0	0	96	**1 428**	-31	-3	**1 394**
Total loans and advances to customers	**91 121**	**1 330**	**7 697**	**107 174**	**-94**	**-1 013**	**106 067**
Loans and advances to banks	90 295	0	0	**90 295**	0	0	**90 295**
Total (Notes 8 and 12)	**181 416**	**1 330**	**7 697**	**197 469**	**-94**	**-1 013**	**196 362**

The rating scale used for evaluating the probability of default of corporate loans 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 Group'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 -13 are partly based on the evaluation of rating agencies, although this category includes mainly Estonian enterprises that do not have an international rating.

Distribution of internal ratings of corporate loans:

- 1 – minimum credit risk. Rating is attributed only on the basis of ratings issued by rating agencies; average rating of rating agencies must be equivalent to at least AAA (Moody's Aaa).
- 2 – minimum credit risk. Rating is attributed only on the basis of ratings issued by rating agencies, average rating must be equivalent to at least AA+ (Moody's Aa1).
- 3 – low credit risk. 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 AA- (Moody's Aa3).
- 4 – relatively low credit risk. 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 A- (Moody's A3).
- 5 – medium credit risk. 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 Baa1).

- 6 – medium credit risk. 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).
- 7 – medium credit risk. 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).
- 8 – higher-than-medium credit risk. 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 BB (Moody's Ba2).
- 9 – high credit risk. 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 BB- (Moody's Ba3).
- 10 – speculative rating. 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 B+ (Moody's B1).
- 11 – speculative rating. 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 B- (Moody's B3).
- 12 – non-satisfactory rating. Rating is attributed on the basis of an evaluation of rating agencies or LHV. In the opinion of a LHV credit analyst, the financial situation of the legal entity is sufficiently weak and the entity probably becomes insolvent and falls into rating class 13. Average rating of rating agencies must be equivalent to at least C (Moody's Caa).
- 13 – insolvent – the entity is insolvent. The entity is 90 days past due or is subject in a restructuring or bankruptcy procedure. Average rating of rating agencies must be equivalent to at least D (Moody's C).

Distribution of corporate loans by internal ratings as of 31.12.2013	**Neither past due nor impaired**	**Individually impaired**	**Total**
4 relatively low credit risk	1 139	0	1 139
5 medium credit risk	350	0	350
6 medium credit risk	8 286	0	8 286
7 medium credit risk	34 284	215	34 499
8 higher-than-medium credit risk	40 054	0	40 054
9 high credit risk	20 463	121	20 584
10 speculative rating	15 205	0	15 205
11 speculative rating	5 286	0	5 286
12 non-satisfactory rating	0	3 215	3 215
13 insolvent	0	201	201
Total	**125 067**	**3 752**	**128 819**

Distribution of corporate loans by internal ratings as of 31.12.2012	**Neither past due nor impaired**	**Past due but not impaired**	**Individually 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	952	880	0	1 832
13 insolvent	0	0	132	132
Total	**77 135**	**1 330**	**132**	**78 597**

In the following table there are presented unused portions of corporate loans and guarantee limits. In addition to that as at 31.12.2013 there are also commitments to grant mortage loans in total amount of 351 thousand euros. No impairment 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	31.12.2013	31.12.2012
4 relatively low credit risk	2 129	1 250
5 medium credit risk	2 950	67
6 medium credit risk	9 581	318
7 medium credit risk	14 205	8 643
8 higher-than-medium credit risk	5 486	2 667
9 high credit risk	3 887	1 372
10 speculative rating	10	568
12 non-satisfactory rating	580	1 246
Total (Note 23)	**38 834**	**16 131**

Distribution of internal ratings for other loan products:

- Excellent – margin loans secured by debt or equity securities and loans with very low business risk.
- Very good – loans with lower business risks and no past due payments.
- Good – loans with lower business risks and past due payments up to 30 days.
- Satisfactory – loans with average business risk and up to 60 days past due.
- Weak or doubtful – loans carrying higher business risk, past due more than 60 days and portfolio in proceedings by the bailiff.

Loans and receivables are divided into 7 groups in the tables below:

1. Leverage loans
2. Credit cards
3. Leasing
4. Consumer loans
5. Hire-purchase
6. Overdraft
7. Mortgage loans

As of 31.12.2013	1	2	3	4	5	6	7	Total
Neither past due nor impaired								
Excellent	9 939	0	0	0	0	0	0	**9 939**
Good and very good	0	2 130	13 864	7 906	4 714	3 947	1 991	**34 552**
Individually impaired								
Good	0	81	1 360	3 486	131	0	0	**5 058**
Satisfactory	0	18	104	1 579	1	0	0	**1 702**
Weak or doubtful	18	69	50	2 911	37	0	0	**3 085**
Total	**9 957**	**2 298**	**15 378**	**15 882**	**4 883**	**3 947**	**1 991**	**54 336**

Other loans to individuals in amount of 15 thousand euros were past due but not impaired as of 31.12.2013.

As of 31.12.2012	1	2	3	4	5	6	7	Total
Neither past due nor impaired								
Excellent	11 144	0	0	0	0	0	0	**11 144**
Good and very good	0	1 428	2 843	5 693	0	0	0	**9 964**
Individually impaired								
Good	0	0	0	3 060	0	0	0	**3 060**
Satisfactory	0	0	0	1 353	0	0	0	**1 353**
Weak or doubtful	18	0	0	3 038	0	0	0	**3 056**
Total	**11 162**	**1 428**	**2 843**	**13 144**	**0**	**0**	**0**	**28 577**

In addition to the loans granted, loan contracts have been concluded and signed whereby the unused loan commitment was EUR 32 629 thousand as at 31.12.2013 (as at 31.12.2012, EUR 13 578 thousand), see also Note 23.

Structure of collateral of loans	2013	2012
Listed securities	5%	10%
Unlisted equity securities	7%	7%
Mortgages, real estate	40%	36%
Guarantee of KredEx and Rural Development Foundation	6%	10%
Pledges of rights of claim	15%	7%
Deposits	2%	6%
Leased assets	7%	2%
Others	9%	7%
Consumer loans and credit card loans without a collateral	9%	14%

The Group 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. The Group 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 2013, the Group provisioned corporate loans in the total amount of EUR 858 thousand (2012: 26 thousand).

	Over-collateralized loans		Under-collateralized loans	
As at 31.12.2013	Balance sheet value	Fair value of collateral	Balance sheet value	Fair value of collateral
Corporate loans and corporate credit lines	99 887	212 692	34 169	16 636

In relation to under-collateralized corporate loans it should be taken into consideration, that the Group has assessed the market value of certain collaterals very conservatively (personal sureties, commercial pledges). Under-collateralized are mainly loans with higher risk, for which the Group carries out montly monitoring in credit committee, in order to hedge potential credit losses.

The Group does not monitor the value of collateral regularly and individually for leasing and hire-purchases, but instead is conservative in granting loans and monitors customers in arrears on regular basis.

Collaterals for leverage loans are monitored on daily basis and in case of collateral value falling immediate measures are taken to avoid credit losses. As of 31 December 2013, all leveraged loans and repurchase loans are over-collateralized, except one leveraged loan in the amount of EUR 18 thousand (2012: 18 thousand), which has been provisioned.

Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour.

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. Loans and receivables are divided into 7 groups in the following tables:

1. Corporate loans
2. Consumer loans
3. Leverage loans
4. Credit cards
5. Leasing
6. Hire-purchase
7. Other loans to individuals

Structure of loans impaired according to past due time:

As at 31.12.2013	1	2	3	4	5	6	7	Total	Individual impairment	Net
No past due payments	2 344	0	0	0	0	0	0	**2 344**	-231	2 113
Past due receivables										
1-30 days	639	3 486	0	81	1 360	131	15	**5 712**	-238	5 474
31-60 days	0	1 579	0	18	104	1	0	**1 702**	-100	1 602
61-90 days	769	517	0	8	13	1	0	**1 308**	-37	1 271
91-180 days	0	1 156	0	61	37	7	0	**1 261**	-333	928
181-360 days	0	1 083	0	0	0	29	0	**1 112**	-284	828
more than 360 days	0	155	18	0	0	0	0	**173**	-96	77
Total	**3 752**	**7 976**	**18**	**168**	**1 514**	**169**	**15**	**13 612**	**-1 319**	**12 293**

As at 31.12.2012	1	2	3	4	Total	Individual impairment	Net
1-30 days	152	3 060	0	53	**3 265**	-35	**3 230**
31-60 days	488	1 353	0	11	**1 852**	-141	**1 711**
61-90 days	0	497	0	7	**504**	-81	**423**
91-180 days	690	952	0	25	**1 667**	-240	**1 427**
181-360 days	132	1 290	0	0	**1 422**	-350	**1 072**
more than 360 days	0	299	18	0	**317**	-166	**151**
Total	**1 462**	**7 451**	**18**	**96**	**9 027**	**-1 013**	**8 014**

Credit quality of other receivables	31.12.2013	31.12.2012
Receivables not impaired and not past due	686	183
Receivables past due (not impaired)	33	71
incl. receivables from individuals	16	39
incl. receivables from legal persons	17	32
Total (Note 13)	**719**	**254**

3.3 Market risk

Market risk arises from the Group'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.

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 Treasury of LHV Pank is responsible for daily monitoring of open foreign currency positions. LHV Panks' foreign currency risk management is based on risk policies, limits and internal procedures. The internal limits for open foreign currency positions are proposed by Risk Control unit and Treasury and the limits are set internally by Risk and Capital Committee. The limits set by the Committee are maximum nominal limits in euro equivalent with a respect to the Bank's net own funds. Limits imposed on individual currencies are in line with the boundaries proposed by the Bank of Estonia. If the open currency position exceeds the limits set by the Committee, measures are immediately implemented to close or reduce such positions (hedging the risk with relevant instruments, such as foreign currency forwards or futures).

Lithuanian litas positions are internally subject to less limitations compared to other currencies as the litas is pegged to the euro using a fixed exchange rate, thus the fluctuations of the litas are not significant. As at 31.12.2013 the LVL position was insignificant due to Latvia's euro adoption as of 1'st of January 2014.

Information regarding assets and liabilities bearing currency risk is presented in the tables on the following pages.

Open currency exposures

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

31.12.2013	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk							
Balances with other banks and inv. companies	139 759	646	410	313	7 784	1 683	**150 595**
Securities	42 394	4	0	1	319	1	**42 719**
Loans granted	203 422	90	295	15	708	33	**204 563**
Receivables from customers	718	0	0	0	1	0	**719**
Other assets	93	0	0	0	558	0	**651**
Total assets bearing currency risk *	**386 386**	**740**	**705**	**329**	**9 370**	**1 717**	**399 247**
Liabilities bearing currency risk							
Deposits from customers and loans received	357 054	685	841	332	9 333	1 617	**369 862**
Interest rate swaps	433	0	0	0	0	0	**433**
Accrued expenses and other liabilities	3 159	32	9	10	73	34	**3 317**
Total liabilities bearing currency risk *	**360 646**	**717**	**850**	**342**	**9 406**	**1 651**	**373 612**
Open foreign currency position	**25 740**	**23**	**-145**	**-13**	**-36**	**66**	**25 635**

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							
Deposits from customers and loans received	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**

* 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. Sensitivity analysis has not been performed for LTL and LVL as the rates are fixed against EUR, while LVL rate had 1% fluctuation corridor, but seized to exist as of 01.01.2014 due to euro adoption in Latvia.

Impact on comprehensive income	Change	2013	Change	2012
USD exchange rate	+/-10%	+/-2	+/-10%	+/-2
SEK exchange rate	+/-10%	+/-2	+/-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 9,10). At the Group, 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 net result from the risk exposures against reasonable possible change (in thousands euros):

Impact on comprehensive income	Change	2013	Change	2012
Equity securities	+/-10%	+/-2	+/-15%	+/-3
Debt securities	+/-0.7%	+/-287	+/-1.9%	+/-830

The Group does not hold significant amounts of equity securities in its position, due to which the sensitivity to change in the market value of these positions is marginal. The Group's debt securities 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 debt security portfolio should remain at around 0.7% (2012: 1.9%).

3.3.3 Interest rate risk

Interest rate risk reflects the mismatch in the balance sheet items and the off-balance sheet items when interest rate repricing periods, volumes or the underlying interest rate of assets, liabilities and derivatives do not correspond exactly. LHV Pank's interest rate risk management is based on risk policies, limits and internal procedures resulting in identification of all significant sources of interest rate risk and balanced risk taking. Interest rate risk is measured through various scenario analyses by calculating several net interest income scenarios and comparing the difference between these scenarios. The basic measures of interest rate risk uses two scenarios – an increase and a decrease of interest rates to measure the effect on the banks net interest income for a 12 month period. Internal limits for interest rate risk management are set by LHV Pank's Risk and Capital Committee and the operational risk management is the Treasury's responsibility.

The goal of monitoring, measuring and managing interest rate risk is to evaluate the profitability of the Group'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 Group'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).

The balance sheet and margins on assets and deposits are assumed to be constant over time.

The interest rates of the deposits ranged from 0.7% up to 1% in the first half of 2013 (up to 3.2% in 2012). A slight increase in interest rates in the second half of 2013 increased interest rates of the deposits back up to 1%. The interest rates for leverage loans granted are changed at most once a month according to fluctuations in market interest rates. In 2013, the interest rate on loans received for specific purposes was 1.5% (2012: the same) and the effective interest rate of subordinated loans entered into in 2012 was 7.27% (2012: 7.38%). The information about contractual interest rates is provided in Note 19.

As at 31.12.2013, an increase of 1% in interest rates would affect the Group's annual net interest income and profit by EUR +1 841 thousand (2012: EUR +158 thousand). In the same time, a decrease of 1% in interest rates would affect the Group's annual net interest income (profit) by EUR -860 thousand (2012: +379 thousand). A 1% increase in market interest rates would raise the Group's economical value, i.e. equity, by EUR 3 117 thousand (2012: EUR 605 thousand). A 1% decrease in market interest rates would decrease the Group's economical value (equity) by EUR -644 thousand (2012: EUR +1179 thousand). In 2013, the effect on the Group's economic value is positive due to the fact that the Group has invested in current assets and because of the nature of demand deposits, hence the average duration of interest-earning assets is shorter 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.

31.12.2013	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest-earning assets					
Balances with other banks and inv. companies	150 595	0	0	0	**150 595**
Financial investments and securities	30 169	7 084	3 854	0	**41 107**
Loans granted	68 529	75 574	58 462	8 148	**210 713**
Total	**249 293**	**85 658**	**62 316**	**8 148**	**402 415**
Interest-bearing liabilities					
Deposits from customers and loans received	96 536	144 946	116 574	1 214	**359 270**
Subordinated loans *	0	0	10 000	0	**10 000**
Total	**96 536**	**144 946**	**126 574**	**1 214**	**369 270**
Interest pricing gap	**152 757**	**-62 288**	**-64 258**	**6 934**	**33 145**

* The contractual term of subordinated loans received in 2012 and 2013 is 8 years. The interest rate will be changed annually after three years.

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					
Deposits from customers and loans received	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**

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. LHV Panks' liquidity management and stragegy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, LHV Panks' liquidity management reflects a conservative approach towards liquidity risk. The liquidity risk management includes stress testing and business continuity plan for liquidity management. Stress testing framework includes a survival period metrics, which represents a combined liquidity risk scenario, including both idiosyncratic and market-wide stress. Internal metrics are complemented by the Basel III metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) which LHV Pank is fully compliant with as of 31.12.2013. 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, also the concentration of bank's liabilities by maturities is monitored. To enable covering unexpected monetary outflows, LHV Pank holds a liquidity buffer. The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Treasury, which can be readily sold or used as a collateral in funding operations with the central bank. LHV Pank has a sufficient supply of liquid resources to enable issuing standby loans. As at 31.12.2013 and 31.12.2012, the Group does not have any debts past due.

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

31.12.2013	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Liabilities by contractual maturity dates					
Deposits from customers and loans received	261 041	92 717	5 687	1 268	**360 713**
Subordinated loans	0	700	3 199	11 787	**15 685**
Other liabilities	3 127	0	0	0	**3 127**
Unused loan commitments	32 629	0	0	0	**32 629**
Financial guarantees by contractual amounts	6 556	0	0	0	**6 556**
Interest rate swaps	24	177	236	0	**436**
Total liabilities	**303 377**	**93 595**	**9 121**	**13 055**	**419 207**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with banks and inv. companies	150 595	0	0	0	**150 595**
Debt securities in market value	12 601	9 313	21 479	0	**43 393**
Loans granted	22 804	39 834	155 216	19 356	**237 211**
Receivables from customers	719	0	0	0	**719**
Total assets held for managing liquidity risk	**186 720**	**49 147**	**176 695**	**19 356**	**431 918**
Maturity gap from assets and liabilities	**-116 657**	**-44 447**	**167 574**	**6 302**	**12 711**

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31.12.2012	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates					
Deposits from customers and loans received	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	13 578	0	0	0	**13 578**
Financial guarantees by contractual amounts	2 568	0	0	0	**2 568**
Interest rate swaps	19	206	431	0	**656**
Total liabilities	**195 579**	**101 796**	**13 128**	**7 977**	**320 400**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	90 295	0	0	0	**90 295**
Debt securities in market value	12 995	20 482	11 824	197	**45 498**
Held-to-maturity debt securities	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	**-72 703**	**-39 288**	**106 445**	**11 493**	**5 443**

3.5 Risk concentration

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

31.12.2013	Estonia	Latvia	Lithuania	Finland	Nether-lands	Germany	EU	USA	Other	Total
Asset distribution by geography										
Balances with banks and inv. companies	143 245	518	1 237	1 150	452	0	2 526	1 359	108	**150 595**
Financial investments and securities	612	0	349	201	282	6 020	29 291	814	5 149	**42 719**
Loans granted	159 116	580	24 692	16 996	15	0	3 163	0	1	**204 563**
Receivables from customers	711	2	6	0	0	0	0	0	0	**719**
Other assets	289	5	3	0	0	0	0	642	0	**939**
Tangible and intangible assets	765	0	0	136	0	0	0	0	48	**949**
Total assets	**304 738**	**1 104**	**26 287**	**18 483**	**750**	**6 020**	**34 980**	**2 816**	**5 305**	**400 484**
Distribution of liabilities by geography										
Deposits from customers and loans received	353 442	860	1 850	569	2	42	2 359	129	585	**359 837**
Subordinated loans	10 025	0	0	0	0	0	0	0	0	**10 025**
Other liabilities	3 581	9	43	105	0	0	11	2	0	**3 750**
Total liabilities	**367 048**	**869**	**1 893**	**674**	**2**	**42**	**2 369**	**131**	**585**	**373 612**

Unused loan commitments to Estonian residents amount to EUR 32 629 thousand (2012: EUR 13 578 thousand).

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										
Deposits from customers and loans received	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**

As at 31.12.2013, the loans issued to 4 customers and 2 correspondent banks (2012: total 11) 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 79% of NOF (2012: 113%). The Group has invested in the bonds of 2 issuers (2012: 15) with a large risk exposure, totalling 51% of NOF (2012: 273%). In 2013 the Group granted loans to another subsidiary of the parent company totalling 24 075 thousand euros, which is 66% of the Group NOF.

Distribution of loans granted by industry (gross):

	31.12.2013	%	31.12.2012	%
Individuals	33 546	16.19%	22 012	20.54%
Real estate	50 077	24.16%	19 479	18.17%
Financial services	43 903	21.18%	19 244	17.96%
Manufacturing	20 875	10.07%	11 163	10.42%
Professional, scientific and technical activities	10 127	4.89%	7 482	6.98%
Wholesale and retail	8 975	4.33%	2 385	2.23%
Other servicing activities	6 052	2.92%	4 491	4.19%
Art and entertainment	6 037	2.91%	786	0.73%
Transport and logistics	5 713	2.76%	2 048	1.91%
Agriculture	5 579	2.69%	5 612	5.24%
Administrative activities	4 197	2.03%	5 354	5.00%
Construction	3 170	1.53%	0	0.00%
Education	2 238	1.08%	2 410	2.25%
Information and communication	2 216	1.07%	710	0.66%
Public administration	0	0.00%	540	0.50%
Other areas at activities	4 540	2.19%	3 458	3.23%
Total	**207 245**	**100%**	**107 174**	**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 estimating fair value, the future cash flows are discounted on the basis of the market interest yield curve.

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	31.12.2013	Level 1	Level 2	Level 3	31.12.2012
Financial assets at fair value through profit or loss								
equity securities	20	0	0	**20**	16	0	0	**16**
debt securities available-for-sale (note 9)	11 903	0	0	**11 903**	0	0	0	**0**
debt securities at fair value through profit or loss (note 10)	30 796	0	0	**30 796**	44 837	0	0	**44 837**
Total financial assets	**42 719**	**0**	**0**	**42 719**	**44 853**	**0**	**0**	**44 853**
Financial liabilities at fair value through profit or loss								
interest rate swaps	0	**433**	0	**433**	**0**	**656**	0	**656**
Total financial liabilities	**0**	**433**	0	**433**	**0**	**656**	**0**	**656**

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

Interest rate swaps are instruments where active markets supply observable inputs to the valuation model which is used for establishing the fair value. The fair value for such OTC derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.

AS at 31.12.2013 the fair value of corporate loans is EUR 522 thousand (0.4%) higher than their carrying amount. The loans have been issued at market conditions in the segment that the Group operates in and therefore their fair value is not much different from their carrying amount as at 31.12.2013 and 31.12.2012. The fair value level of corporate loans is 3 as significant judgmental assumptions are used for the valuation process.

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 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 31.12.2012: same). The fair value level of leveraged and consumer loans is 3 as significant judgmental assumptions are used for the valuation process.

As at 31.12.2012, the fair value of held-to-maturity financial investments was EUR 2 201 thousand higher than their carrying amount, taking into consideration the quoted market price for respective instruments. Therefore, as of 31.12.2012, held-to-maturity financial investments were valued as level 1. In spring 2013 management board decided to reclassify held-to-maturity portfolio to available-for-sale portfolio, recognized in fair value.

Trade receivables (other than the receivables related to loans and advances to customers), 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. The fair value level of those receivables, accrued expenses and other liabilities is 3.

Customer deposits with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount. The fair value level of customer deposits is 3 as significant judgmental assumptions are used for the valuation process.

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

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 Group's performance and adding value. Internal audit helps achieving the goals of the Group, 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, 9, 10, 11 and 12).

According to IAS 39, the Group classified a portion of its bond portfolio as a held-to-maturity portfolio. At the start of 2013, the bank's management estimated that it does not intend to hold the investments until maturity and the bond portfolio that was held-to-maturity was reclassified as available-for-sale portfolio (see also Note 9). As a result of the reclassification of the portfolio, the Group's equity increased by EUR 2.2 million since the market value of the portfolio was higher than the amortised cost recognised in the balance sheet. The difference between carrying amount and fair value of the portfolio was at first recognized in other comprehensive income and after selling most of the portfolio reclassified to statement of profit or loss. According to IAS 39 the Group can not classify debt securities to held-to-maturity for the next two years because of the breach of held-to-maturity criteria set in IAS 39.

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	2013	2012
Balances with credit institutions and investment companies	21	110
Balances with central bank	45	96
Debt securities	1 066	2 993
incl. debt securities held-to-maturity	*0*	*1 763*
incl. debt securities available-for-sale	*601*	*0*
incl. debt securities at fair value through profit or loss	*465*	*1 230*
Leasing	352	28
Leverage loans and lending of securities (Note 12)	833	968
Consumer loans (Note 12)	3 404	2 282
Loans to companies	6 622	4 461
Other loans (Note 12)	954	0
incl. loans to related parties (Note 24)	*407*	*0*
Total	**13 297**	**10 938**
Interest expense		
Deposits from customers and loans received (Note 16)	-2 802	-4 729
incl. loans from related parties (Note 24)	*-424*	*-188*
Total	**-2 802**	**-4 729**
Net interest income	**10 495**	**6 209**

Interest income of loans by customer location (interests from bank balances and debt securities not incluced):	**2013**	**2012**
Estonia	8 229	5 285
Finland	3 404	2 282
Latvia	42	51
Lithuania	490	121
Total	**12 165**	**7 739**

NOTE 6 Net fee and commission income

Fee and commission income	2013	2012
Financial advisory services	0	5
Security brokerage and commissions	2 072	2 145
incl. related parties	8	9
Asset management and similar fees	619	549
Currency convert revenues	350	230
Fees from cards and payments	399	166
Fees related to collection of debts	341	282
Other fee and commission income	228	103
Total	**4 009**	**3 480**
Fee and commission expense		
Security brokerage and commissions paid	-504	-528
Collection costs	-524	-361
Total	**-1 028**	**-889**
Net fee and commission income	**2 981**	**2 591**

Fee and commission income by customer location:	2013	2012
Estonia	3 294	2 740
Finland	341	283
Latvia	116	143
Lithuania	258	314
Total	**4 009**	**3 480**

NOTE 7 Operating expenses

Staff costs	Note	2013	2012
Wages, salaries and bonuses		3 897	3 300
Social security and other taxes		1 242	1 090
Total staff costs		**5 139**	**4 390**
IT expenses		748	751
Information services and bank services		430	509
Marketing expenses		1 126	1 103
Office expenses		347	347
Transportation and communication costs		119	138
Training and travelling expenses of employees		167	164
Other outsourced services		760	483
Other administrative expenses		830	729
Depreciation	15	537	526
Operating lease payments	21	733	718
Other operating expenses		59	64
Total operating expenses		**10 995**	**9 922**

The average number of employees for the financial year was 169 (2012: 148).

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

	31.12.2013	31.12.2012
Demand deposits *	16 756	12 328
Statutory reserve capital at central bank	3 397	2 551
Other receivables from central bank *	130 442	75 414
Accrued interest	0	2
Total	**150 595**	**90 295**
* cash and cash equivalents in the statement of cash flows	147 198	87 742

Distribution of receivables by countries is presented in Note 3.5. Balances with investment companies amounting to EUR 1 466 thousand (2012: EUR 1 547 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 31.12.2013 was 1% (2012: 1%) of all financial resources taken in (Deposits from customers and loans received). 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 Available-for-sale financial assets

The Group has available-for-sale bond portfolio in amount of 11 903 thousand euros as of 31.12.2013 which resulted from reclassification of held-to-maturity portfolio. In result of reclassification unrealized gain of 2 233 thousand euros was recognized in other comprehensive income. After selling most of the portfolio, financial gain of EUR 2 278 thousand EUR was reclassified from other comprehensive income to statement of profit or loss. The balance of other comprehensive loss in equity is 27 thousand euros, which includes also revaluation of the remaining of portfolio during the year.

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

Securities held for trading:	**31.12.2013**	**31.12.2012**
Equity securities	20	16
Debt securities	30 796	44 837
Total financial assets	**30 816**	**44 853**
Interest rate swaps	433	656
Total financial liabilities	**433**	**656**

Bid price is the fair value for quoted financial investments and securities.
In 2013, financial loss of EUR 43 thousand (2012: gain of EUR 734 thousand) resulted from revaluation of bonds and EUR 7 thousand (2012: EUR 343 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 Group set up a held-to-maturity bonds portfolio, which was carried at amortised cost in the balance sheet. The portfolio volume as at 31.12.2012 totalled EUR 67 965 thousand. In 2013 bank reclassified the portfolio as available-for-sale portfolio and sold most of it, see also note 9.

NOTE 12 Loans granted

	31.12.2013	**31.12.2012**
Loans to legal persons	**173 699**	**85 162**
incl. loans to other subsidiaries of the parent company	24 075	0
incl. corporate loans	128 819	78 597
incl. overdraft	3 918	0
incl. leveraged loans	4 218	4 658
incl. leasing	12 579	1 862
incl. credit card loans	47	0
incl. mortgage loans	43	44
Loans to individuals	**33 546**	**22 012**
incl. consumer loans	15 882	13 144
incl. hire-purchase	4 883	0
incl. leveraged loans	5 739	6 504
incl. leasing	2 799	815
incl. credit card loans	2 251	1 428
incl. mortgage loans	1 948	121
incl. overdraft	29	0
Incl. other loans	15	0
Total	**207 245**	**107 174**
Impairment provisions	-2 682	- 1 107
Total	**204 563**	**106 067**

As at 31.12.2013 loans have been issued to related parties in the amount of EUR 24 423 thousand and the loans have been issued on market terms (as at 31.12.2012 EUR 49 thousand). See also Note 24.

In 2013, the average effective interest rate of new consumer loans issued to individuals was 28-40% (2012: 20-28%). The average effective interest rate for hire-purchase was around 24%, credit cards 13% and leasing 4%. 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.

Deferred income in 2012 included service fees of loans in the amount of EUR 590 thousand, which are released to interest income over the loan term and the current portion of which totalled EUR 251 thousand and the non-current portion totalled EUR 339 thousand. In 2013 deferred income is included in loan portfolio on asset side of the balance sheet.

Changes in impairments in 2013	**Corporate loans**	**Consumer loans**	**Credit cards**	**Hire-purchase**	**Leasing**	**Leverage loans**	**Total**
Balance as at January 1	-26	-1 029	-34	0	0	-18	**-1 107**
Impairment provisions set up during the year	-858	-1 496	-49	-69	-147	0	**-2 619**
Written off during the year	14	1 030		0	0	0	**1 044**
Balance as at December 31 (Note 13)	**-870**	**-1 495**	**-83**	**-69**	**-147**	**-18**	**-2 682**

Changes in impairments in 2012	**Corporate loans**	**Consumer loans**	**Credit cards**	**Hire-purchase**	**Leasing**	**Leverage loans**	**Total**
Balance as at January 1	0	-3 042	0	0	0	0	**-3 042**
Impairment provisions set up during the year	-26	-996	-34	0	0	-18	**-1 074**
Written off during the year	0	3 009	0	0	0	0	**3 009**
Balance as at December 31 (Note 13)	-26	-1 029	-34	0	0	-18	**-1 107**

Net and gross investments on Leasings

	31.12.2013	**31.12.2012**
Net investment according to remaining maturity		
up to 1 year	4 505	512
1-5 years	10 801	2 064
over 5 years	72	18
Total net investment	**15 378**	**2 594**
Unearned future interest income according to remaining maturity		
up to 1 year	323	79
1-5 years	786	156
over 5 years	120	1
Total unearned future interest income	**1 229**	**236**
Gross investment according to remaining maturity		
up to 1 year	4 828	591
1-5 years	11 587	2 220
over 5 years	192	19
Total gross investment	**16 607**	**2 830**

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

	31.12.2013	31.12.2012
Securities brokerage fees from intermediaries	0	29
Asset management fees from customers	45	46
Other fees for providing services to customers	661	79
incl. related parties (Note 24)	*17*	*19*
Payments in transit	1	65
Other receivables related to collection of receivables	12	35
Total	**719**	**254**

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.

NOTE 14 Other assets

	31.12.2013	31.12.2012
Guarantee deposits of Baltic stock exchanges	8	9
Guarantee deposit of MasterCard	642	704
Prepayments to Financial Supervision Authority	144	85
Other prepayments *	145	148
Total	**939**	**946**

* 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 31.12.2011			
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**
Changes occurred in 2013:			
Purchase of non-current assets	64	350	414
Depreciation/amortisation charge	-279	-258	-537
Balance as at 31.12.2013			
Cost	1 752	1 095	2 847
Accumulated depreciation and amortisation	-1 336	-562	-1 898
Carrying amount	**416**	**533**	**949**

Tangible assets include computer technology and office equipment, furniture, capitalized costs of office renovation. Intangible assets include licences and development costs. In 2013 and 2012, there was no indication of impairment of tangible and intangible assets.

NOTE 16 Deposits from customers and loans received

	Individuals	Legal entities	Public sector	31.12.2013 total	Individuals	Legal entities	Public sector	31.12.2012 total
Demand deposits	49 187	109 176	5 790	**164 153**	34 951	41 628	220	**76 799**
Term deposits	80 857	86 505	24 226	**191 588**	106 493	87 112	10 112	**203 717**
Loans received	0	107	3 422	**3 529**	0	0	4 141	**4 141**
Accrued interest liability	322	202	43	**567**	1 075	401	30	**1 506**
Total	**130 366**	**195 990**	**33 481**	**359 837**	**142 519**	**129 141**	**14 503**	**286 163**
incl. related parties (Note 24)	*110*	*5 192*	*0*	*5 302*	*81*	*55*	*0*	*136*

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

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

NOTE 17 Accrued expenses and other liabilities

	31.12.2013	31.12.2012
Financial liabilities		
Trade payables	*1 343*	*500*
Other short-term liabilities	*679*	*483*
Payments in transit	*158*	*264*
Financial guarantee contracts issued	*191*	*89*
Subtotal	**2 371**	**1 336**
Non-financial liabilities		
Tax liabilities	377	240
Payables to employees	567	433
Subtotal	**944**	673
Total	**3 317**	**2 009**

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

As at 31.12.2012 in the balance sheet, a provision has been recognised in the amount of EUR 13 thousand, the cost of which was included within operating expenses. In 2013 the provision was reversed due to expiring of the possible claim.

NOTE 19 Subordinated loans

As at 31.12.2013, subordinated loans include bonds issued in the total amount of EUR 10 000 thousand (31.12.2012: EUR 7 000 thousand). The parent LHV Group purchased these securities, having issued subordinated bonds itself and partially 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 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.

On 8 March 2013, LHV Pank redeemed bonds which were subscribed by its parent LHV Group in 2010 in the total amount of EUR 3 million.

During the 2013 subordinated bonds were issued in two times – in June and in December, both in amount of EUR 3 000 thousand. The interest rate for both is 7% during the first three-year period and 7% + 3 months EURIBOR onwards. The due date of the bonds is 21 June 2021 and 20 December 2021 respectively.

Interest expenses on subordinated bonds in the amount of EUR 422 thousand (2012: EUR 184 thousand) are included within interest expenses in the income statement. As of 31 December 2013, the accrued interest liability of subordinated bonds was EUR 25 thousand (31 December 2012: EUR 365 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 Group is a company registered in Estonia, AS LHV Group. Rain Lõhmus who owns 34.5% of the voting rights and Andres Viisemann who owns 10.3% of the voting rights in AS LHV Group have significant influence over the company.

	31.12.2013	**31.12.2012**
Share capital *(in EUR thousand)*	33 500	23 700
Number of shares (pcs)	33 500 000	23 700 000
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. The share capital of AS LHV Pank was in 2013 increased in three times – in March, in June and in December. The Bank's sole shareholder LHV Group made to share capital monetary contributions of 3 million, 1.8 million and 5 million euros respectively. The Bank's share capital increased to EUR 33.5 million by the year-end 2013.
As at 31.12.2013, the accumulated deficit of the Group totalled EUR 6 678 thousand (31.12.2012: accumulated deficit EUR 9 044 thousand). Thus, it is not possible to pay dividends to the shareholders.

NOTE 21 Operating lease

The Group leases office premises under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The future minimum lease payments under unilaterally non-cancellable lease payable in the next period amounts to EUR 1 190 thousand (2012: EUR 1 618 thousand), the current portion of which amounts to EUR 558 thousand (2012: EUR 758 thousand) and the non-current portion amounts to EUR 633 thousand (2012: EUR 859 thousand). In 2013, the operating lease payments for office premises in the amount of EUR 711 thousand (2012: EUR 718 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:

	31.12.2013	31.12.2012
Cash balance of customers	5 620	6 234
Securities of customers	**356 051**	240 206
incl. parent company	*38 062*	*27 713*
incl. shareholders of the parent company and related entities	*17 708*	*11 647*
Total	**361 671**	**246 440**

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 Group'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

Off-balance sheet obligations	Unused loan commitments	Financial guarantees	Total
Contractual amount 31.12.2013	32 629	6 556	**39 185**
Contractual amount 31.12.2012	13 578	2 553	**16 131**

Tax authorities have the right to review the company's tax records for up to 5 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 Group during 2012 - 2013. The Group's management estimates that there are no such circumstances which may lead the tax authorities to impose significant additional taxes on the Group.

Due to the losses of earlier periods of the Finnish branch, the Group 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 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	2013	2012
Interest income	**6**	**407**	**0**
incl. entities in the consolidation group of the parent		407	0
Interest expenses	**6**	**424**	**188**
incl. management		*2*	*4*
incl. parent company		*422*	*184*
Fee and commission income	**5**	**8**	**9**
incl. ultimate controlling party (refer to Note 1) and related entities	*1*	*8*	*8*
incl. management		0	1
Other income		**45**	**28**
incl. ultimate controlling party (refer to Note 1) and related entities	*1*	*45*	*28*

Balances	Note	31.12.2013	31.12.2012
Loans and receivables as at the year-end		**24 078**	**19**
incl. ultimate controlling party and related entities	*13*	*24 078*	*19*
Loans received as at the year-end		**10 025**	**7 365**
incl. management		*0*	*0*
incl. parent company		*10 025*	*7 365*

In 2013 the Group granted loans to another subsidiary of the parent company in amount of 24 million euros. The interest rate of this loan is dependant of financing cost and capital requirements of the Group and is changed on quarterly basis. As of 31.12.2013 the interest rate was 4.54%. As of 31.12.2013 the Group has taken a commitment to grant loans up to 30 million euros.

The term deposits due to management as at 31.12.2013 are with maturities in January to July 2014 and with interest rates 0.4 - 1.0% (31.12.2012 with maturities in January to August 2013 and with interest rates 1.0 - 2.6%). The subordinated loan received in December 2012 has the interest rate of 7% during the first three years and 3 months EURIBOR + 7% since December 2015.

The subordinated loans received in June and December 2013 both have the interest rate of 7% during the first three years and 3 months EURIBOR + 7% since June and December 2016 accordingly.

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.

In 2013, salaries and other compensations paid to the management of LHV totalled EUR 430 thousand (2012: EUR 366 thousand), including all taxes. The Management Board of the Bank had 6 members in 2013 and 5 members in 2012. As at 31.12.2013, remuneration for December and accrued holiday pay in the amount of EUR 56 thousand (as at 31.12.2012: EUR 63 thousand) is reported as a payable to management (Note 17). The Group did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2013 and 31.12.2012 (pension liabilities, termination benefits, etc). In 2013, the remuneration paid to the members of the Supervisory Board totalled EUR 23 thousand (2012: EUR 27 thousand).

The Group has signed contracts with the members of the Management Board, which do not provide for severance benefits upon termination of the contract. In any matters not regulated by the contract, the parties adhere to the procedure specified in the legislation of the Republic of Estonia.

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

NOTE 25 Separate financial statements of parent company

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

Statement of comprehensive income of the parent
(in thousand euros)

	2013	**2012**
Interest income	13 008	10 938
Interest expense	-2 802	-4 729
Net interest income	**10 206**	**6 209**
Fee and commission income	4 007	3 480
Fee and commission expense	-1 027	-889
Net fee and commission income	**2 980**	**2 591**
Net gains from financial assets measured at fair value	2 354	385
Foreign exchange rate losses	-12	-1
Net gains from financial assets	**2 342**	**384**
Other income	75	75
Operating expenses	-10 505	-9 922
Profit/loss before loan losses	**5 098**	**-663**
Impairment losses on loans and advances	-2 550	-1 074
Net profit/loss for the year	**2 548**	**-1 737**
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss:		
Available-for-sale investments:		
Revaluation of available-for-sale financial assets	-27	0
Total comprehensive income/loss for the year	**2 521**	**-1 737**

Statement of Financial Position of the parent

(in thousand euros)

	31.12.2013	31.12.2012
Assets		
Balances with central bank	133 839	77 965
Due from credit institutions	15 300	10 783
Due from investment companies	1 456	1 547
Available-for-sale financial assets	11 903	0
Other financial assets at fair value through profit or loss	30 816	44 853
Held-to-maturity financial investments	0	67 965
Loans and advances to customers	203 457	106 067
Receivables from customers	687	254
Other assets	938	946
Subsidiaries	325	0
Tangible assets	414	631
Intangible assets	442	441
Total assets	**399 577**	**311 452**
Liabilities		
Deposits from customers and loans received	359 837	286 163
Financial liabilities at fair value through profit or loss	433	656
Accrued expenses and other liabilities	2 305	2 009
Deferred income	0	590
Provisions	0	13
Subordinated loans	10 025	7 365
Total liabilities	**372 600**	**296 796**
Equity		
Share capital	33 500	23 700
Other reserves	-27	0
Accumulated deficit	-6 496	-9 044
Total equity	**26 977**	**14 656**
Total liabilities and equity	**399 577**	**311 452**

Statement of cash flows of the parent

(in thousand euros)

	2013	2012
Cash flows from operating activities		
Interest received	12 536	10 938
Interest paid	-4 081	-4 729
Fees and commissions received	3 995	3 479
Fees and commissions paid	-1 027	-889
Other operating income received	75	75
Staff costs paid	-4 802	-4 390
Administrative and other operating expenses paid	-5 063	-5 006
Cash flows from/used in operating activities before change in operating assets and liabilities	**1 633**	**-522**
Net increase/decrease in operating assets:		
Net acquisition/disposal of trading portfolio	-4	0
Loans and advances to customers	-100 492	-40 561
Term deposits with other credit institutions	2	9 189
Mandatory reserve at central bank	-846	-767
Security deposits	64	-90
Other assets	-56	-45
Net increase/decrease in operating liabilities:		
Demand deposits of customers	87 354	41 672
Term deposits of customers	-12 128	30 996
Loans received and repayments	-612	-194
Financial liabilities for trading at fair value through profit or loss	-223	216
Other liabilities	165	710
Net cash used in / generated from operating activities	**-25 143**	**40 604**
Cash flows from investing activities		
Purchase of non-current assets	-306	-222
Acquisition of investment securities held to maturity	-2 790	-45 988
Proceeds from disposal and redemption of investment securities available for sale (previously held to maturity)	61 130	8 295
Net changes of investment securities at fair value through profit or loss	14 090	977
Investment in share capital of subsidiary	-325	0
Net cash from / used in investing activities	**71 799**	**-36 938**
Cash flows from financing activities		
Paid in share capital	9 800	6 000
Subordinated loans received	3 000	4 000
Net cash from financing activities	**12 800**	**10 000**
Net increase in cash and cash equivalents	**59 456**	**13 666**
Cash and cash equivalents at the beginning of the year	87 742	74 076
Cash and cash equivalents at the end of the year	**147 198**	**87 742**

Statement of changes in shareholders' equity

(in thousand of euros)

	Share capital	Other reserves	Accumulated deficit	Total
Balance as at 01.01.2012	**17 700**	**0**	**-7 307**	**10 393**
Paid-in share capital	6 000	0	0	**6 000**
Total comprehensive income for 2012	0	0	-1 737	**-1 737**
Balance as at 31.12.2012	**23 700**	**0**	**-9 044**	**14 656**
Carrying amount of holdings under control and significant influence	0	0	0	0
Value of holdings under control and significant influence under equity method	0	0	0	0
Adjusted unconsolidated equity as at 31.12.2012	**23 700**	**0**	**-9 044**	**14 656**
Balance as at 01.01.2013	**23 700**	**0**	**-9 044**	**14 656**
Paid-in share capital	9 800	0	0	**9 800**
Profit for the year	*0*	*0*	*2 548*	***2 548***
Other comprehensive income	*0*	*-27*	*0*	***-27***
Total comprehensive income for 2013	0	-27	2 548	**2 521**
Balance as at 31.12.2013	**33 500**	**-27**	**-6 496**	**26 977**
Carrying amount of holdings under control and significant influence	0	0	-325	-325
Value of holdings under control and significant influence munder equity method	0	0	143	143
Adjusted unconsolidated equity as at 31.12.2013	**33 500**	**-27**	**-6 678**	**26 795**

Signatures of the Management Board to the Consolidated Annual Rreport

The Management Board has prepared the management report and the consolidated financial statements of AS LHV Pank for the financial year ended on 31 December 2013. The consolidated financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

31.03.2014

Erki Kilu / signed /
Chairman of the Management Board

Indrek Nuume / signed /
Member of the Management Board

Kerli Lõhmus / signed /
Member of the Management Board

Jüri Heero / signed /
Member of the Management Board

Martti Singi / signed /
Member of the Management Board

Andres Kitter / signed /
Member of the Management Board

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of AS LHV Pank

We have audited the accompanying consolidated financial statements of AS LHV Pank and its subsidiary, which comprise the consolidated statement of financial position as of 31 December 2013 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

AS PricewaterhouseCoopers, Pärnu mnt 15, 10141 Tallinn, Estonia; License No. 6; Registry code: 10142876
T: +372 614 1800, F: +372 614 1900, www.pwc.ee

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of AS LHV Pank and its subsidiary as of 31 December 2013, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

/signed/	/signed/
Ago Vilu Auditor's Certificate No. 325	Verner Uibo Auditor's Certificate No. 568

31 March 2014

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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 profit distribution

The Management Board of LHV Pank proposes to the General Meeting of Shareholders to add the profit for reporting period attributable to shareholders of the parent in the amount of EUR 2 366 thousand to the accumulated deficit.

Signatures of the Supervisory Board to the Annual Report

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.

23.04.2014

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

Allocation of income according to EMTA classificators

EMTAK	Activity	2013	2012
66121	Security and commodity contracts brokerage	2 691	2 694
64191	Credit institutions (banks) (granting loans)	14 263	11 691
66191	Financial consultancy services	0	5
64911	Leasing	352	28
	Total income	**17 306**	**14 418**