versobank

Versobank AS

CONSOLIDATED ANNUAL REPORT 2012

(TRANSLATION FROM ORIGINAL IN ESTONIAN)

Beginning of reporting year	01.01.2012
End of reporting year	31.12.2012

Registry code	10586461
Address	Pärnu mnt 12, 10148 Tallinn, Estonia
Phone	(+372) 6802 500
Fax	(+372) 6802 501
E-mail	info@versobank.com
Internet home page	www.versobank.com

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INTRODUCTION

General Data of Credit Institution

Business name	Versobank AS
Location and address	Pärnu mnt 12, 10148 Tallinn, Estonia
Registered in state	Republic of Estonia
Registration date	14.10.1999
Registry code	10586461 (Estonian Commercial Register)
Phone	(+372) 6 802 500
Fax	(+372) 6 802 501
S.W.I.F.T.'s BIC code	SBMBEE22
E-mail	info@versobank.com
Internet home page	http://www.versobank.com

Auditor

Auditor's business name	KPMG Baltics OÜ
Auditor's registry code	10096082
Auditor's location and address	Narva mnt 5, 10117 Tallinn, Estonia
Name of partner in charge	Taivo Epner

Report Data

Balance sheet date of report	31.12.2012
Report period	01.01.2012 – 31.12.2012
Report currency and units	Euro (EUR), in thousands of euros

Classification of Economic Activities (EMTAK 2008): 64191 Credit institutions (banks)

Following terms are used in the report:
"Bank"- Versobank AS;
"Group" – Versobank AS and its 100% subsidiary Osito Casa OÜ (deleted from the Commercial Register on 28.12.2012). Group existed and income and expenses were consolidated until the deletion of the subsidiary, Group no longer existed as of 31.12.2012.

MANAGEMENT REPORT

Description of the Credit Institution and its Management Bodies

Versobank AS is a credit institution, established in 1999 and operating in Estonia. Versobank AS (hereinafter: the Bank) holds the activity license issued by the Bank of Estonia, which allows the Bank to engage in all banking operations. Bank has an account manager status of Estonian Central Depository for Securities, is a member of S.W.I.F.T. and an associate member of Visa Europe. Bank has joined SEPA (Single Euro Payments Area) systems as an indirect member, cross-border clearing system TARGET2-Eesti and domestic clearing system ESTA.

Change of majority shareholders and business name of the Bank were concluded in year 2012, changes occurred in share capital and management bodies. Cyprus Popular Bank Public Co Ltd. (with former business name Marfin Popular Bank Public Co Ltd.) signed a Share Purchase-Sale Agreement with the Ukrainian company UKRSELHOSPROM PCF LLC on 22 December 2011 for the sale of its total participation. The transaction became effective from 29 March 2012. In addition, Cyprus Popular Bank Public Co Ltd. transferred all its obligations and rights arising from a subordinated loan which was granted to the Bank to UKRSELHOSPROM PCF LLC. The new business name of MARFIN PANK EESTI AS is Versobank AS following the entry of the registration department of Harju County Court dd. 7 May 2012.

The shareholders of the Bank decided on 12.04.2012 to increase the share capital by issuing new shares. The new majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full and EUR 5,040,000 was credited to the Bank's account on 28 May 2012 as a monetary payment for shares.

The owners of Versobank AS, as of the report date 31.12.2012 are:
82.8239% of shares are owned by UKRSELHOSPROM PCF LLC (location Dnepropetrovsk, Ukraine);
11.4594% of shares are owned by Mr. Nikolaos Sarros (place of residence Athens, Greece);
2.2350% of shares are owned by Sigma Real Estate OÜ (location Tallinn, Estonia), a private limited company under control of Mr. Nikolaos Sarros;
1.7277% is owned by Frösundaviksparken AB (location Stockholm, Sweden);
0.8814% of shares are owned by Mirage Investments OÜ (location Tallinn, Estonia) and
0.8726% is owned by Mr. Emmanouil Karavelakis (place of residence Athens, Greece).

Extraordinary Meeting of Shareholders decided on 27.11.2012 to increase the share capital of the Bank by EUR 2,000,001, i.e. from EUR 12,088,774.20 to EUR 14,088,775.20 by issuing new shares. The majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full on 13.12.2012 and the payment for the new shares was credited on 27.02.2013.

The Supervisory Board of the Bank had five members as of the report date and the date of report compilation. Mr. Oleksandr Rechytskyi is the Chairman of the Supervisory Board, members are Mr. Vadym Iermolaiev, Mr. Stanislav Vilens'kyy, Mrs. Steinunn Kristin Thordardottir and Mr. Härmo Värk. Mr. Härmo Värk was elected to member of the

Supervisory Board and Mr. Nikolaos Sarros called back on the extraordinary meeting of shareholders dd. 13.06.2012.

The Management Board of the Bank had four members as of the report date and the date of report compilation. Mr. Riho Rasmann is the Chairman of the Management Board and the members of the Management Board are Mr. Sven Raba, Mr. Mart Veskimägi and Mrs. Marija Sutirina as a new member (starting from May 2012). The Chairman of the Management Board and the members of the Management Board do not own shares neither hold options to acquire shares of the Bank.

The Bank's only subsidiary Osito Casa OÜ was liquidated in year 2012. The main real estate activities of the company were moved under the bank in September 2011 and the subsidiary was deleted from the commercial register on 28.12.2012. The Bank has no participating interests, exceeding 20% shareholding in any company, but the Bank owns 16% of business development company European Business Development AS.

Description of Economic Environment

Estonian economy remained at a stable level in year 2012 despite the continued debt crisis in the European Union. Estonian economic confidence index was 101.8 points in December 2012 compared with long-term average (100) according to data published by the European Commission, surpassing the European Union average of 88.4 and all other European Union countries except Latvia. Debt crisis induced uncertainty and a slower recovery in key export markets of Estonia affected negatively overall economic growth which slowed down to 2.9% in 2012 according to preliminary data. In the following years the economic growth is expected to pick up again to 4%. Inflationary pressures remained at an elevated level throughout year 2012 as the consumer prices rose by 3.9% in 2012 according to Statistics Estonia, being mainly influenced by events in the world market, particularly by the increase of oil price. Labor market was predominantly characterised by positive trends in year 2012 as the employment continued with steady growth and unemployment declined.

European Central Bank continued with extraordinary measures throughout the year by keeping the euro base rates at historically low levels, purchasing distressed sovereign bonds and expanding the list of acceptable collaterals for lending. As a result the general background risk level in European Union fell and bond markets gained, but the fragmentation in financial markets remained and the trust between financial market participants has not recovered completely. Therefore we can expect that in the near future the European Central Bank will keep interest rates at continuously low levels.

Despite of the low base rates the loan and leasing portfolio of Estonian banks increased only by 1.6% in year 2012. Loans and leases to Estonian businesses and households totalled EUR 14.7 billion at the end of the year. Low growth rate of the loan portfolio and simultaneous decrease in the base rates affected negatively the interest income of banks too. The overall profitability was supported by the decrease in the volume of problem loans and reduction of loan loss provisions formed against potential loan losses. Loans overdue for more than 60 days decreased to 3.2% of the loan portfolio at the end of the year.

Unlike loan portfolio the deposits continued a vigorous growth throughout year 2012. Deposits of Estonian companies and households increased by 9% reaching 8.7 billion euros at the end of the year. Deposit growth was not significantly slowed down even by ultra low levels of deposit interest rates.

Major Economic Events

Replacement of the main shareholder of the Bank was the most important economic event of the last year, followed by the change of business name, share capital increase and changes in strategy which lead to substantial growth in the number of non-resident corporate customers. These events had a more significant impact on the economic results of the Bank starting from July 2012, when a new price list came into force which also distinguishes between the fees for residents and non-residents. The proportion of non-resident customers, volumes of transactions and thereby also the fees and commissions income of the Bank have increased significantly as a result of these changes.

Number of customers of the Bank increased 9.3% during the last year (year earlier 10.6%), the number of active depositors increased 3.0% (decreased 0.6% year earlier).The growth of deposits was very fast: 54.6% in year 2012, compared with a 28.8% decrease year earlier. Client deposits with the Bank totalled 50.8 million euros as of 31.12.2012 (32.8 million euros as of 31.12.2011). Total balance sheet of the Bank has increased 46.3% from beginning of the year, reaching 62.1 million euros as of 31.12.2012 (as of 31.12.2011 the balance sheet total was 42.5 million euros).

Gross loan portfolio (excluding deposits with financial institutions) comprised 25.1 million euros, decreasing 19.3% from beginning of the last year (decrease was 17.0% year earlier) and forming 40.4% of total assets as at the end of financial year (31.12.2011: 73.2%). Gross loan portfolio amounted 31.1 million euros as of 31.12.2011. Decrease was mainly due to the write-off of non-performing claims in the amount of 5.1 million euros during year 2012 (0.3 million euros during year 2011). Bank had continuously much more deposits than loans – deposits ratio to loans stood at 2.02 as of 31.12.2012 (1.06 at year-end 2011).

Decrease in interest income, conservative loan and other loss provisions caused the net loss of the Bank in year 2012, but the Bank forecasts a significant improvement of results in next reporting periods. Net loss of year 2012 comprised 3.5 million euros (net loss of year 2011 was 2.2 million euros). Bank's investments in debt securities have been significantly increased for the diversification of interest income sources.

Net interest income of the reporting period was 0.9 million euros (2011: 1.2 million euros), earned mostly on loans. Net fees and commissions income totalled 0.17 million euros (2011: 0.02 million euros). 0.08 million euros were earned on foreign exchange transactions (2011: 0.06 million euros). Total operating income from banking activities (excluding loan provisions) comprised 1.0 million euros in year 2012 compared with 1.1 million euros year earlier. Administrative expenses of year 2012 and 2011 were 2.3 million euros and 2.2 million euros correspondingly.

Bank's equity totalled 7.5 million euros as of 31 December 2012 and the regulatory capital adequacy stood at 26.60% (31.12.2011: 4.8 million euros, capital adequacy 23.01%). Share capital increase by 2.0 million euros was finalised in February 2013 via monetary payment for new shares.

No new branch offices were opened in year 2012, but preparations were made for opening bank's representative office in Dnepropetrovsk, Ukraine. The Bank received appropriate license from the National Bank of Ukraine in January 2013. The Bank is going to continue its expansion to Ukraine and other CIS countries and is planning to open a representative office also in Moscow during year 2013. The Bank closed the Tartu branch office from 11 July 2012, due to less demand for services rendered in bank branch and the end of office lease contract. With the intention of the Bank to operate more effectively and considering the limited usage of our Stocker service, the Bank discontinued the Stocker service from 30 June 2012, and also the membership status with the Baltic stock exchanges. Bank renewed its internet web page and internet bank design to reflect the new corporate identity. Bank has increased the functionality of its internet bank ibVerso and added the possibility to use digipasses (PIN calculators) for authentication.

Bank paid a lot of attention last year to correspondent banking and liquidity management. Swiss bank BSI AG opened a 10 million euro credit line to the Bank as a new cooperation partner. Bank has opened several new correspondent accounts (incl. accounts with Commerzbank AG, Sberbank, Raiffeisen Bank International AG) aiming at better and faster service to customers, increased the speed of foreign payment settlements and prolonged the clearing day. Letters of credit have been added to new products, and the start of the VISA bank card issuing has been planned for second half of year 2013.

Public Information on Remuneration

Remuneration of the work of the members of the Supervisory Board is decided by the general meeting of shareholders of the Bank. The work of three members of the Supervisory Board was compensated in year 2012 (in year 2011: 1). Total of 81 thousand euros of membership fees was calculated in year 2012 (total of 25 thousand euros in year 2011).

No membership fees have been paid to the members of the Management Board.

Supervisory Board of the Bank formed a Remuneration Committee with its decision of 17 June 2011. Remuneration Committee has four members and consists mainly of Supervisory Board members, rules and regulations of the committee are under preparation. Former remuneration was dependent on the yearly budget of the Bank, approved by the Supervisory Board, salaries of the members of the Management Board were approved by the Supervisory Board of the Bank, salaries of employees by the managing director of the Bank, chairman of the Management Board. There is no performance pay system. Remuneration does not depend on risk management. Bank does not pay remuneration in shares, share options or other similar rights.

Calculated salaries of the members of the Management Board totalled 217 thousand euros in year 2012, of employees 718 thousand euros. Calculated salaries of the members of the Management Board totalled 204 thousand euros in year 2011, of employees 704 thousand euros. Performance fees nor resignation compensations (redundancy payments at amounts higher than mandatory by law) have been paid in 2012 and 2011, no payments have been made in connection with employment commencement either. There are no accrued unpaid performance fees. Average number of employees was 39 in year 2012 (39 year earlier), number of employees at the end of year 2012 was 42 (38 at the end of 2011). Additional details of components of personnel expenses have been disclosed in Note 8 of the financial statements.

Corporate Governance Report

"Corporate Governance Recommendations" guideline issued by the Estonian Financial Supervision Authority is in force since 01.01.2006. Whereas the shares of Versobank AS are not traded in the regulated market of Estonia and the Bank has no other issued securities listed in the stock exchange as of report date, Corporate Governance Recommendations are not mandatory for the Bank. Information is disclosed as required by legislation, international financial reporting standards (IFRS EU) and good banking practices.

Ratios

		2012	2011
Return on equity	ROE	-57.39%	-42.37%
Equity multiplier	EM	8.49	8.39
Profit margin	PM	-162.20%	-94.91%
Asset utilisation	AU	4.17%	5.32%
Return on assets	ROA	-6.76%	-5.05%
Net interest margin	NIM	2.05%	3.82%
Basic earnings per share	Basic EPS	-0.21	-0.17
Diluted earnings per share	Diluted EPS	-0.21	-0.17
Spread	SPREAD	2.03%	4.50%
Yield on interest-earning assets	YIEA	3.72%	7.29%
Cost of interest-bearing liabilities	COL	1.69%	2.79%

Explanations to ratios

Total income includes the following income items: interest income, fees and commissions income, dealing profits, income from financial investments, other operating income, extraordinary income, income from value adjustments of fixed and intangible assets (+), income from value adjustments of advances and off-balance sheet commitments (+), income from value adjustments of long term financial investments (+).

ROE	Net profit (loss) / Average equity * 100
Average equity	(Equity of current end year as of 31.12.2012 + Equity of previous year end as of 31.12.2011)/2
EM	Average assets / Average equity
Average assets	(Assets of current year end as of 31.12.2012 + Assets of previous year end as of 31.12.2011)/2
PM	Net profit (loss) / Total income * 100
AU	Total income / Average assets * 100
ROA	Net profit (loss) / Average assets * 100
NIM	Net interest income / Average interest earning assets * 100
Basic EPS	Net profit (loss) / Average number of shares
Diluted EPS	Net profit (loss) / Average number of shares (considering all convertible securities)
SPREAD	Yield on interest earning assets - Cost of interest bearing liabilities = YIEA - COL
YIEA	Interest income / Average interest earning assets * 100
COL	Interest expense / Average interest bearing liabilities * 100

Ratings

Versobank AS has not been rated by international rating agencies.

Legal Disputes

Courts are proceeding with Bank actions against different persons, who have not fulfilled their obligations, and where the mutually satisfying agreements have not been reached in negotiations. Bankruptcy proceedings are also taking place against obligors as well as guarantors and execution proceedings are taking place with regard to pledged collateral assets and private person debtors.

The total of five court actions have been filed against the Bank as of the date of compiling the management report. There are no cases pending in courts or arbitration bodies that might cause significant proprietary damage to the Group.

Consolidated Financial Statements 2012

Consolidated Statement of Comprehensive Income

	Note	EUR ths. 2012	EUR ths. 2011
Interest income	1	1,722	2,163
Interest expense	2	-773	-1,073
Net interest income		**949**	**1,090**
Fee and commission income	3	222	71
Fee and commission expense	4	-57	-47
Net fees and commissions income		**165**	**24**
Net trading gains	5	**120**	**59**
Other operating income	6	**116**	**167**
Other operating expenses	7	**-345**	**-205**
Administrative expenses		**-2,269**	**-2,174**
Personnel expense	8	-1,067	-955
Payroll related taxes	9	-363	-325
Other administrative expenses	10	-839	-894
Depreciation and amortisation of tangible and intangible assets	11	**-79**	**-109**
Provisions (+/-)	12	**142**	**-90**
Operating profit/loss before allowances		**-1,201**	**-1,238**
Impairment loss on assets	13	**-2,335**	**-1,007**
NET LOSS FOR THE PERIOD		**-3,536**	**-2,245**
Net change in revaluation reserve of available-for-sale financial assets		**94**	**1**
COMPREHENSIVE LOSS FOR THE PERIOD		**-3,442**	**-2,244**
Basic earnings/loss per share		-0.21 EUR	-0.17 EUR
Diluted earnings/loss per share		-0.21 EUR	-0.17 EUR

The accounting policies on pp. 15-28 and notes to the financial statements on pp. 29-69 form an integral part of the Financial Statements.

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Consolidated Statement of Financial Position

	Note	EUR ths. 31.12.2012	EUR ths. 31.12.2011
ASSETS			
Cash	14	**130**	**117**
Loans and advances		**48,183**	**37,221**
Balances with central bank	15	4,545	8,778
Due from other credit institutions	16	22,979	4,679
Due from customers	17	20,659	23,764
Financial assets held for trading	18	**19**	**5**
Available-for-sale financial assets	19	**4,404**	**124**
Held-to-maturity investments	20	**5,039**	**0**
Property and equipment	21	**129**	**184**
Investment properties	22	**3,938**	**4,557**
Intangible assets	23	**96**	**105**
Other assets	24	**204**	**152**
TOTAL ASSETS		**62,142**	**42,465**
LIABILITIES			
Financial liabilities held for trading	18	**16**	**6**
Financial liabilities measured at amortised cost		**54,161**	**37,022**
Due to credit institutions	25	276	15
Due to customers	25	50,755	32,808
Subordinated debt	26	2,931	4,033
Borrowed funds from government and foreign aid	27	199	166
Provisions	12	**230**	**372**
Tax liabilities	28	**143**	**87**
Other liabilities	29	**96**	**149**
TOTAL LIABILITIES		**54,646**	**37,636**
SHAREHOLDERS' EQUITY			
Share capital	30	12,089	7,049
Other equity instruments	26	1,069	0
Statutory reserve capital		36	36
Fair value reserve of available-for-sale financial assets	19	83	-11
Accumulated deficit		-5,781	-2,245
TOTAL SHAREHOLDERS' EQUITY		**7,496**	**4,829**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**62,142**	**42,465**

The accounting policies on pp. 15-28 and notes to the financial statements on pp. 29-69 form an integral part of the Financial Statements.

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Consolidated Statement of Cash Flows

	Note	EUR ths. 2012	EUR ths. 2011
Cash flows from operating activities		**17,548**	**-5,556**
Interests received		1,466	2,021
Interests paid		-704	-799
Fee and commission received		206	56
Fee and commission paid		-57	-47
Administrative expenses		-2,227	-2,133
Trading income received	5	120	59
Other operating income		116	92
Other operating expenses		-345	-201
Change in due from other credit institutions		211	2,106
Change in due from customers of credit institution		2,849	5,579
Change in due to credit institutions		94	1,538
Change in due to customers		17,865	-13,370
Change in assets and liabilities connected with other operationg activities		-2,046	-457
Cash flows from investing activities		**-8,497**	**-78**
Purchase of property and equipment	21	-16	-56
Purchase of intangible assets	23	-8	-6
Purchase of investment properties	22	0	-95
Investment properties sold	22	382	79
Debt securities purchased	19,20	-10,815	0
Debt securities sold	19	1,960	0
Cash flows from financing activities		**5,240**	**1,312**
Increase of share capital	30	5,040	1,600
Interest of subordinated debt		0	-182
Other borrowings received	25,27	295	100
Borrowings repaid	27	-95	-206
Total cash flows		**14,291**	**-4,322**
Cash and cash equivalents at the beginning of year		**12,977**	**17,299**
Net change in cash and cash equivalents		**14,291**	**-4,322**
Cash and cash equivalents at the end of the year *		**27,268**	**12,977**

*** Cash and cash equivalents at the end of the year comprise:**

	Note	EUR ths. 2012	EUR ths. 2011
Cash	14	130	117
Balances with the central bank without mandatory reserve	15	4,159	8,181
Deposits with credit institutions with original maturity of less than 3 months	16	22,979	4,679
Total		**27,268**	**12,977**

The accounting policies on pp. 15-28 and notes to the financial statements on pp. 29-69 form an integral part of the Financial Statements.

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Consolidated Statement of Changes in Equity

	Note	EUR ths. 2012	EUR ths. 2011
Share capital			
Balance at the beginning of period		7,049	9,384
Share capital reduction to cover losses		0	-3,935
Share capital increase		5,040	1,600
Balance at the end of period		**12,089**	**7,049**
		0	
Other equity instruments			
Balance at the beginning of period		0	0
Equity component of subordinated debt	26	1,069	0
Balance at the end of period		**1,069**	**0**
Statutory reserve capital			
Balance at the beginning of period		36	36
Balance at the end of period		**36**	**36**
Fair value reserve of available-for-sale financial assets			
Balance at the beginning of period		-11	-12
Revaluation		94	1
Balance at the end of period		**83**	**-11**
Accumulated deficit			
Balance at the beginning of period		-2,245	-3,935
Share capital reduction to cover losses		0	3,935
Comprehensive loss for the period		-3,536	-2,245
Balance at the end of period		**-5,781**	**-2,245**
Total shareholders' equity:			
at the beginning of period		**4,829**	**5,472**
at the end of period		**7,496**	**4,829**

Additional information in Note 30.

The accounting policies on pp. 15-28 and notes to the financial statements on pp. 29-69 form an integral part of the Financial Statements.

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Accounting Policies

Accounting policies

Versobank AS Group (hereinafter also "the Group") consists of Versobank AS and its subsidiary Osito Casa OÜ (deleted on 28.12.2012). Group existed and income and expenses were consolidated until the deletion of the subsidiary, Group no longer existed as of 31.12.2012. Versobank AS (hereinafter also "the Bank") is a credit institution domiciled in Estonia, address of registered office: Pärnu mnt 12, Tallinn 10148, Estonia. UKRSELHOSPROM PCF LLC is the parent company of the Bank, Mr Vadym Iermolaiev and Mr Stanislav Vilens'kyy being the beneficial owners of the group.

The Management Board of the Bank has approved the financial statements on 04 March 2013. The shareholders have a right not to approve the annual report prepared and presented by the management board, and require compilation of a new report.

These financial statements of the Group have been prepared in accordance with the International Financial Reporting Standards (IFRSs) as adopted by the European Union (hereinafter IFRS EU).

Basis of Preparation

The functional and presentation currency of the Group is Euro (EUR). Numeric data in the financial statements is presented in thousands of monetary units.

Consolidated financial statements include all subsidiaries controlled by the parent company. When an entity began or ceased to be controlled by the parent company during the year, its results are included only from the date control commenced or up to the date control ceased. Control of the parent company over the subsidiary is presumed to exist where more than one half of a subsidiary's voting power is controlled by the parent company, or the parent company is able to govern the operational and financial policies of a subsidiary, or control the removal or appointment of a majority of subsidiary's management board. Intra-group transactions and balances, and any unrealised gains and losses arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements.

The financial statements are prepared on the historical cost basis, except for cases described in some of the following accounting policies.

Significant Judgements and Estimates by the Management

The preparation of financial statements in conformity with IFRSs as adopted by the European Union requires management to make certain judgements and estimates that affect the amounts reported in the financial statements. Judgements and estimates by the management are also required in applying the accounting principles and measurement bases.

The judgements and estimates made by the management are reviewed on an ongoing basis, and they are based on historical experience and other factors including assumptions of likely future events which are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Impairment losses on loans and advances. The Group regularly reviews its loan portfolio to assess potential impairment of asset value. This evidence may include observable data indicating that there has been an adverse change in the payment ability of borrower, or state or local economic conditions that correlate with the borrowers default. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows.

Impairment of available-for-sale debt investments. The Group determines that available-for-sale debt investments are impaired when there has been a change in expected cash flows to be collected from the instrument. The determination of whether the expected cash flows have changes requires judgement. In making this judgement, the Group evaluates among other factors, the changes in solvency position of the issuer, possible changes in credit behavior and any other relevant information available to the management. In addition, impairment may be appropriate when there is evidence of changes in technology or a deterioration in the financial health of the investment object, industry and sector performance, or operational or financing cash flows.

Impairment of real-estate investments. The Group regularily reviews its real estate investments one by one to assess potential impairment of assets. The determination of whether the expected cash flows have changes requires judgement. Group utilises the services of authorised real estate valuators.

Effects of Changes in Economic Environment

Events in global and Estonian financial markets

The ongoing uncertainty on financial markets which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, volatility in stock markets. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against. Subsection "Description of Economic Environment" of the Management Report gives a more detailed overview of current economic conditions and future scenarios in Estonia.

Financial crises has had limited impact on the Group, as all the previously issued bonds have been redeemed already in year 2007, and there is practically no dependency on extra-group banks. Group liquidity is at all times ensured by Group's liquidity buffer. Management is not in a position to reliably predict the effect of small liquidity on financial markets and increased volatility in currency and securities' markets to the financial position of the Group. Management believes that all measures necessary to ensure Group's sustainability and growth under current conditions have been applied.

Impact on loan collateral (especially real estate)

The amount of provision for impaired loans is based on management's appraisals of these assets at the balance sheet date after taking into consideration the cash flows that may result from foreclosure less costs for obtaining and selling the collateral. Although the market in Estonia for many types of collateral, also real estate, has shown first signs of growth, the liquidity is still low for certain types of assets. As a result, the actual realisable

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value on foreclosure may differ from the value ascribed in estimating allowances for impairment.

Impact on customers

Customers (borrowers) of the Group have been affected and may be affected further by the lower liquidity situation and other effects of the macroeconomic downturn which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for customers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial assets. To the extent that information is available, management has properly and to the best of its knowledge reflected revised estimates of expected future cash flows in its impairment assessments.

Liquidity

The liquidity of the Group has not been significantly affected by the changes in economic environment. Noticable growth in deposits has improved the overall liquidity situation. Swiss bank BSI AG opened a 10 million euro credit line to the Bank as a new cooperation partner, which has been utilised in minimal amounts.

Assets and Liabilities Denominated in Foreign Currencies

Foreign currency transactions are recorded in the official currency of the Republic of Estonia based on the foreign currency exchange rates of the European Central Bank valid on the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated based on the foreign exchange rates of the European Central Bank valid on the balance sheet date. Changes in exchange rates are recognised in the statement of comprehensive income under "Net trading income". Translation differences related to changes in the amortised cost are recognised in the statement of comprehensive income, and other changes in the carrying amount are recognised in equity under revaluation reserve. Translation differences of non-monetary items (e.g. shares in fair value through the statement of comprehensive income) are recognised as a part of fair value income/expense.

Offsetting

Financial assets and liabilities are offset only if a relevant legal right exists and there is intent to settle the amounts on a net basis or to realise the asset and settle the liability simultaneously.

Financial Instruments

Cash, short-term financial investments, amounts due from credit institutions and customers, other receivables and accruals are classified as financial assets. Financial liabilities include payables to customers, debts evidenced by certificates, accrued expenses and other liabilities. Financial assets and liabilities are initially recognised at their fair value. Financial liabilities are stated in the balance sheet at amortised cost, using the effective interest rate method, incl. for transaction fees.

A financial asset is removed from the balance sheet when the bank loses right to the cash flows arising from the financial asset, or passes the cash flows arising from the asset and

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substantially all the risks and rewards relating to the financial asset, to a third party. A financial liability is removed from the balance sheet, when it is settled or discharged or it expires.

Purchases and sales of financial assets are consistently recognised on the settlement date, i.e. on the date on which the Group acquires or loses ownership of the financial asset.

Financial assets at fair value through profit or loss

An instrument is classified as a financial asset at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial assets at fair value through profit or loss are reported in the balance sheet at fair value, based on quoted market prices and the official foreign exchange rates of the European Central Bank. The shares and debt securities not actively traded on an active market are valued at fair value according to the last quotation from an acknowledged provider with a presumption that there have been regular quotations available for the shares/debt securities and the price volatility has been in normal range for similar instruments. If the price is not available from quotations or there is no sufficient regularity of the quotations or the volatility of the instrument price quotations is outside the normal range, the shares/debt securities are revaluated into fair value based on all available information regarding the issuer to benchmark the financial instrument price against similar instruments available on active market to determine the fair value. For held for trading debt securities, for which the quoted prices from an active market are not available, cash flows are discounted at market interest rates, issuer's risk added. In any case, if the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, and other valuation techniques commonly used by market participants.

Any gain or loss arising from changes in fair value is recognised in the statement of comprehensive income under "Net trading gains less losses".

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor/customer with no intention of trading the resulting receivable. Loans and receivables are recognised in the balance sheet when the cash is paid to the borrower or right to demand payment has arisen and are derecognised only when they are repaid or written-off. Loans and receivables are measured at amortised cost using the effective interest method.

Cash and Cash Equivalents

Cash on hand is recognised as cash in the balance sheet. Cash and cash equivalents in the statement of cash flows include cash, demand and overnight deposits with other credit institutions and the surplus of the mandatory reserve balance with the Bank of Estonia. Cash flows are reported in the statement of cash flows using the direct method. Cash and cash equivalents are stated in the balance sheet at amortised cost.

Mandatory Reserve in the Bank of Estonia

Mandatory reserve rate of 2% of deposits and borrowings with maturities up to two years, less allowed deductions, is applicable from 01.01.2011, fulfilled as period's average

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established by the European Central Bank by depositing corresponding amount in euros to the TARGET2 account with the Bank of Estonia.

Held-to-maturity investments

If the Group has the positive intention and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, deducted by the impairment charge.

Available-for-sale financial assets

The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and gains and losses on changes of fair value (other than impairment losses, interest income and foreign exchange gains and losses) are recognised directly in other comprehensive income/loss. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established and it is probable that the dividends will be collected. Fair value is determined by reference to the market quotations and indicative bid prices of big banks. When an investment is derecognised, the cumulative gain or loss in equity is transferred to the statement of comprehensive income.

Derivative Instruments

Derivative instruments (e.g. forwards and swaps) are recognised on the trade date at fair value. After initial recognition, derivative instruments are measured at fair value, based on their quoted market prices and the official exchange rates of the European Central Bank. The valuation is recognised in the balance sheet under respective line "Financial assets held for trading" or "Financial liabilities held for trading" depending whether the fair value of the respective derivative is positive or negative and the result of the revaluation is recognised in the statement of comprehensive income under "Net trading gains less losses". Interest income received from derivatives is recognised in the statement of comprehensive income under "Interest income".

Impairment of Financial Assets

Valuation and Impairment of Loans and Advances

Loans to clients are recognised in the balance sheet under "Due from customers" and funds held at other banks are recognised under "Due from other banks". Group regulations require monthly evaluation of the loan portfolio. Receivables arising from loan agreements are recognised in the balance sheet at amortised cost. Cost is adjusted for repayments of the principal and, where necessary, any impairment losses. Amortised cost is calculated by discounting the estimated future cash flows of the instrument using the initial effective interest rate. If there is any indication of impairment, a receivable is written down to the present value of the estimated future receipts, discounted at initial effective interest rate.

Impairment losses are recognised in profit or loss 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

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group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and reliability of related collateral, if any and the expected cash flows.

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.

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.

If the value of an impaired receivable rises in subsequent periods, a previously recognised impairment loss is reversed to an amount equal to the present value of the item's estimated future cash flows or, if lower, the carrying amount of the receivable which would have been determined if no impairment loss had been recognised.

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 the profit and loss.

Securities purchase and resale transactions (reverse repos) are recognised and assessed for impairment similarly to other loans.

Impairment of available-for-sale financial assets

Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity instrument below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in the statement of comprehensive income – is removed from equity and recognised in the statement of comprehensive income. Impairment gains on equity instruments are not reversed through statement of comprehensive income. Debt instrument is considered to be impaired when there is a change in expected cash flows to be collected from the instrument. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of comprehensive income, the impairment loss is reversed through current period's statement of comprehensive income/loss.

Impairment of held-to-maturity investments

Held-to-maturity investments are recognised in the balance sheet at amortised cost. Cost is adjusted for repayments of the principal and, where necessary, any impairment losses. Amortised cost is calculated by discounting the estimated future cash flows of the instrument using the initial effective interest rate. If there is any indication of impairment, a receivable is written down to the present value of the estimated future receipts, discounted at initial effective interest rate. Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset.

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Financial Liabilities

Financial liabilities include customer deposits, liabilities to other banks and other liabilities. Financial liabilities to customers are recognised in the statement of financial position on their settlement date (value date) at fair value net of transaction costs and are subsequently measured at amortised cost using effective interest rate method and recorded under line "Financial liabilities measured at amortised cost". Interest expenses are recorded under "Interest expense".

The effective interest rate is the rate that exactly discounts the expected stream of future cash payments through maturity. The amortisation of the transaction costs is presented in the statement of comprehensive income together with the interest expenses. The respective interest expenses are recorded under "Interest expense ".

Unutilised borrowing limit is recognised as contingent asset.

Property and equipment

Significant assets which are used in the business activities and which expected useful life extends over one year are recognised as property and equipment. New items of property and equipment are initially recognised at cost and are depreciated from the month of implementation until they are depreciated to the residual value. Property and equipment are measured in the statement of financial position at cost less any accumulated depreciation and any impairment losses. The straight-line method is used for depreciating property and equipment and the annual depreciation rates are:

Computers, communication equipment	30%
Office equipment	25%
Office furniture	20%
Telephones	40%
Capitalised improvements to leased office space	20%
Other tangible assets	20%

The subsequent repairs of an item of property and equipment shall be recognised as an asset if these are in accordance with definition of non-current assets and if it is probable that future economic benefits associated with the item will flow to the entity. All other repairs and maintenance are charged to other operating expenses during the financial period in which they are incurred.

The appropriateness of depreciation/amortisation rates, methods and residual values are assessed at each reporting date.

Investment Properties

Investment properties include assets (land, buildings, incl. capitalised expenses), which are kept with an intention to earn rent income or gain through the increase of market value (capital gain) and which the Group does not use for its own business, also assets which the Group has purchased during the solution process of non-performing claims. Investment properties are initially recognised at cost, consisting of purchase price and other directly attributable expenses. Assets are subsequently measured at fair value.

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Intangible Assets

Purchased patents, licenses and software are recognised as intangible assets. Intangible assets are measured in the balance sheet at cost less any amortisation and any impairment losses. The straight-line method is used for amortising intangible assets. The amortisation rate for intangible assets is 5-20% per year.

Impairment of Assets

The management of the company assesses if there is any indication that an asset may be impaired at each reporting date. If such indication exists, an impairment test is performed and the recoverable amount of the asset estimated. The recoverable amount of an asset is the higher of its fair value (less costs to sell) and value in use calculated using the discounted cash flow method. If the test results show that the recoverable amount of an asset is lower than its carrying amount, the asset is written down to its recoverable amount. If the recoverable amount cannot be determined for an individual asset, the recoverable amount is determined for the smallest group of assets (the cash-generating unit) the asset belongs to. Impairment losses are recognised as expenses in the period in which they are incurred.

If a subsequent impairment test of an asset which has been written down shows that its recoverable amount has risen above its carrying amount, the former impairment loss is reversed and the asset's carrying amount is increased. The increased carrying amount may not exceed the carrying amount which would have been determined (net of amortisation or depreciation) had no impairment loss been recognised.

Borrowed Funds from Government and Foreign Aid

Borrowed funds from government and foreign aid include loans of Rural Development Foundation to the Bank. Borrowed funds from government and foreign aid are recognised on settlement date at fair value less transaction costs. Subsequent measurement is at amortised cost using effective interest rate.

Interest, Fees and Commissions

All interest and similar income is recognised as interest income. Similar income includes income connected with the contractual maturity/redemption date or amount of the asset and it is recognised over the term of the receivable. Interest income is calculated using the original effective interest rate applied in discounting the estimated future cash flows of the asset.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future credit 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.

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.

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Fees and commissions income is recognised in the fair value of the consideration received or receivable for the services provided in the ordinary course of the Group's activities. Fees and commission income and expense are recognised on an accrual basis. Loan fees (less direct expenses) are included in the calculation of the effective interest rate.

Other transaction fee income and other income are recognised on accrual basis at the moment of executing the respective transactions.

Dividends are recognised in the statement of comprehensive income when the entity's right to receive payment is established.

Payables to employees

Payables to employees contain the contractual right arising from employment contracts. In addition to the salaries payable, this liability also includes accrued social and unemployment taxes calculated on it. Pursuant to employment contracts and current legislation, payables to employees also include an accrued holiday pay liability as of the reporting date. In addition to the holiday pay, this liability also includes accrued social and unemployment insurance premium payments.

Short-term employee benefits, including contractual salary, holiday pay and social tax and unemployment insurance premium calculated on them pursuant to legal acts are charged to operating expenses on an accrual basis. Additional benefits (incl. supplementary pension and share options) have not been implemented for employees.

Accounting for Leases

Lease agreements are classified as finance leases if all significant risks and rewards arising from the agreement are transferred to the lessee. Assets leased on terms of finance lease are recognised at the lower of fair value and present value of minimum lease payments and depreciated according to their useful life of the asset or lease term. All other lease agreements are treated as operating leases and the payments made on the basis of those agreements are expensed linearily in the period for which they are made.

Contingent Liabilities

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

Corporate Income Tax

The profit of Estonian legal entities is not taxed according to effective legislation; therefore deferred income tax assets and liabilities do not exist. In place of profit, income tax is levied on dividends paid out of retained earnings. The tax rate is 21/79 of the amount paid out as net dividends. The corporate income tax payable on dividends is recognised in the

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statement of comprehensive income as the income tax expense of the same period in which the dividends are declared, irrespective of the period for which the dividends are declared or the period in which the dividends are actually paid out.

Earnings/Losses per Share

Basic earnings/losses per share are calculated by dividing profit/loss for the financial year by the weighted average number of ordinary shares outstanding during the period.

Net profit/loss attributable to ordinary shareholders and the weighted average number of ordinary shares are adjusted for all dilutive potential ordinary shares, having dilutive effect on earnings/losses per share, when calculating diluted earnings/losses per share. As the Group does not have financial instruments, which could dilute earnings/losses per share in the future, basic earnings/losses per share and diluted earnings/losses per share are equal.

Financial Guarantees

Guarantees issued by the Group to customers and potential loan commitments as well as unused loan amounts are recognised on off-balance sheet accounts. Received guarantee fees are reported in income over the period of the guarantee.

Financial guarantee liabilities are initially recorded at their fair value and the initial fair value is amortised over the life of the financial guarantee. Therefore the financial guarantee liability is carried at the higher of the amortised amount and present value of future payments (if it is likely that payments are to be made under the guarantee). Liabilities arising from financial guarantees are reported under other liabilities.

Adoption of New or Revised Standards and Interpretations

The following new Standards and Interpretations are not yet effective for the annual period ended 31 December 2012 and have not been applied in preparing these financial statements *[IAS 8.30 (a)]*.

Amendments to IFRS 7 Disclosures - *Offsetting Financial Assets and Financial Liabilities*

(Effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods; to be applied retrospectively.)

The Amendments contain new disclosure requirements for financial assets and liabilities that are:

- offset in the statement of financial position; or
- subject to master netting arrangements or similar agreements.

The Group does not expect the Amendments to have any impact on the financial statements since it does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

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IFRS 10 *Consolidated Financial Statements* and IAS 27 (2011) *Separate Financial Statements*

(Effective for annual periods beginning on or after 1 January 2014. Earlier application is permitted if IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are also applied early.)

This Standard is to be applied retrospectively when there is a change in control conclusion.

IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are SPEs in the scope of SIC-12. IFRS 10 introduces new requirements to assess control that are different from the existing requirements in IAS 27 (2008). Under the new single control model, an investor controls an investee when:

(1) it is exposed or has rights to variable returns from its involvements with the investee;
(2) it has the ability to affect those returns through its power over that investee; and
(3) there is a link between power and returns.

The new Standard also includes the disclosure requirements and the requirements relating to the preparation of consolidated financial statements. These requirements are carried forward from IAS 27 (2008).

The Group does not expect the new standard to have any impact on the financial statements, since the assessment of control over its current investees under the new standard is not expected to change previous conclusions regarding the Group's control over its investees.

IFRS 11 *Joint Arrangements*

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively subject to transitional provisions. Earlier application is permitted if IFRS 10, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are also applied early.)

IFRS 11, *Joint Arrangements*, supersedes and replaces IAS 31, *Interest in Joint Ventures*. IFRS 11 does not introduce substantive changes to the overall definition of an arrangement subject to joint control, although the definition of control, and therefore indirectly of joint control, has changed due to IFRS 10.

Under the new Standard, joint arrangements are divided into two types, each having its own accounting model defined as follows:

- A joint operation is one whereby the jointly controlling parties, known as the joint operators, have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- A joint venture is one whereby the jointly controlling parties, known as joint venturers, have rights to the net assets of the arrangement.

IFRS 11 effectively carves out from IAS 31 jointly controlled entities those cases in which, although there is a separate vehicle for the joint arrangement, separation is ineffective in certain ways. These arrangements are treated similarly to jointly controlled assets/operations under IAS 31, and are now called joint operations. The remainder of IAS 31 jointly controlled entities, now called joint ventures, are stripped of the free choice of equity accounting or proportionate consolidation; they must now always use the equity method in its consolidated financial statements.

The Group does not expect IFRS 11 to have material impact on the financial statements since it is not a party to any joint arrangements.

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IFRS 12 ***Disclosure of Interests in Other Entities***

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted.)

IFRS 12 requires additional disclosures relating to significant judgements and assumptions made in determining the nature of interests in an entity or arrangement, interests in subsidiaries, joint arrangements and associates and unconsolidated structured entities.

The Group does not expect the new Standard will have a material impact on the financial statements.

IFRS 13 ***Fair Value Measurement***

(Effective prospectively for annual periods beginning on or after 1 January 2013. Earlier application is permitted.)

IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 explains how to measure fair value when it is required or permitted by other IFRSs. The standard does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

The standard contains an extensive disclosure framework that provides additional disclosures to existing requirements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income.

The Group does not expect IFRS 13 to have material impact on the financial statements since management considers the methods and assumptions currently used to measure the fair value of assets to be consistent with IFRS 13.

Amendments to IAS 1 ***Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income***

(Effective for annual periods beginning on or after 1 July 2012; to be applied retrospectively. Earlier application is permitted.)

The amendments:

- require that an entity presents separately the items of other comprehensive income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. If items of other comprehensive income are presented before related tax effects, then the aggregated tax amount should be allocated between these sections.
- change the title of the *Statement of Comprehensive Income to Statement of Profit or Loss and Other Comprehensive Income*, however, other titles are also allowed to be used.

The amendments are not relevant to the Group's financial statements, since the Group does not have other comprehensive income.

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Amendments to IAS 12: ***Deferred Tax: Recovery of Underlying Assets***

(Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively. Earlier application is permitted.)

The amendments introduce a rebuttable presumption that the carrying value of investment property measured using the fair value model would be recovered entirely by sale. Management's intention would not be relevant unless the investment property is *depreciable* and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset. This is the only instance in which the presumption can be rebutted.

The Group does not expect the amendments to have any impact on the financial statements, since it does not results in a change in the Group's accounting policy. The measurement of deferred tax assets and liabilities relating to investment properties measured using the fair value model in IAS 40 will not change.

IAS 19 (2011) ***Employee Benefits***

(Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively. Transitional provisions apply. Earlier application is permitted.)

The amendment requires actuarial gains and losses to be recognised immediately in other comprehensive income. The amendment removes the corridor method previously applicable to recognising actuarial gains and losses, and eliminates the ability for entities to recognise all changes in the defined benefit obligation and in plan assets in profit or loss, which currently is allowed under the requirements of IAS 19. The amendment also requires the expected return on plan assets recognised in profit or loss to be calculated based on rate used to discount the defined benefit obligation.

The amendments are not relevant to the Group's financial statements, since the Group does not have any defined benefit plans.

IAS 28 (2011) ***Investments in Associates and Joint Ventures***

(Amendments effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted if IFRS 10, IFRS 11, IFRS 12 and IAS 27 (2011) are also applied early.)

There are limited amendments made to IAS 28 (2008):

- *Associates and joint ventures held for sale.* IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. For any retained portion of the investment that has not been classified as held for sale, the equity method is applied until disposal of the portion held for sale. After disposal, any retained interest is accounted for using the equity method if the retained interest continues to be an associate or a joint venture.

- *Changes in interests held in associates and joint ventures.* Previously, IAS 28 (2008) and IAS 31 specified that the cessation of significant influence or joint control triggered remeasurement of any retained stake in all cases, even if significant influence was succeeded by joint control. IAS 28 (2011) now requires that in such scenarios the retained interest in the investment is not remeasured.

The Group does not expect the amendments to Standard to have material impact on the financial statements.

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Amendments to IAS 32 – Offsetting Financial Assets and Financial Liabilities

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted, however the additional disclosures required by Amendments to IFRS 7 Disclosures - *Offsetting Financial Assets and Financial Liabilities must also be made.*)

The Amendments do not introduce new rules for offsetting financial assets and liabilities; rather they clarify the offsetting criteria to address inconsistencies in their application.

The Amendments clarify that an entity currently has a legally enforceable right to set-off if that right is:

- not contingent on a future event; and
- enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

The Group does not expect the Amendments to have any impact on the financial statements since it does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

(Effective for annual periods beginning on or after 1 January 2013. It applies prospectively to production stripping costs incurred on or after the beginning of the earliest period presented. Earlier application is permitted.)

The Interpretation sets out requirements relating to the recognition of production stripping costs, initial and subsequent measurement of stripping activity assets.

To the extent that benefits from production stripping are realised in the form of inventory produced, the related production stripping costs are accounted for in accordance with IAS 2 *Inventories.*

Production stripping costs that improve access to ore to be mined in the future are recognised as a non-current asset if, and only if, all of the following criteria are met:

- it is probable that future economic benefits will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and
- the costs relating to the stripping activity associated with that component can be measured reliably.

The stripping activity asset shall be accounted for as an addition to, or as an enhancement of, an existing asset.

The stripping activity asset shall initially be recognised at cost while after initial recognition, it shall be carried at either its cost or its revalued amount, less depreciation or amortisation and impairment losses, in the same way as the existing asset of which it is a part.

The Interpretation also requires that when the costs of the stripping activity asset and of the inventory produced are not separately identifiable, the entity allocates production stripping costs between the two based on a relevant production measure.

The Group does not expect the Interpretation to have any impact on the financial statements since it does not have any stripping activities.

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.

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Notes to the Financial Statements

Note 1: Interest Income

	EUR ths. 2012	EUR ths. 2011
From loans	1,464	1,998
From demand deposits with other credit institutions	23	10
From time deposits with other credit institutions	23	149
From debt securities	212	5
Other interest income	0	1
Total	**1,722**	**2,163**
Interest income by geographical areas		
Estonia	1,478	2,046
OECD countries (excl. Estonia)	244	117
Total	**1,722**	**2,163**

Note 2: Interest Expense

	EUR ths. 2012	EUR ths. 2011
On demand deposits	7	13
On time deposits	793	864
On derivatives	0	7
On subordinated debt *	-32	185
Other interest expense	5	4
Total	**773**	**1,073**
Interest expense by geographical areas		
Estonia	797	878
OECD countries (excl. Estonia)	-24	195
Total	**773**	**1,073**

* The Bank and UKRSELHOSPROM PCF LLC signed a change of subordinated debt agreement on 27.04.2012, whereby the interest rate was retroactively changed to 0% from 31.10.2011. Interest expense was adjusted accordingly and subordinated debt is partly disclosed under equity starting from year 2012 (please refer to Note 26).

Note 3: Fee and Commission Income

	EUR ths. 2012	EUR ths. 2011
Account opening and maintenance fees	68	21
Bank transaction fees	134	37
Securities' transaction fees	5	7
Letters of credit fees	5	0
Other fees and commissions income	10	6
Total	**222**	**71**

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Note 3 continued:

Fees and commissions income by geographical areas

Estonia	31	45
OECD countries (excl. Estonia)	191	26
Total	**222**	**71**

Note 4: Fee and Commission Expense

	EUR ths. 2012	EUR ths. 2011
Securities' transactions expenses	11	6
Bank transaction expenses	24	15
S.W.I.F.T. expenses	16	26
Other fees and commission expenses	6	0
Total	**57**	**47**

Note 5: Net Trading Gains

	EUR ths. 2012	EUR ths. 2011
From foreign exchange	76	60
From shares and debt securities in trading portfolio	8	-1
From available-for-sale financial assets	36	0
Total	**120**	**59**

Note 6: Other operating income

	EUR ths. 2012	EUR ths. 2011
Rental income from investment property	85	108
Operating expenses from property generating rental income	7	-16
Other operating income	24	75
Total	**116**	**167**

Rental income from investment property by due dates

	EUR ths. 2012	EUR ths. 2011
Rental income during next reporting period from uninterruptable contract:		
up to 1 year	50	78
1 to 5 years	13	78
over 5 years	9	22

Versobank AS had concluded 25 rent agreements as as of 31.12.2012 (25 rent agreements as of 31.12.2011)

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Note 7: Other Operating Expenses

	EUR ths. 2012	EUR ths. 2011
Guarantee Fund payments	65	68
Financial Supervision Authority fees	56	55
Stock Exchange fees	14	22
Other operating expenses *	210	60
Total	**345**	**205**

* Other operating expenses include investment properties expenses, property evaluation expenses and membership fees. Direct costs from non-profit real estate investments in year 2012 EUR 13 ths (2011: EUR 14 ths).

Note 8: Personnel Expense

	EUR ths. 2012	EUR ths. 2011
Salaries	947	920
Compensation to the Supervisory Board members	81	25
Fringe benefits	24	15
Income tax on fringe benefits	8	4
Change in vacations pay accrual	7	-9
Total	**1,067**	**955**

Note 9: Payroll Related Taxes

	EUR ths. 2012	EUR ths. 2011
From salaries	321	312
From compensation to the Supervisory Board members	27	8
From fringe benefits	12	8
Social insurance tax from change in vacations pay accrual	3	-3
Total	**363**	**325**

Note 10: Other Administrative Expenses

	EUR ths. 2012	EUR ths. 2011
Rent of premises	380	378
Other professional services purchased	180	180
Advertising expenses	42	83
Office expenses	52	58
Transportation expenses	69	73
Other expenses	16	34
Post and telecommunication expenses	49	54
Training and business trip expenses	27	12
IT expenses	24	22
Total	**839**	**894**

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Note 11: Depreciation and Amortisation of Tangible and Intangible Assets

	Note	EUR ths. 2012	EUR ths. 2011
Depreciation of tangible assets	21	62	84
Amortisation of intangible assets	23	17	25
Total		**79**	**109**

Note 12: Provisions

	EUR ths. 2012	EUR ths. 2011
Provision to cover potential liabilities *	230	372

* Group has formed a short-term provision both as of 31.12.2012 and 31.12.2011 to cover potential liabilities in connection with the sale contracts of assets disclosed as property investments.

Note 13: Impairment Loss on Assets

	EUR ths. 2012	EUR ths. 2011
Available-for-sale financial assets (Note 19)		
Impairment loss on available-for-sale financial assets	0	-194
Loans		
Impairment loss on claims	-2,537	-1,405
Recoveries of impaired loans	410	525
Total loans	**-2,127**	**-880**
Impairment on investment properties	-98	136
Impairment on other assets *	-110	-69
Total	**-2,335**	**-1,007**

* Impairment losses on fees receivable and property and equipment have been disclosed as impairment on other assets.

Note 14: Cash

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
In Euros	117	102
In foreign currency	13	15
Total	**130**	**117**

Note 15: Balances with Central Bank

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Mandatory reserve with the Bank of Estonia	386	597
Surplus of the mandatory reserve with the Bank of Estonia	4,159	8,181
Total	**4,545**	**8,778**

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Note 15 continued:

After Estonia joined the Euro-zone on 01.01.2011, the mandatory reserve requirement is followed in accordance with the Regulation of the European Central Bank on the application of minimum reserves (ECB/2003/9). Changes included the basis of the mandatory reserve, rate of mandatory reserve as well as allowed deductions. The mandatory reserve rate is 2% of deposits and borrowings, after allowed deductions, from 01.01.2011, filled by average of period set by the European Central Bank, by depositing the appropriate amount of euros on TARGET2 account with the Bank of Estonia.

Note 16: Due from Other Credit Institutions

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Correspondent accounts	**22,979**	**4,679**
Receivables by country		
Estonia	8,431	4,067
OECD countries (excl. Estonia)	14,548	612
Total	**22,979**	**4,679**
Due from other banks by bank ratings (Moody's Investors Service)		
A1	8,421	4,067
A2	4,387	0
A3	7,706	517
B2	0	8
Caa1	2,002	0
Not rated *	463	87
Total	**22,979**	**4,679**

* Claims to a credit institution registered in Denmark and Ukraine, which has no foreign rating.

Note 17: Due from Customers

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Due by customer types (gross)		
Due from financial institutions	242	317
Loans:		
Loans to financial institutions	0	997
Loans to private companies	20,081	24,337
Loans to non-profit organisations	0	54
Loans to private persons	4,152	4,612
Total loans	**24,233**	**30,000**
Accrued interest receivable	882	1,138
Total due from customers (gross)	**25,357**	**31,455**
Specific loan loss allowances	-4,583	-7,551
General loan loss allowances	-100	-85
Unamortised transaction fees	-15	-55
Total due from customers (net)	**20,659**	**23,764**

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Note 17 continued:

Loans by collaterals (gross)		
Mortgage	22,365	24,993
Commercial pledge	1,337	368
Deposit	35	8
Other security over movables	12	999
Other	285	3,210
Without collateral	1,081	1,560
Total	**25,115**	**31,138**
Due by remaining maturity (gross)		
On demand	242	317
Up to 3 months	2,021	383
3 to 12 months	1,506	1,499
1 to 2 years	1,331	3,142
2 to 5 years	4,293	5,711
over 5 years	6,589	4,258
past due	437	1,585
impaired loans	8,056	13,422
Accrued interest receivable from past due and impaired loans	848	1,095
Accrued interest receivable from other loans	34	43
Total	**25,357**	**31,455**
Loans by categories (gross)		
category 1 – low risk	13,317	12,162
category 2 – moderate risk	476	816
category 3 – medium risk	351	1,498
category 4 – high risk	10,971	16,662
Total	**25,115**	**31,138**
Incl. working loans by categories (gross)		
category 1 – low risk	13,130	11,920
category 2 – moderate risk	340	796
category 3 – medium risk	236	167
category 4 – high risk	2,068	2,153
Total	**15,774**	**15,036**
Due by countries (gross)		
Estonia	24,603	31,116
OECD countries (excl. Estonia)	754	339
Total	**25,357**	**31,455**

Past Due and Impaired Loans

Overdue loans by client type (gross)		
Loans to private companies	7,093	12,894
Interest claims to private companies	805	1,029
Loans to private persons	1,400	2,113
Interest claims to private persons	43	66
Total	**9,341**	**16,102**
No. of non-performing loans	37	65

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Note 17 continued:

Incl. impaired loans by customer type (gross)		
Loans to private companies	6,834	8,468
Accrued interest receivable from private companies	804	692
Loans to private persons	1,222	1,633
Accrued interest receivable from private persons	43	54
Total	**8,903**	**10,847**

Fair Value of Collaterals of Past Due and Impaired Loans

	EUR ths. **31.12.2012**	EUR ths. **31.12.2011**
Collaterals of past due loans	581	4,113
Collaterals of impaired loans	4,777	8,301
Total	**5,358**	**12,414**
Specific Loan Loss Allowances by Client Type		
Private companies		
Loan loss allowances at beginning of period	-6,518	-6,071
New loan loss allowances during period	-2,293	-939
Claims written off	4,398	344
Deductions of allowances during period	213	148
Loan loss allowances at end of period	**-4,200**	**-6,518**
Private persons		
Loan loss allowances at beginning of period	-1,033	-1,001
New loan loss allowances during period	-156	-409
Claims written off	700	377
Deductions of allowances during period	106	0
Loan loss allowances at end of period	**-383**	**-1,033**
Total specific loan loss allowances	**-4,583**	**-7,551**

All under-collaterised loans and overdrafts, where the payments are overdue by more than 90 days, are reported as non-performing claims. 31 claims have been written off in year 2012 (4 claims have been written off in year 2011).

Maximum credit risk arising from on-balance sheet assets is equal to the carrying value of the financial assets, as the conditions have not been re-negotiated. Credit risk arising from unused loan limits disclosed off-balance sheet comprise EUR 741 ths. (2011: EUR 640 ths.).

Issued but unused letters of credit comprised EUR 100 ths. as of 31.12.2012 (EUR 0 ths. as of 31.12.2011), disclosed as off-balance sheet commitments. Letters of credit were covered with deposits in the same amount.

Management has disclosed its opinion on fair value of loans in Note 43.

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Note 17 continued:

Overdue financial assets maturity structure

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Private companies		
Up to 90 days	525	1,764
91 days to 1 year	376	2,863
1 to 2 years	2,530	1,894
over 2 years	4,467	7,402
Total	**7,898**	**13,923**
Private persons		
Up to 90 days	438	492
91 days to 1 year	357	546
1 to 2 years	387	628
over 2 years	261	513
Total	**1,443**	**2,179**
Total overdue financial assets	**9,341**	**16,102**

incl. maturity structure of unimpaired financial assets

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Private companies		
Up to 90 days	273	1,695
91 days to 1 year	345	348
1 to 2 years	0	1,610
over 2 years	98	1,110
Total	**716**	**4,763**
Private persons		
Up to 90 days	335	262
91 days to 1 year	104	0
1 to 2 years	0	231
Total	**439**	**493**
Total unimpaired financial assets	**1,155**	**5,256**

Restructured loans

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Loans to private companies	7,530	10,101
Loans to private persons	644	704
Total	**8,174**	**10,805**

Bank has restructured 24 loans, as of 31.12.2012, where the payment difficulties have temporary nature. 31 loans were restructured as of 31.12.2011.

4 loans were restructured during year 2012, all 4 loans to companies. Claim balances as of 31.12.2012 were accordingly EUR 7,530 ths. and EUR 604 ths.

10 loans were restructured during year 2011, including 6 loans to companies and 4 loans to private persons. Claim balances as of 31.12.2011 were accordingly EUR 10,101 ths. and EUR 704 ths.

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Note 17 continued:

Financial effect of collateral of overdue loans

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Over-collaterised loans		
Loan balance	4,555	7,912
Fair value of collateral	5,309	12,037
Under-collaterised loans		
Loan balance	203	835
Fair value of collateral	49	373

Note 18: Financial Assets/Financial Liabilities Held for Trading

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Financial assets Held for Trading		
Derivatives *	16	2
Financial assets in fair value through profit and loss		
shares listed on a stock exchange (active market)	3	3
Total	**19**	**5**

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Financial Liabilities Held for Trading		
Derivatives *	16	6
Total	**16**	**6**
Total financial assets/financial liabilities held for trading	**3**	**-1**
Shares and other securities by countries		
Estonia	0	-4
OECD countries (excl. Estonia)	3	3
Total	**3**	**-1**

*** Derivatives**

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Currency related derivatives:		
claims (in contract value)	12,739	5,956
commitments (in contract value)	12,739	5,960
fair value	0	-4

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Note 19: Available-for-Sale Financial Assets

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Debt securities and other shares by issuer		
Debt securities of central goverment	690	0
Debt securities of credit institutions	2,211	55
Debt securities of private companies	1,500	66
Shares and fund units of private companies	3	3
Total	**4,404**	**124**

Movements in debt securities and other shares	**2012**	**2011**
Balance at beginning of year	124	317
Purchases	5,865	0
Sold	-1,960	0
Impairment charge (Note 13)	0	-194
Amortised premium discount	202	0
Fair value revaluation	83	0
Interest accruals	90	1
Total	**4,404**	**124**
Debt securities and other shares by ratings		
Baa1	2,115	0
Caa1	1,564	0
Without ratings	725	124
Total	**4,404**	**124**
Debt securities and other shares by countries		
Estonia	69	124
OECD countries (excl. Estonia)	4,335	0
Total	**4,404**	**124**

Impairment charges of available-for-sale financial assets

	EUR ths. 2012	EUR ths. 2011
Debt securities of private companies	0	194
Total	**0**	**194**

Note 20: Held-to-maturity investments

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Debt securities and other shares by issuer		
Debt securities of central goverment	1,543	0
Debt securities of credit institutions	2,746	0
Debt securities of private companies	750	0
Total	**5,039**	**0**

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Note 20 continued:

Movements in debt securities and other shares	**2012**	**2011**
Balance at beginning of year	0	0
Purchases	4,950	0
Amortised premium discount	-49	0
Interest accruals	138	0
Total	**5,039**	**0**

Debt securities by ratings		
A3	1,039	0
Baa1	697	0
Baa2	2,754	0
Baa3	549	0
Total	**5,039**	**0**

Debt securities and other shares by countries		
Estonia	0	0
OECD countries (excl. Estonia) *	5,039	0
Total	**5,039**	**0**

* Held-to-maturity bonds kept with credit institution can be used as collateral, if a credit line opened there is utilised.

Note 21: Property and Equipment

EUR ths.

	Capitalised construction expenses *	**Computers**	**Furniture**	**Other tangible assets**	**Total**
Balance as of 01.01.2012					
At cost	**315**	**84**	**68**	**281**	**748**
Accumulated depreciation	-245	-72	-57	-190	**-564**
Net value	**70**	**12**	**11**	**91**	**184**
Changes in 2012					
Purchases during period	0	8	0	8	**16**
Depreciation expense (Note 11)	-22	-6	-4	-30	**-62**
Property and equipment write-offs (at cost)	-232	-12	-25	-82	**-351**
Accumulated depreciation of property and equipment write-offs	227	11	25	79	**342**
Balance as of 31.12.2012					
At cost	**83**	**80**	**43**	**207**	**413**
Accumulated depreciation	-40	-67	-36	-141	**-284**
Net value	**43**	**13**	**7**	**66**	**129**

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Note 21 continued:

EUR ths.

	Capitalised construction expenses *	Compu-ters	Furni-ture	Other tangible assets	Total
Balance as of 01.01.2011					
At cost	**370**	**79**	**87**	**267**	**801**
Accumulated depreciation	-248	-68	-67	-181	**-565**
Net value	**121**	**10**	**19**	**85**	**236**
Changes in 2011					
Purchases during period	0	9	1	46	**56**
Depreciation expense (Note 11)	-34	-7	-7	-36	**-84**
Property and equipment write-offs (at cost)	-55	-4	-20	-32	**-111**
Accumulated depreciation of property and equipment write-offs	37	3	17	27	**84**
Balance as of 31.12.2011					
At cost	**315**	**84**	**68**	**281**	**748**
Accumulated depreciation	-245	-72	-57	-190	**-564**
Net value	**70**	**12**	**11**	**91**	**184**

* Reconstruction expenses of rented premises.

Note 22: Investment Properties

	EUR ths. **2012**	EUR ths. **2011**
Investment properties at beginning of year	4,557	4,617
Investment properties acquired	0	-160
Investment properties sold	-382	-36
Fair value revaluation	-237	136
Total	**3,938**	**4,557**

Group has acquired several collateral properties including flats from repertory auctions, with an intention to sell them in the few coming years.

Investment properties are valued at fair value, derived by the Bank mainly from transactions in market value with similar assets. Discounted cash flows method has been used in fair value valuation for assets covered with existing contracts, realising in the future, in the carrying value of 2,286 thousand euros as of 31.12.2012 (2,278 thousand euros as of 31.12.2011).

Rent income earned on investment properties and direct expenses on assets earning rent income are disclosed in Note 6.

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Note 23: Intangible Assets

Software and licenses	EUR ths. 2012	EUR ths. 2011
Balance as of 01.01.		
At cost	**384**	**378**
Accumulated amortisation	-279	-254
Net value	**105**	**124**
Changes during report year		
Purchases during period	8	6
Amortisation expense (Note 11)	-17	-25
Balance as of 31.12.		
At cost	**392**	**384**
Accumulated amortisation	-296	-279
Net value	**96**	**105**

Note 24: Other Assets

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Fees and commissions receivable	19	3
Prepaid supervision fees *	56	57
Other prepaid expenses **	109	71
Other receivables	20	19
Other assets and accrued revenue	0	2
Total	**204**	**152**

* Prepaid supervision fees include fees paid to the supervisory authority in accordance with the Financial Supervision Authority Act. The rate of supervision fee consists of the capital share which is an amount equal to 1% of the minimum amount of the net own funds and the share calculated on the basis of assets in an amount equal to 0.005% - 0.05% of the assets of the credit institution. The supervision fee is prepaid once a year for the next year.

** Other prepaid expenses include the collateral amounts paid according to the lease agreements for premises, insurance payments and server maintenance fees.

Note 25: Deposits

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Deposits from credit institutions	276	15
Other deposits	50,755	32,808
Total	**51,031**	**32,823**
Demand deposits	22,650	9,020
Time deposits	27,799	23,456
Other borrowings	166	0
Accrued interests	416	347
Total	**51,031**	**32,823**

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Note 25 continued:

Demand deposits by customer groups		
Companies	19,923	7,494
Private persons	2,384	1,252
Non-profit organisations	233	259
Credit institutions	110	15
Total	**22,650**	**9,020**
Time deposits by customer groups		
Private persons	18,888	16,561
Companies	6,651	6,567
Non-profit organisations	2,260	328
Total	**27,799**	**23,456**
Deposits by maturities		
On demand	22,650	9,021
Up to 3 month	7,981	9,254
3 to 12 months	17,553	11,676
1 to 2 years	1,608	2,241
2 to 5 years	1,239	631
Total	**51,031**	**32,823**

Note 26: Subordinated Debt

	EUR ths. **2012**	EUR ths. **2011**
Debt balance at beginning of period	4,033	4,033
Effective interest rate correction	-1,102	0
Total	**2,931**	**4,033**

Group took a 4.0 million euro subordinated debt from Marfin Egnatia Bank S.A., a bank belonging to the group, in December 2009. Initial borrower transferred all the rights and obligations arising from subordinated debt to UKRSELHOSPROM PCF LLC with the agreement concluded on 29.03.2012. The Bank and UKRSELHOSPROM PCF LLC signed a change of subordinated debt agreement on 27.04.2012, whereby the interest rate was retroactively changed to 0% from 31.10.2011. Interest expense was adjusted accordingly (please refer to Note 2) and subordinated debt is partly disclosed under equity starting from year 2012 (EUR 1,069 ths. as of 31.12.2012) based on effective interest rate of 4.661% p.a. This 10-year subordinated loan can be treated as tier 2 own funds.

Note 27: Borrowed Funds from Government and Foreign Aid

	EUR ths. **2012**	EUR ths. **2011**
Debt balance at beginning of period	166	272
Borrowings received	128	100
Borrowings repaid	95	206
Balance at end of period	**199**	**166**

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Note 27 continued:

Debts by maturities		
Up to 3 months	43	62
3 to 12 months	41	33
1 to 2 years	63	40
2 to 5 years	52	31
Total	**199**	**166**

Borrowings from Estonian Rural Development Foundation are reported under borrowed funds from government and foreign aid. Borrowings bear a fixed interest rate 1.5% p.a.

Note 28: Tax Liabilities

	EUR ths.	EUR ths.
	31.12.2012	**31.12.2011**
Taxes payable	**143**	**87**

There has not been any tax audits in the Bank, and thus no additional taxes have been assigned. Tax authority has the right to audit tax calculations of the Bank during 6 years from due date of filing tax declaration, and in case of mistakes assign additional taxes, interests and penalties.

Note 29: Other Liabilities

	EUR ths.	EUR ths.
	31.12.2012	**31.12.2011**
Payments in transmission *	15	55
Payables to employees	55	45
Payables to suppliers	20	43
Prepaid expenses	5	6
Other liabilities	1	0
Total	**96**	**149**

* Payments in transmission include payments of customers and the bank, which are under processing as well as unsettled payments (incl. incorrectly received funds, returnable funds etc.).

Note 30: Shareholders' Equity

Shares

Paid-in share capital comprised 12,088,774.20 euros as of 31.12.2012, divided into 20,147,957 common shares with nominal value of 0.60 euros (as of 31.12.2011: share capital 7,048,774.20 euros, 11,747,957 common shares with nominal value 0.60 euros). According to the articles of association, the minimum share capital of the Bank is 6,391,164 euros and maximum share capital is 25,564,660 euros. Registered share gives shareholder a right to participate in the management of the Bank, in profit distribution and in case of liquidation in distribution of remaining assets, also other rights stipulated in law and articles of association.

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Note 30 continued:

Majority shareholder of the Bank was replaced in year 2012, other shareholders remained the same. The shareholders of the Bank decided on 12.04.2012 to increase the share capital by issuing new shares. The new majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full and EUR 5,040,000 was credited to the Bank's account on 28 May 2012 as a monetary payment for shares (8,400,000 common shares were issued). Extraordinary Meeting of Shareholders decided on 27.11.2012 to increase the share capital of the Bank by EUR 2,000,001, i.e. from EUR 12,088,774.20 to EUR 14,088,775.20 by issuing new shares. The majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full on 13.12.2012 and filed an application with the National Bank of Ukraine for receiving appropriate license. Payment for new shares was credited on 27.02.2013.

Other equity instruments
Part of subordinated debt (please refer to Note 26) is disclosed under equity starting from year 2012. Effective interest rate correction was due to the fact that the Bank and UKRSELHOSPROM PCF LLC signed a change of subordinated debt agreement on 27.04.2012, whereby the interest rate was retroactively changed to 0% from 31.10.2011.

Revaluation Reserve for Available-for-Sale Financial Assets

Revaluation gains and losses from available-for-sale financial assets (debt securities portfolio) are reflected as revaluation reserve in accordance with IAS 39 through the other comprehensive income.

Statutory Legal Reserve
Statutory legal reserve has been formed in accordance with the Estonian Commercial Code. Statutory legal reserve is formed by means of yearly appropriations from the net profit. At least 1/20 of the net profit must be set aside to statutory legal reserve, until the statutory legal reserve is at least 1/10 of share capital. Statutory legal reserve can be used to cover losses, also to increase share capital. No payments can be made to the owners from the statutory legal reserve.

Note 31: Related-Party Transactions

The following parties are considered to be related in the Annual Report of Versobank AS:

a. owners (UKRSELHOSPROM PCF LLC is the parent of the Bank);
b. other companies belonging to the same consolidation group;
c. executive management and Supervisory Board;
d. close relatives of the persons mentioned previously and the companies related to them;
e. subsidiary Osito Casa OÜ (deleted from Commercial Register on 28.12.2012).

Management Board members of the credit institution, head of internal audit and their related parties, also companies controlled jointly of privately by these persons:	EUR ths. **2012**	EUR ths. **2011**
Loans:		
Balance of loans at beginning of period 01.01	19	13
Disbursed loans	0	20
Repaid loans	-4	-14
Balance of loans at end of period 31.12	15	19
Interest income	1	0
Liabilities:		
Deposits	72	37
Salaries of the members of the Management Board	217	204

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Note 31 continued:

Shareholders of the credit institution and their related parties, also companies controlled jointly of privately by these persons:	EUR ths. **2012**	EUR ths. **2011**
Loans:		
Balance of loans at beginning of period 01.01	180	687
Disbursed loans	0	0
Repaid loans	-15	-507
Balance of loans at end of period 31.12	165	180
Interest income	6	103
Interest receivable	1	1
Due from credit institutions	352	0
Liabilities:		
Deposits	193	195
Interests paid	0	186
Fees and commission income	9	1
Administrative and other operating expenses	0	285

Company belonging to the consolidation group	EUR ths. **31.12.2012**	EUR ths. **31.12.2011**
Loans:		
Interest income	0	73
Liabilities:		
Deposits	0	14
Other operating income	0	89
Other operating expenses	0	1
Payment of the liquidation proceeds *	11	0

* Osito Casa OÜ was deleted from the Commercial Register as of 28.12.2012.

Members of the Supervisory Board of the credit institution and their related parties, also companies controlled jointly of privately by these persons:	EUR ths. **31.12.2012**	EUR ths. **31.12.2011**
Deposits	1	0
Fees and commission income	2	0
Compensation to the members of the Supervisory Board	81	25

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Note 31 continued:

Parent company of the Bank: UKRSELHOSPROM PCF LLC	EUR ths. **31.12.2012**	EUR ths. **31.12.2011**
Pay share capital	5,040	0
Subordinated debt (gross)	4,000	0
Including disclosed under equity	-1,069	0
Fees and commission income	1	0
Fees receivable	1	0

Loans to related parties have no loan loss allowances.

Agreements concluded with the members of the Management Board include one-time compensations in the amount of salaries of 6 – 10 calendar months in case agreement is terminated by the Bank.

Note 32: Geographical Concentration of Clients' Debts

EUR ths., as of 31.12.2012

	Balance sheet claims				
Area	**loans ***	**incl. overdue and doubtful claims**	**securities ****	**contin-gent assets**	**by area (%)**
Note	15, 16, 17	17	18, 19, 20	18	
Estonia	32,637	4,895	71	3,722	51,76%
United States of America	4,277	0	1,863	0	8,72%
United Kingdom	243	0	547	9,017	13,93%
Denmark	111	0	0	0	0,16%
Latvia	2	0	0	0	0,00%
Germany	7,661	0	0	0	10,88%
Ukraine	2,354	0	0	0	3,34%
Russia	1	0	282	0	0,40%
Austria	85	0	0	0	0,12%
Switzerland	58	0	0	0	0,08%
Panama	754	0	0	0	1,07%
Bahrein	0	0	1,340	0	1,90%
Italy	0	0	1,556	0	2,21%
Spain	0	0	495	0	0,70%
France	0	0	492	0	0,70%
Luxembourg	0	0	631	0	0,90%
Romania	0	0	549	0	0,78%
Slovenia	0	0	994	0	1,41%
Turkey	0	0	642	0	0,91%
Total	**48,183**	**4,895**	**9,462**	**12,739**	**100,00%**

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Note 32 continued:

EUR ths., as of 31.12.2011

Area	Balance sheet claims				
	loans *	incl. overdue and doubtful claims	securities **	contin-gent assets	by area (%)
Estonia	36,118	10,626	124	1,127	86,29%
United States of America	338	0	3	0	0,79%
United Kingdom	312	0	2	4,829	11,88%
Denmark	86	0	0	0	0,20%
Germany	179	0	0	0	0,41%
Cyprus	9	0	0	0	0,02%
Greece	179	0	0	0	0,41%
Total	**37,221**	**10,626**	**129**	**5,956**	**100,00%**

* Includes claims on credit institutions and financial institutions.
** Comprises financial assets held for trading, available-for-sale financial assets and held-to-maturity financial investments.

Note 33: Concentration of Clients' Debts by Economic Sector

EUR ths., as of 31.12.2012

Economic sector	Balance sheet claims				
	loans *	incl. overdue and doubtful claims	securities **	contin-gent assets	by area (%)
Note	15, 16, 17	17	18, 19, 20	18	
Agriculture, forestry and fishing	1,594	849	0	0	2,26%
Mining and quarrying	95	0	0	0	0,13%
Manufacturing	352	2	0	0	0,50%
Electricity, gas, steam and air conditioning supply	471	0	749	0	1,73%
Construction	466	157	0	0	0,66%
Wholesale and retail trade	521	154	0	3,722	6,03%
Transportation and storage	61	3	0	0	0,09%
Accommodation and food service activities	947	3	0	0	1,35%
Information and communication	0	0	1,434	0	2,04%
Financial and insurance activities	27,872	159	4,977	9,017	59,48%
Real estate activities	9,208	3,026	66	0	13,18%
Professional, scientific and technical activities	76	0	0	0	0,11%
Administrative and support service activities	46	0	0	0	0,07%
Public administration and defence; compulsory social security	0	0	2,233	0	3,17%
Human health and social work activities	40	0	0	0	0,06%
Arts, entertainment and recreation	227	0	0	0	0,32%
Other service activities	2,594	1	3	0	3,69%
Private persons	3,613	541	0	0	5,13%
Total	**48,183**	**4,895**	**9,462**	**12,739**	**100,00%**

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Note 33 continued:

EUR ths., as of 31.12.2011	Balance sheet claims				
Economic sector	loans *	incl. overdue and doubtful claims	securities **	contin-gent assets	by area (%)
Agriculture, forestry and fishing	1,067	703	0	0	3,28%
Mining and quarrying	136	0	0	0	0,25%
Manufacturing	518	3	0	0	0,97%
Electricity, gas, steam and air conditioning supply	182	0	0	0	0,34%
Construction	404	1,286	0	0	3,13%
Wholesale and retail trade	1,404	502	0	0	3,53%
Transportation and storage	196	21	0	1,127	2,49%
Accommodation and food service activities	191	2	0	0	0,36%
Financial and insurance activities	14,929	323	60	4,829	37,35%
Real estate activities	12,907	5,951	66	0	35,09%
Professional, scientific and technical activities	14	0	0	0	0,03%
Administrative and support service activities	8	0	0	0	0,01%
Human health and social work activities	55	0	0	0	0,10%
Arts, entertainment and recreation	263	4	0	0	0,50%
Other service activities	1,323	368	3	0	3,14%
Private persons	3,624	1,463	0	0	9,43%
Total	**37,221**	**10,626**	**129**	**5,956**	**100,00%**

* Includes claims on credit institutions and financial institutions.
** Comprises financial assets held for trading, available-for-sale financial assets and held-to-maturity financial investments.

Note 34: Contingent Assets and Liabilities

		31.12.2012
	EUR ths.	EUR ths.
	Claims	**Liabilities**
Irrevocable transactions	**12,739**	**13,580**
Unused loan limits (Note 17)	0	741
Letters of credit granted but not utilised	0	100
Currency forward transactions (Note 18, 35)	12,739	12,739

		31.12.2011
	EUR ths.	EUR ths.
	Claims	**Liabilities**
Irrevocable transactions	**5,956**	**6,599**
Unused loan limits (Note 17)	0	640
Currency forward transactions (Note 18, 35)	5,956	5,959

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Note 35: Liquidity (Assets and Liabilities by Remaining Maturities)

EUR ths., as of 31.12.2012

Claims, liabilities	Note	On demand	Over-due	Up to 1 month	1 to 3 months	3 to 12 months	1 to 2 years	2 to 5 years	Over 5 years	Total
Claims of the Bank		**17,775**	**1,510**	**11,060**	**2,186**	**3,023**	**2,078**	**5,263**	**15,084**	**57,979**
Cash and claims to credit institutions		17,505	0	10,149	0	0	0	0	0	**27,654**
Claims to customers	17	242	1,444	886	2,169	2,867	1,586	4,550	6,915	**20,659**
Securities		6	66	16	0	0	492	713	8,169	**9,462**
Other claims	24	22	0	9	17	156	0	0	0	**204**
Liabilities of the Bank		**21,709**	**0**	**4,549**	**4,885**	**17,594**	**1,671**	**1,291**	**4,000**	**55,699**
Amounts owed to credit institutions	25	109	0	0	167	0	0	0	0	**276**
Amounts owed to clients	25	21,355	0	4,309	4,691	17,553	1,608	1,239	0	**50,755**
Subordinated debt	26	0	0	0	0	0	0	0	4,000	**4,000**
Other borrowings	27	0	0	16	27	41	63	52	0	**199**
Other liabilities		245	0	224	0	0	0	0	0	**469**
Net		**-3,934**	**1,510**	**6,511**	**-2,699**	**-14,571**	**407**	**3,972**	**11,084**	**2,280**
Contingent:										
assets (Note 18,34)		**0**	**0**	**12,739**	**0**	**0**	**0**	**0**	**0**	**12,739**
liabilities (Note 18, 34)		**741**	**0**	**12,739**	**0**	**100**	**0**	**0**	**0**	**13,580**

EUR ths., as of 31.12.2011

Claims, liabilities	Note	On demand	Over-due	Up to 1 month	1 to 3 months	3 to 12 months	1 to 2 years	2 to 5 years	Over 5 years	Total
Claims of the Bank		**2,017**	**3,681**	**13,268**	**176**	**2,573**	**5,177**	**6,213**	**4,527**	**37,632**
Cash and claims to credit institutions		1,672	0	11,902	0	0	0	0	0	**13,574**
Claims to customers	17	317	3,615	1,359	162	2,463	5,177	6,158	4,513	**23,764**
Securities		6	66	2	0	0	0	55	0	**129**
Other claims	24	22	0	5	14	110	0	0	14	**165**
Liabilities of the Bank		**7,454**	**0**	**6,544**	**4,646**	**12,171**	**2,654**	**1,681**	**4,596**	**39,746**
Amounts owed to credit institutions	25	15	0	0	0	0	0	0	0	**15**
Amounts owed to clients	25	7,384	0	6,350	4,597	11,944	2,420	696	12	**33,403**
Subordinated debt	26	0	0	0	0	194	194	582	4,584	**5,554**
Other borrowings	27	0	0	13	49	33	40	31	0	**166**
Other liabilities		55	0	181	0	0	0	372	0	**608**
Net		**-5,437**	**3,681**	**6,724**	**-4,470**	**-9,598**	**2,523**	**4,532**	**-69**	**-2,114**
Contingent:										
assets (Note 18, 34)		**0**	**0**	**5,956**	**0**	**0**	**0**	**0**	**0**	**5,956**
liabilities (Note 18, 34)		**0**	**0**	**5,959**	**0**	**80**	**44**	**30**	**486**	**6,599**

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Note 36: Loss Per Share

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
Net loss for the reporting period	-3,536	-2,245
Weighted average no. of shares (ths. pcs.)	16,728	12,857
Basic loss per share	**-0.21**	**-0.17**
Diluted loss per share	**-0.21**	**-0.17**

Versobank AS has not issued convertible securities.

Note 37: Operating Lease Liabilities

Rental payments for vehicles

Versobank AS has concluded operating lease agreements for four vehicles as of 31.12.2012. Longest contract ends on 15.12.2015, i.e. no agreement exceeds 5 years. Operating lease agreements for five vehicles were concluded as of 31.12.2011 and the maturity date of the longest contract was 15.12.2015.

All contractual rent payments are uninterruptable.

Rental payments for vehicles by due dates

	EUR ths. 2012	EUR ths. 2011
Rental payment paid and expensed during reporting year	30	32
Rental payments payable:		
up to 1 year	30	30
1 to 5 years	40	71

Rental payments for bank premises

Versobank AS had concluded agreements for renting bank premises in Tallinn and Tartu. Tartu rent agreement matured on 31.07.2012. Tallinn rent agreement ends on 31.05.2021.

Rental payments for bank premises by due dates

	EUR ths. 2012	EUR ths. 2011
Rental payment paid and expensed during reporting year	347	343
Rental payments payable during next reporting period:		
from uninterruptable contract:		
up to 1 year	344	334
1 to 5 years	1,718	1,591
over 5 years	830	1,087

Agreements for renting bank premises can be terminated before the prescribed time upon agreement in six months notice time.

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Note 38: Risk and Capital Management

Key developments in 2012

In 2012, the Bank made significant efforts in further strengthening its approach to risk, capital and liquidity management. The Supervisory Board approved new Policy for the Risk and Capital Management enhancing the general principles and organizational framework for risk and capital management as well as renewed description of the Bank risk profile and risk appetite. During the year new organisational units Compliance Division, Risk Management Division and Financial Monitoring Department was established in the Bank for increasing independent risk management and control. New liquidity risk management principles and framework was adopted according to new Policy for Liquidity Management approved by the Supervisory Board in November 2012. Supervisory Board of the Bank also substantially reviewed and updated existing Credit Policy.

Risk and Capital Management Policy

The Policy for Risk and Capital Adequacy Management sets out overall aim and framework of the risk taking activities within the Bank. Through the policy, the Supervisory Board provides guidelines for the Bank on risk management, risk control, capital adequacy management, risk capital allocation and capital planning. The Management Board has the overall responsibility for implementation of risk and capital management.

The policy determine general risk and capital management principles, formulate risk strategy and appetite for main risk categories, formulate general requirements for internal risk limits system, determine capital adequacy and capital planning principles and determine risk management and internal control organisation.

As a general principle, the risk management is an integrated part of all the Bank business activities and should be presented at all levels and to all activities within the Bank. The Bank must keep at all times a balanced risk structure and diversified risk portfolio. The Bank maintains low and conservative risk profile from both capital and liquidity perspective. The Bank keeps adequate capital level to ensure compliance with regulatory requirements and have sufficient risk capital to cover risks taken.

Risk management is business-oriented. Risk management plays an important role in assessing and keeping customer relationships of the Bank. Risk management supports Bank's management by analysing the balance of potential risk and reward scenarios. Every risk taken must have a prior analysis within the appropriate risk management framework.

Risk organisation and risk management process

The Bank has three levels of risk management decision-making – the Supervisory Board, the Management Board and the Credit Committee. Asset-Liability Committee (ALCO) functions as well as Risk Committee functions are currently performed by the Management Board considering the size of the Bank.

According to new organisational structure roles and responsibilities for the Bank risk management and internal control system are defined under "three lines of defense" concept. The first line of defense (risk management by business units) is that all business units are required to ensure effective management of risks within the scope of their organisational responsibilities. The second line of defense (independent risk control) is control and monitoring functions which include risk management (risk control) function and compliance function. The third line of defense is the independent assurance provided by the internal audit.

The Bank continuously assesses and monitors its current risk profile by most important business areas and most important risk types identified throughout the bank. The risk infrastructure incorporates the relevant business divisions and provides the basis for tailor-made reporting on risk positions, capital adequacy and limit utilisation to the relevant functions both on a regular and ad-hoc basis.

Credit risk

Credit risk is a risk that the counterparty to transaction is not capable of performing or willing to perform its contractual obligations and the risk that pledged collateral will not cover the Bank´s claim. Credit risk arises from all transactions where actual, contingent or potential claims against any

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counterparty, borrower or obligator exist. Within credit risk country and concentration risk shall be considered.

Credit Policy

The Credit Policy sets up the primary criteria for the acceptable credit risks, define the Bank credit risk appetite and target markets, identify high risk areas which require special attention, formulate requirements for the Bank´s credit portfolio limits system, describe risk taking framework and risk management system for loan portfolio.
The strategy and limits system for management credit risk in bond portfolios (both available-for-sale and held-to-maturity portfolio) set out by Policy for Liquidity Management.

The credit transaction and credit due-diligence realised by the Bank complies with the following general standards:

- lending in line with the credit policy;
- understanding the transaction and the risks involved;
- know your customer;
- sufficient information to enable the comprehensive assessment of risk profile;
- risk/reward assessment;
- customer´s credit capacity assessment;
- requirements for self financing;
- requirements for securing loans.

Risk organisation and risk management process

Decisions related to loans, guarantees and sureties are made by the credit committee. Credit exposures above certain level or which exceed certain loan to value level shall be approved also by Supervisory Board according to the rules set by Credit Policy. The daily administration and monitoring of the credit exposures takes place in the Credit Division, following very detailed procedures. Procedures cover analysis of loan projects taking into consideration creditworthiness of customer, previous credit history, financial condition, market conditions and other important factors affecting the credit risk. The Bank has internal risk rating system for managing, controlling and establishing limits for credit portfolio.
Please see Note 17 for summary of quantitative data and credit quality of credit portfolio (including gross credit portfolio customers by customer types and credit portfolio by risk categories).

Collateral

General requirements for securing loans, decision making authorities regarding collateral type, maximum allowed loan to market value ratios and maximum allowed amount of unsecured loans are set out by credit policy. The collateral and collateral values are regularly monitored by credit administration of the Bank. Please refer to Note 17 for value of positions exposed to credit risk by collateral type.

Impaired loans

The loan is considered impaired if it is overdue for 90 days or more. The loan may also consider as impaired if there is objective evidence that a loss event has occurred and such loss event has an impact on future estimated cash flows. Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower´s financial position, where the Bank made concessions by agreeing to terms and conditions that are more favorable for the borrower. The Bank writes off a loan and any related allowances for impairment losses when the Bank determines that the loan is uncollectible and proceeds from collateral will not be sufficient to pay pack the entire exposure. The credit committee reviews loans in arrears weekly, other loans are reviewed at least yearly. The adequacy and amount of loan loss allowances are reviewed monthly.
Note 17 provides analysis and details of past due and impaired loans, value of collaterals of past due and impaired loans, value of loans have been written off, overdue financial assets by maturity structure, information about restructured loans and overview of financial effect of collateral of overdue loans.

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Counterparty credit risk
The Bank has a limit system for counterparty risk management. All counterparty risk limits, including total exposure, maximum maturity of deposits, foreign exchange risks, are approved by the Management Board. The counterparty analysis depends on the counterparty´s rating, country of origin, size of limit requested and other important factors affecting counterparty credit risk.

Risk concentration
The Bank limits concentration of exposures to counterparties, geographies and higher risk areas. Risk concentration is considered high if the liabilities and potential liabilities of one single customer or connected customer group to the credit institution exceed 10% of the net own funds of the Bank (maximum limit allowed by the law is 25% of net own funds). To maintain conservative approach and reduce the concentration risk, the Bank maximum exposure limit set by Credit Policy shall not exceed 10%. All exemptions to this limit shall be approved by Supervisory Board. The Bank credit exposure with related persons shall not exceed 4.5% of the Bank net own funds.
Please see Note 32 for value of positions exposed to credit risk by type and geographical area.
Please see Note 33 for value of positions exposed to credit risk by sector of economy.
Please see Note 17 for value of positions exposed to credit risk by remaining maturity.
Please see Note 42 for total number of clients and due from customers with high risk concentration.

Bond portfolios
According to Bank's new strategy for liquidity management and treasury portfolios the *available-for-sale* and *held-to-maturity* debt instruments portfolio were purchased in the year 2012. The objectives of treasury portfolios are to provide liquidity, provide the interest rate management and provide additional profit.
The objective of the *available-for-sale* portfolio is to warehouse liquidity of the Bank in order to earn interest income and capital gain in instruments that can be sold to meet Bank´s liabilities. The objective of the *held-to-maturity* portfolio is to retain the value of the capital and to provide a long-term stable return of interest income. The general limits and composition principles for treasury portfolios are set by Policy for Liquidity Management. The bond portfolios are managed by Treasury Department according to Policy for Liquidity Management and trading strategy approved by Management Board.
Please see Note 20 for financial assets held-to-maturity and Note 19 for financial assets available-for-sale.

Liquidity risk

Liquidity risk is a risk arising from the Bank´s potential inability to meet all payment obligations when they come due or only being able to meet these obligations at excessive cost. Liquidity risk is the risk that the Bank will incur losses because it finds it difficult to secure the necessary funds or is forced to obtain funds at far higher cost than under normal conditions. It is also the risk that the Bank will incur losses because it is unable to conduct market transactions or is forced to conduct transactions at far more unfavorable prices than under normal conditions.
The Bank approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage of the Bank´s reputation.
The Bank liquidity management is the process of balancing the cash inflows and outflows across on- and off-balance sheet items as well as across currencies, counterparties and locations. The liquidity management includes the control of maturity/currency mismatches and the management of liquid assets holdings to ensure both that adequate sources of cost-effective funding are available and that those sources are used appropriately.
Liquidity management also comprises the management of the Bank's balance sheet risk. This includes the mitigation of currency risk, interest rate risk and maturity risk in the balance sheet through active hedging and position-taking strategies as well using derivatives within prescribed risk guidelines. Furthermore, liquidity management involves setting the cost of funds for lending transactions based on the internal transfer prices applicable from time to time.

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Liquidity management strategy
In November 2012 the Bank's Supervisory Board approved new Policy for Liquidity Management. The key elements of the Bank´s liquidity strategy are as follows:

- maintaining a diversified funding base consisting of customer deposits and wholesale market deposits and maintaining contingency facilities;
- carrying a portfolio of highly liquid assets;
- monitoring liquidity ratios, maturity mismatches, characteristics of the Bank´s financial assets and liabilities;
- carrying out stress testing of the Bank´s liquidity position.

According to the policy the Bank shall maintain conservative liquidity management strategy and to avoid significant liquidity risks by maintaining rather larger liquidity reserves. The Bank shall all the time hold sufficient amount of liquidity reserves as defined by Policy for Liquidity Management. The Bank shall conservatively assess its stock of highly liquid assets. The profit expectations shall not override liquidity requirements. The financial strength and proper assets-liabilities structure is the first priority for the Bank.
To manage liquidity risk, the Bank monitors its liabilities and commitments by estimating the cash flows emanating from all assets and liabilities up to different maturities and by setting limits to the available liquidity in relation to the estimated liquidity requirements.
The primary funding resources for the Bank are the Customers' deposits. To acquire the proper funding the Bank shall ensure the well diversified and stable funding base. The Bank carefully monitors and mitigates concentration of funding. Over-concentration shall be taken into account on liquidity buffer determination. The liquidity management strategy takes into account large concentration of funding as well as highly volatile wholesale (demand) fund base.

Liquidity management organisation
The Supervisory Board determines the Bank´s liquidity and funding strategy and risk appetite by approving the Policy for Liquidity Management. The Management Board is responsible for the execution of liquidity and funding strategies. Due to the size and complexity of the Bank the Asset Liability Committee functions are performed by Management Board. The Money and Capital Markets Division has primary responsibility for operational and strategic management of the Bank liquidity, funding and assets-liabilities structure and management. The operational unit for liquidity management is the Liquidity Management Department who responsible for:

a) operational (daily) management of the Bank's liquidity and liquidity buffers;
b) management of the liquidity portfolios;
c) management of funding sources and liabilities;
d) management of compulsory reserve;
e) management of currency positions and maturity gaps.

Liquidity management process
Our liquidity risk management framework is designed to identify, measure and manage the liquidity risk position of the Bank. Our liquidity risk management approach starts at the intraday liquidity management
The Bank actively monitors and manages its intraday liquidity positions and risks to meet payment and settlement obligations as well as to meet the compulsory reserve requirement on a timely basis under both normal and stressed conditions. On short-term liquidity management The Bank shall ensure that it maintains an adequate level of unencumbered, high-quality liquid assets (liquidity buffer) that can be converted into cash to meet its liquidity needs for the survival period under the severe liquidity stress scenario. The aim of the strategic (long –term) liquidity management is to maintain respective liquidity buffers and liquidity ratios when establishing strategic goals like growth of credit or investment portfolio or rebalancing the balance sheet structure. The Bank assesses as a part of liquidity management its aggregate foreign currency liquidity needs and currency mismatches, differences in the duration of assets and liabilities in each currency considering potential constraints in times of stress.
The Bank uses cash flow and maturity gap analysis, financial ratios, sensitivity analysis and stress testing for liquidity risk measurement. The Bank conduct stress tests and liquidity scenario modeling on a regular basis under variety of stress scenarios.

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The Bank use liquidity risk mitigation tools, including system of limits and liquidity buffer´s. The liquidity buffer´s size and composition principles as well as liquidity limits are set by Policy for Liquidity Management.
Please see the Bank assets and liabilities by remaining maturities in Note 35.

Market risk

Market risk can arise from adverse changes in interest rates, foreign exchange rates, equity prices, commodity prices and other relevant parameters, such as market volatility and market implied default probabilities. Market risk is the risk that value of a portfolio will decrease due to the change in value of the market risk factors. In order to mitigate market risk limits have been established for the debt portfolios an for open foreign currency exposures. The Money and Capital Markets Division has primary responsibility for market risk management.

<u>Interest rate risk</u>
The Bank interest risk strategy is to minimize exposure to the interest risk primarily by keeping similar interest rate sensitivity of its assets and liabilities. Interest rate risk sensitivity is analyzed by measuring the sensitivity of claims and liabilities with interest rate re-pricing taking place within a year to + 200 basis points parallel shift of all interest curves and its affect on profits. Assets´ and liabilities´ interest sensitivity gaps periodised by interest re-pricing and grouped by period from a basis for analysis. Affect is annualised by weighting interest sensitivity gaps by average length of respective period until year-end. Additionally the effect of cumulative current year interest sensitivity gap is assessed on next year´s profit.
The Bank planning to adopt additional interest rate risk measurement methods such as duration gap analysis in year 2013.
Please refer to Note 40 for interest positions and sensitivity analysis.

<u>Foreign currency risk</u>
The Bank general strategy on foreign currency risk is conservative. The aim of currency risk management is to minimize open net foreign currency positions so that the Bank would not be sensitive to foreign currency rate movements. The Bank does not undertake speculative proprietary foreign exchange risks.

The foreign currency risk is managed by setting conservative limits for all currencies and by monitoring the net open currency positions. Everyday assessment and management of the foreign currency risk is conducted by the Money and Capital Markets Division.
See Note 39 for open currency positions and sensitivity analysis.

Operational risk

Operational risk is a risk of direct or indirect impacts resulting form human factors, inadequate or failed internal processes, systems or external events. Operational risk is the potential for failure (including from legal risk) in relation to employees, contractual specifications and documentation, technology, infrastructure, disasters, external influences and client relations. Operational risk excludes business and reputational risk. Operational risk arises from all of the Bank´s operations.
The Bank operational risk strategy is to prevent and minimize losses that would pose a material treat, mitigation of specific critical risks and ensuring the level of operational losses below limit.

<u>Operational risk management organization</u>
The Management Board is guiding and coordinating the operational risk management. While the day-to-day operational risk management lies with the Bank business divisions and infrastructure functions (operational risk owners), the risk management function monitoring the cross Bank operational risk to ensure a consistent application of our operational risk management strategy across the Bank. The Compliance Division acts as consultative and controlling capacity in case of new products, services and internal regulations. The internal audit is responsible for evaluating the

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Note 38 continued:

current internal control system, the sufficiency and efficiency of the control mechanisms, makes recommendations for improvements of the system and test its operability.

Operational risk management process

The Bank uses several techniques for measurement, mitigation and reporting operational risk.

- The process of the operational risks identification and assessment is based mainly on risk and control self assessment which is performed periodically at the level of all organizational divisions and with the Management Board of the Bank.
- The operational loss events database is the tool for systematic collection and analysis of actual and potential operational loss events affecting the Bank. Analysis of the operational risk events can provide insight into the causes of operational losses and information on whether control failures are isolated or systematic.
- Key risk indicators are used to monitor the operational risk profile and alert the Bank to impending problems in a timely fashion.
- All operational risk events with actual or potential loss are reported to the Management Board.
- Compliance with relevant legislation, regulatory requirements and recommendations in product development performed by Compliance Division.
- Business continuity management – Bank has established disaster recovery and business continuity plans.

The Bank has not registered any serious operational risk incidents in 2012. Overall level of operational risk decreased in year 2012 through closure of one branch. In 2012, new organisational units Compliance Division and Financial Monitoring Department were founded to intensify operational risk management. Realised operational losses remained at the same level (EUR 1.5 ths. in year 2012 and 2011).

Capital management

The Bank policy is to maintain a strong capital base, conservative risk profile from capital perspective and maintain adequate risk capital level to cover risks.

Own funds

In the year 2012, the Bank strengthened its Tier I capital by issuing new shares in the amount of EUR 5.0 million, paid in on 28.05.2012. At the end of 2012 a new issue in the amount of EUR 2.0 million was decided, which was also subscribed by the main shareholder and for which the payment was credited on 27.02.2013. The Bank Tier 2 own funds mainly consists of allocated debt. There are no Tier 3 funds within the composition of own funds of the Bank.
Please see Note 41 as the summary of the information concerning the principles of calculating own funds, main components of own funds presented by the tiers and deductions made from own fund.

Capital adequacy calculation principles

The Bank's capital adequacy considerations are based on an assessment of the capital requirements under the regulatory capital adequacy calculation rules and internal capital adequacy assessment process (ICAAP) for risks not covered by regulatory requirements. The Bank implemented ICAAP procedures in year 2008. The Bank's is subject of the supervisory review and evaluation process (SREP), which is a dialogue between an institution and the Financial Supervision Authority on the institution's risks and capital needs.

The Bank uses standard method for calculating regulatory capital requirements for credit risk. Based on application of a Bank from 01.01.2008, the Estonian Financial Supervision Authority has made an exemption for the Bank to cover risks associated with the trading portfolio (as per Credit Institutions Act § 79 clause 2 sub-clauses 2 and 3). As the Bank trading portfolio from 30.11.2012 exceeds the limits set by Credit Institutions Act § 79 clause 2 the Estonian Financial Supervision Authority exemption expired and the Bank is calculating trading portfolio capital requirements by general rules from 30.11.2012.

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Note 38 continued:

All balance sheet and off-balance sheet risk positions are divided between classes of risk exposures stipulated in the Credit Institutions Act, to calculate risk-weighted assets followed by a division to steps of credit quality in order to establish risk weights. The Bank uses rating agency Moody´s Investors Service´s external credit quality assessments in determining capital requirements as per credit quality steps as defined by Financial Supervision Authority. Starting from 01.11.2012 the Bank uses Moody´s, Standard & Poor´s and Fitch Ratings external credit rating assessments as included in the list of external credit assessment institutions compiled by the Estonian Financial Supervision Authority. If two credit assessments are available, the higher risk weight shall be assigned.

The Bank calculates and measures regulatory capital for operational risk using base method. For market risk, the Bank uses maturity-based approach to calculate the capital requirement for general risk on debt instruments and specific risk on the basis of the issuer, debtor, external rating or internal rating, and the residual maturity. As the do not required to calculate the capital requirement for foreign-exchange risk as the overall net open currency position do not exceeds 2% of the Bank net own funds.

The regulatory minimum capital requirement under Pillar I required by Bank of Estonia is defined as 10% of risk-weighted assets for credit risk, market risk and operational risk. The Bank capital adequacy remained strong in the end of 2012 and was 26.60% as of 31.12.2012 (23.85% as of 31.12.2011).
Please refer to Note 41 for the Bank regulatory capital position under Basel II presented by methods used, by exposure classes and capital requirements broken down by credit risk, market risk and operational risk.

Note 39: Foreign Currency Risk

31.12.2012

EUR ths.

	Balance sheet position		Off-balance sheet position		Net
	assets	liabilities	assets	liabilities	position
EUR and EEK joint position	45,640	36,064	5,316	7,620	7,272
USD position	15,783	17,874	7,422	5,329	2
SEK position	580	580	0	0	0
JPY position	119	119	0	0	0

31.12.2011

EUR ths.

	Balance sheet position		Off-balance sheet position		Net
	assets	liabilities	assets	liabilities	position
EUR and EEK joint position	38,917	32,571	2,738	3,863	5,221
USD position	4,125	4,606	3,217	2,736	0
RUB position	26	26	0	0	0
SEK position	267	268	0	0	0

The net position of other currencies does not exceed 1% of own funds.

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Note 39 continued:

Net position in a currency is calculated by adding all balance sheet and off-balance sheet assets and liabilities, subject to changes in currency rates.

Net position in a foreign currency is considered to be short, when liabilities fixed in a foreign currency exceed the assets fixed in the same foreign currency; and long, when assets fixed in a foreign currency exceed the liabilities fixed in the same foreign currency.

Sensitivity analysis of foreign currency risk

The Bank is minimising its exposure to foreign currency risks on a daily basis, following the principles of risk management and approved limits. Actual openness of Bank to foreign currency risks is continuously very small. Simultaneous 10% change of all exchange rates (except EUR/EEK) in adverse direction would cause additional expense in amount of EUR 1.3 ths. (31.12.2011: EUR 0.3 ths.), i.e. the actual openness of the Bank to foreign currency risk can be considered irrelevant from the aspect of potential losses. The method of sensitivity analysis was changed to more conservative in year 2012 (from 5% to 10%), following the changes in ICAAP process. 10% is an approx. VaR with 99.9% confidence limits and 10-days period for yearly volatility 14%, which is the average volatility of the currencies belonging to Bank's open currency position, without regarding the potential negative intercorrelation of currencies.

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Note 40: Interest-Bearing Assets and Liabilities by Interest Repricing Period

EUR ths., as of 31.12.2012

Claims, liabilities	Note	up to 1 month	1 to 3 months	3 to 12 months	1 to 2 years	2 to 5 years	Over 5 years	accrued claims - commitments	Total
Claims of the Bank		**27,679**	**2,559**	**5,306**	**2,982**	**5,674**	**12,321**	**1,247**	**57,768**
Claims to credit institutions	14, 15, 16	27,524	0	0	0	0	0	130	**27,654**
Claims to customers		155	2,559	5,306	2,982	4,664	3,957	1,051	**20,674**
Securities		0	0	0	0	1,010	8,364	66	**9,440**
Bank's liabilities		**26,466**	**4,793**	**17,366**	**1,651**	**1,279**	**4,000**	**416**	**55,971**
Due to banks		109	167	0	0	0	0	0	**276**
Deposits	25	25,600	4,599	17,325	1,588	1,227	0	416	**50,755**
Subordinated debt	26	0	0	0	0	0	4,000	0	**4,000**
Other borrowings	27	16	27	41	63	52	0	0	**199**
Unused loan limits	34	741	0	0	0	0	0	0	**741**
Net		**1,213**	**-2,234**	**-12,060**	**1,331**	**4,395**	**8,321**	**831**	**1,797**

EUR ths., as of 31.12.2011

Claims, liabilities	Note	up to 1 month	1 to 3 months	3 to 12 months	1 to 2 years	2 to 5 years	Over 5 years	accrued claims - commitments	Total
Claims of the Bank		**19,463**	**6,109**	**6,392**	**1,074**	**163**	**50**	**4,271**	**37,522**
Claims to credit institutions	14, 15, 16	13,457	0	0	0	0	0	117	**13,574**
Claims to customers		5,951	6,109	6,392	1,074	163	50	4,080	**23,819**
Securities		55	0	0	0	0	0	74	**129**
Bank's liabilities		**13,652**	**4,529**	**16,195**	**2,280**	**615**	**11**	**380**	**37,662**
Due to banks		15	0	0	0	0	0	0	**15**
Deposits	25	13,624	4,480	11,523	2,208	615	11	347	**32,808**
Subordinated debt	26	0	0	4,000	0	0	0	33	**4,033**
Other borrowings	27	13	49	32	72	0	0	0	**166**
Unused loan limits	34	0	0	640	0	0	0	0	**640**
Net		**5,811**	**1,580**	**-9,803**	**-1,206**	**-452**	**39**	**3,891**	**-140**

Current note includes loan claims, where there is no legal claim to interest, as non-interest bearing claims.

Sensitivity analysis of interest rate risk

Bank has changed and elaborated the methods used in interest rate risk sensitivity analysis. According to the new Policy for Liquidity Management the Bank internal limit for interest risk is calculated as change of economic value from the 200 bps movement of interest rates. This value shall be all times lower than 5% of net own funds. According to Interest rate risk duration GAP analysis the Bank change of economic value from 200 bps movement of interest rates is 1.6% of net own funds as 31.12.2012, that is considered to be relatively low risk level.

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Note 40 continued:

Interest risk assessment was also performed as of 31.12.2011, where the effect of a 200 bps deposit interest curve shift to profit was measured, while the Euribor-based and fixed loan interest rates were kept constant and the interest rate difference remained the same during the period of 1 year. Time deposits with the term up to one year, which would roll-over with 200 bps higher interest rate, were used as the basis for stress test. Deposits with such conditions totalled 20,622 thousand euros as of 31.12.2011, the absolute maturity-weighted effect of 200 bps interest curve rise on interest expense being 256 thousand euros in one year. Considering that the Bank monthly adjusts loan interest rates for loan contracts connected with Bank's base interest rate in accordance with its actual interest expenses, the effect of deposit interest rise on net interest income is not expressed in the amount of loans tied with base interest rate. The loans tied with base interest rate totalled 4,850 thousand euros as of 31.12.2011, by which the deposit volumes open to interest risk were adjusted during stress test, and the appropriate effect of 200 bps interest curve rise was 195 thousand euros.

Note 41: Capital Adequacy

	EUR ths.	EUR ths.
	31.12.2012	**31.12.2011**
Share capital paid-in	12,089	7,049
Other reserves	36	36
Accumulated deficit of the previous years	-2,245	-3
Intangible assets	-96	-105
Net loss of the period	-3,536	-2,245
Net profit of the periid	0	0
Total tier 1 own funds	**6,248**	**4,732**
Subordinated debt	4,000	4,000
Available-for-sale financial instruments	37	0
Tier 2 own funds, which exceed the limits	-876	-1,632
Second level equity	**3,161**	**2,368**
Minimum own funds	9,409	7,102
Tier 1 own funds after deductions	6,248	4,732
Tier 2 own funds after deductions	3,161	2,367
Own funds for capital adequacy calculations	**9,409**	**7,100**
Central governments and central banks under standard method	55	0
Credit institutions and investment companies under standard method	689	106
Companies under standard method	313	241
Mass claims under standard method	889	962
Claims backed by mortgages under standard method	162	109
Overdue claims under standard method	461	881
Other assets under standard method	427	491
Total capital requirement for credit risk and counterparty credit risk	**2,996**	**2,790**
Capital requirement for interest rate position risk	314	0
Capital requirement for share position risk	0	0
Total capital requirements for currency risk, commodity risk and trading portfolio position risk	**314**	**0**
Operational risk base method	227	296
Total capital requirement for operational risk	**227**	**296**
Capital requirements for adequacy calculations	**3,537**	**3,086**
Capital adequacy	**26.60%**	**23.01%**

Minimum capital adequacy ratio, as required by the Bank of Estonia, is 10%.
Bank uses standard method for calculating capital requirements for credit risk and base method for calculating capital requirement for operational risk as per capital adequacy calculation directive Basel II.

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Note 41 continued: **Credit risk and counterparty credit risk report following the standard method**

EUR ths., 31.12.2012

	Balance sheet						Collaterals	Off-balance sheet			
	Initial value (gross)			Allowances and corrections (-)							
	Claims	Loans	Held-to-maturity securities and shares	Unamortised fees	Loan provisions	Debt security provisions	Financial collaterals simple method	Loan limits	Derivatives *	Risk weight	Risk-adjusted amount
Note:	15, 16, 17	17	18, 19	17	17	19		34	34		
Central government and central banks	**4,544**	**0**	**1,543**	**0**	**0**	**0**	**0**	**0**	**0**		**549**
I rate credit quality	4,544	0	994	0	0	0	0	0	0	0%	0
IV rate credit quality	0	0	549	0	0	0	0	0	0	100%	549
Credit institutions and investment firms	**23,222**	**0**	**2,747**	**0**	**0**	**0**	**0**	**0**	**71**	0%	**6,886**
I rate credit quality	23,222	0	0	0	0	0	0	0	71	20%	4,659
II rate credit quality	0	0	1,039	0	0	0	0	0	0	50%	520
III, IV and V rate credit quality			1,708								1,708
Companies	**0**	**2,377**	**750**	**0**	**-31**	**0**	**0**	**0**	**38**	0%	**3,134**
III and IV rate credit quality	0	2,377	750	0	-31	0	0	0	38	100%	3,134
Retail claims	**0**	**11,951**	**0**	**-15**	**-254**	**0**	**-33**	**0**	**0**	0%	**8,737**
Claims up to EUR 1 mln	0	11,951	0	-15	-254	0	-33	0	0	75%	8,737
Claims with real estate collaterals	**0**	**2,409**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0%	**1,625**
Claims fully covered wiht real estate:	0	0	0	0	0	0	0	0	0	0%	0
Claims, fully covered by mortgage to residential real estate, covered claims up to 70% of the real estate collateral value	0	1,206	0	0	0	0	0	0	0	35%	422
Claims, fully covered by mortgage to residential real estate, covered claims over 70% of the real estate collateral value	0	1,203	0	0	0	0	0	0	0	100%	1,203
Claims in arrears	**0**	**8,378**	**66**	**0**	**-4,398**	**0**	**0**	**0**	**0**	0%	**4,607**
III and IV rate credit quality	0	7,234	0	0	-4,310	0	0	0	0	100%	2,924
V and VI rate credit quality	0	1,144	66	0	-88	0	0	0	0	150%	1,683
Other assets	**4,401**	**0**	**6**	**0**	**0**	**-3**	**0**	**741**	**0**	0%	**4,422**
Cash	130	0	0	0	0	0	0	0	0	0%	0
Property and equipment	4,067	0	0	0	0	0	0	0	0	100%	4,067
Prepayments and prepaid expenses	204	0	0	0	0	0	0	0	0	100%	204
Investments to shares of other companies, not deducted from own funds	0	0	6	0	0	-3	0	0	0	100%	3
Loan limits and overdraft limits with contractual maturity up to 1 year (can not be terminated by one party)	0	0	0	0	0	0	0	741	0	20%	148
Total	**32,167**	**25,115**	**5,112**	**-15**	**-4,683**	**-13**	**-33**	**741**	**109**		
										TOTAL RISK-WEIGHTED ASSETS	**29,960**

*Position open to credit risk of derivatives is calculated in fair value method based on notional value of risk position.

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Note 41 continued: **Credit risk and counterparty credit risk report following the standard method**

EUR ths., 31.12.2011

	Balance sheet						Collaterals	Off-balance sheet			
	Initial value (gross)			Allowances and corrections (-)							
	Claims	Loans	Held-to-maturity securities and shares	Unamortised fees	Loan provisions	Debt security provisions	Financial collaterals simple method	Loan limits	Derivatives *	Risk weight	Risk-adjusted amount
Note:	15, 16, 17	17	18, 19	17	17	19		34	34		
Central government and central banks	**8,778**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**		**0**
I rate credit quality	8,778									0%	0
Credit institutions and investment firms	**4,991**	**0**	**65**	**0**	**0**	**-11**	**0**	**0**	**51**		**1,062**
I rate credit quality	4,991								51	20%	1,008
II rate credit quality			65			-11				100%	54
Companies	**5**	**2,389**	**3**	**-55**	**0**	**0**	**0**	**0**	**11**		**2,408**
III and IV rate credit quality	5	2,389	3	-55	0				11	100%	2,408
Retail claims	**0**	**13,210**	**0**	**0**	**-445**	**0**	**-49**	**0**	**0**		**9,643**
Claims up to EUR 1 mio		13,210		0	-445		-49			75%	9,643
Claims with real estate collaterals	**0**	**1,693**	**0**	**0**	**0**	**0**	**0**	**0**	**0**		**1,088**
Claims fully covered wiht real estate:											0
Claims, fully covered by mortgage to residential real estate, covered claims up to 70% of the real estate collateral value		930								35%	326
Claims, fully covered by mortgage to residential real estate, covered claims over 70% of the real estate collateral value		763								100%	763
Claims in arrears	**0**	**13,846**	**66**	**0**	**-7,191**	**0**	**0**	**0**	**0**		**8,807**
III and IV rate credit quality		9,638			-7,090					100%	2,548
V and VI rate credit quality		4,207	66		-101					150%	6,259
Other assets	**5,008**	**0**	**20**	**0**	**0**	**-3**	**0**	**640**	**0**		**5,037**
Cash	117									0%	0
Property and equipment	4,741									100%	4,741
Prepayments and prepaid expenses	150									100%	150
Investments to shares of other companies, not deducted from own funds			20			-3				100%	18
Loan limits and overdraft limits with contractual maturity up to 1 year (can not be terminated by one party)								640		20%	128
Total	**18,782**	**31,138**	**155**	**-55**	**-7,636**	**-13**	**-49**	**640**	**62**		
										TOTAL RISK-WEIGHTED ASSETS	**28,046**

*Position open to credit risk of derivatives is calculated in fair value method based on notional value of risk position.

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Information Disclosed on Capital Adequacy

Bank is following the principles set by the Estonian Credit Institutions Act and Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions" in establishing and calculating own funds, as well as deductions and limits from own funds.

All balance sheet and off-balance sheet risk positions are divided between classes of risk exposures stipulated in the Credit Institutions Act, to calculate risk-weighted assets followed by a division to steps of credit quality in order to establish risk weights. Bank uses rating agency Moody's Investors Service's external credit quality assessments in determining capital requirements as per credit quality steps as defined by Financial Supervisory Authority. If there is no foreign rating, the risk weight is assigned following the credit risk standard method principles as stipulated in Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions".

Bank considers the following direct funded credit protection facilities in calculation of the credit risk capital requirement, with the prior assessment each time that they are in compliance with the requirements for recognising financial collaterals as set by Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions": 1) On-balance sheet netting – recognised by agreement as an each time decision; 2) Financial collaterals – recognised depending on the type of underlying asset.
Bank accepts as financial collateral: 1) cash on deposit with, or cash assimilated instruments held by the Bank; 2) shares and convertible debt instruments listed in a main list on a recognised stock exchange and debt instruments meeting the requirements stipulated in Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions". Bank includes only such financial collaterals in the calculation of the credit risk capital requirement, the remaining maturity of which is at least equal to the remaining maturity of the secured risk position. Bank uses the financial collateral simple method, calculating the effect by assigning the value equal to the fair value of financial collateral.

Bank considers the following unfunded credit protection facilities in calculation of the credit risk capital requirement, with the prior assessment each time that they are in compliance with the requirements for recognising unfunded credit protection facilities and credit derivatives as set by Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions":
1) Unfunded credit protection transactions - recognised by agreement as an each time decision or by protection provider, when the credit risk protection is provided by each time standard agreement;
2) Credit derivatives – recognised by transaction as an each time decision.

Bank applies the procedure, as set by Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions", in calculating the effects of unfunded credit protection using credit risk standard method.
Credit risk protection transactions applied as of 31.12.2012 and 31.12.2011 were all financial collaterals of cash deposited with the Bank. Bank has not used unfunded credit protection facilities nor credit derivatives as of 31.12.2012 and 31.12.2011.
Bank applies the principles set by Bank of Estonia Governor's decree „Procedure for application and calculation of prudential ratios of credit institutions and consolidation groups of credit institutions" for calculation of risk-weighted exposure amounts for securitised exposures: „Calculating risk-weighted exposure amounts for securitisation positions under the Standardised Approach".

Bank applies credit risk standard method in calculating capital requirements on instruments and counterparty credit risk associated with the trading portfolio.

Equity investments acquired under strategic purposes to the bank portfolio are classified by each time decision of the Management Board of the Bank.

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Note 42: Concentration of Risks

			31.12.2012
	no.	EUR ths.	% of net own funds
Number of customers (client groups) with high risk concentration *	18		
Due from customers with high risk concentration		33,125	352.06%
Due from persons related with credit institution		369	3.92%

			31.12.2011
	no.	EUR ths.	% of net own funds
Number of customers (client groups) with high risk concentration	20		
Due from customers with high risk concentration		17,148	241.45%
Due from persons related with credit institution		123	1.73%

* Concentration of risks is high, when a risk position of a customer or group of connected persons exceeds 10% of own funds of credit institution.

The maximum allowed risk concentration limit by the central bank of 25% of net own funds was not breached for any clients as of 31.12.2012. The risk concentration limit was breached for one customer as of 31.12.2011, the breach was elliminated by increase of share capital.

Note 43: Fair value of financial assets and liabilities

Financial instruments not measured at fair value

	EUR ths. 31.12.2012		EUR ths. 31.12.2011	
	Carrying value	Fair value	Carrying value	Fair value
ASSETS				
Cash	130	130	117	117
Balances with central bank	4,545	4,545	8,778	8,778
Due from other credit institutions	22,979	22,979	4,679	4,679
Due from customers	20,659	20,659	23,764	23,764
Held-to-maturity investments	5,039	5,489	0	0
Other assets	204	204	152	152
TOTAL ASSETS	**53,556**	**54,006**	**37,490**	**37,490**
LIABILITIES				
Due to credit institutions and loans	276	276	15	15
Due to customers	50,755	50,755	32,808	32,808
Subordinated debt	2,931	2,931	4,033	4,033
Borrowed funds from goverment and foreign aid	199	199	166	166
Other liabilities	469	469	608	608
TOTAL LIABILITIES	**54,630**	**54,630**	**37,630**	**37,630**

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Note 43 continued:

Assets and Liabilities Measured at Fair Value

as of 31.12.2012

	EUR ths. Level 1	EUR ths. Level 2	EUR ths. Level 3	EUR ths. Total
Financial assets at fair value trough profit and loss				
Financial assets held for trading				
Equity securities	3	0	0	3
Derivative financial instruments	16	0	0	16
Available-for-sale financial assets				
Debt securities	4,335	0	66	4,401
Equity securities	0	0	3	3
Total assets	**4,354**	**0**	**69**	**4,423**
				0
Financial liabilities at fair value trough profit and loss				
Derivative financial instruments	16	0	0	16
Total liabilities	**16**	**0**	**0**	**16**

as of 31.12.2011

	EUR ths. Level 1	EUR ths. Level 2	EUR ths. Level 3	EUR ths. Total
Financial assets at fair value trough profit and loss				
Financial assets held for trading				
Equity securities	3	0	0	3
Derivative financial instruments	2	0	0	2
Available-for-sale financial assets				
Debt securities	0	55	66	121
Equity securities	0	0	3	3
Total assets	**5**	**55**	**69**	**129**

Note 43 continued:

Financial liabilities at fair value trough profit and loss				
Derivative financial instruments	6	0	0	6
Total liabilities	**6**	**0**	**0**	**6**

Levels used in hierarchy:
Level 1 – price quoted on active market
Level 2 – price based on indication of market price of similar transactions, rates or interest curves
Level 3 – other valuation methods (e.g. method of discounted cash flows)

Management is of opinion that the fair value of other financial assets and financial liabilities, which have arised during usual business activities and are short term, does not differ significantly from their carrying value. These assets and liabilities do not bear interest.

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Note 44: Unconsolidated Financial Statements of the Bank

STATEMENT OF FINANCIAL POSITION

	EUR ths. 31.12.2012	EUR ths. 31.12.2011
ASSETS		
Cash	**130**	**117**
Loans and advances	**48,183**	**37,221**
Balances with central bank	4,545	8,778
Due from other credit institutions	22,979	4,679
Due from customers	20,659	23,764
Financial assets held for trading	**19**	**5**
Available-for-sale financial assets	**4,404**	**124**
Held-to-maturity investments	**5,039**	**0**
Property and equipment	**129**	**184**
Investment properties	**3,938**	**4,557**
Intangible assets	**96**	**105**
Other assets	**204**	**165**
TOTAL ASSETS	**62,142**	**42,478**
LIABILITIES		
Financial liabilities held for trading	**16**	**6**
Financial liabilities measured at amortised cost	**54,161**	**37,035**
Due to credit institutions	276	15
Due to customers	50,755	32,821
Subordinated debt	2,931	4,033
Borrowed funds from government and foreign aid	199	166
Provisions	**230**	**372**
Tax liabilities	**143**	**87**
Other liabilities	**96**	**149**
TOTAL LIABILITIES	**54,646**	**37,649**
SHAREHOLDERS' EQUITY		
Share capital	12,089	7,049
Other equity instruments	1,069	0
Statutory reserve capital	36	36
Fair value reserve of available-for-sale financial assets	83	-11
Accumulated deficit	-5,781	-2,245
TOTAL SHAREHOLDERS' EQUITY	**7,496**	**4,829**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**62,142**	**42,478**

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Note 44 continued:

STATEMENT OF COMPREHENSIVE INCOME

	EUR ths.	EUR ths.
	2012	**2011**
Interest income	1,722	2,235
Interest expense	-773	-1,073
Net interest income	**949**	**1,162**
Fee and commission income	222	71
Fee and commission expense	-57	-47
Net fees and commissions income	**165**	**24**
Net trading gains	**120**	**59**
Other operating income	**116**	**92**
Other operating expenses	**-345**	**-201**
Total operating income	**1,005**	**1,136**
Administrative expenses	**-2,269**	**-2,174**
Personnel expense	-1,067	-955
Payroll related taxes	-363	-325
Other administrative expenses	-839	-894
Depreciation and amortisation of tangible and intangible assets	**-79**	**-109**
Provisions (+/-)	**142**	**-90**
Operating profit/loss before allowances	**-1,201**	**-1,237**
Impairment loss on assets	**-2,335**	**-1,007**
NET LOSS FOR THE PERIOD	**-3,536**	**-2,244**
Net change in revaluation reserve of available-for-sales financial assets	**94**	**1**
COMPREHENSIVE LOSS FOR THE PERIOD	**-3,442**	**-2,243**

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Note 44 continued:

STATEMENT OF CASH FLOWS

	EUR ths. 2012	EUR ths. 2011
Cash flows from operating activities	**17,537**	**-5,556**
Interests received	1,466	2,021
Interests paid	-704	-799
Fees and commissions received	206	56
Fees and commissions paid	-57	-47
Administrative expenses	-2,227	-2,133
Trading income received	120	59
Other operating income	116	92
Other operating expenses	-345	-201
Change in loans and advances to credit institutions and mandatory reserve in central bank	211	2,106
Change in loans and advances to customers	2,849	5,579
Change in due to credit institutions	94	1,538
Change in due to customers	17,865	-13,370
Change in assets and liabilities connected with other operationg activities	-2,057	-457
Cash flows from investing activities	**-8,486**	**-78**
Purchase of property and equipment	-16	-56
Purchase of intangible assets	-8	-6
Purchase of investment properties	0	-95
Investment properties sold	382	79
Proceeds from liquidation of subsidiaries	11	0
Debt securities purchased	-10,815	0
Debt securities sold	1,960	0
Cash flows from financing activities	**5,240**	**1,312**
Increase of share capital	5,040	1,600
Interest of subordinated debt	0	-182
Other borrowings received	295	100
Borrowings repaid	-95	-206
Total cash flows	**14,291**	**-4,322**
Cash and cash equivalents at the beginning of year	**12,977**	**17,299**
Net change in cash and cash equivalents	**14,291**	**-4,322**
Cash and cash equivalents at the end of the year *	**27,268**	**12,977**

*** Cash and cash equivalents at the end of the year comprise:**

	EUR ths. 2012	EUR ths. 2011
Cash	130	117
Balances with the central bank without mandatory reserve	4,159	8,181
Deposits with credit institutions with original maturity of less than 3 months	22,979	4,679
Total	**27,268**	**12,977**

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Note 44 continued:

STATEMENT OF CHANGES IN EQUITY

	EUR ths. 2012	EUR ths. 2011
Share capital		
Balance at the beginning of period	7,049	9,384
Share capital reduction to cover losses	0	-3,935
Share capital increase	5,040	1,600
Balance at the end of period	**12,089**	**7,049**
Other equity instruments		
Balance at the beginning of period	0	0
Equity component of subordinated debt	1,069	0
Balance at the end of period	**1,069**	**0**
Statutory reserve capital		
Balance at the beginning of period	36	36
Balance at the end of period	**36**	**36**
Fair value reserve of available-for-sale financial assets		
Balance at the beginning of period	-11	-12
Comprehensive loss for the period	94	1
Balance at the end of period	**83**	**-11**
Accumulated deficit		
Balance at the beginning of period	-2,245	-3,935
Share capital reduction to cover losses	0	3,935
Comprehensive loss for the period	-3,536	-2,245
Balance at the end of period	**-5,781**	**-2,245**
Total shareholders' equity:		
at the beginning of period	**4,829**	**5,472**
at the end of period	**7,496**	**4,829**
Book value of holdings under control or significant influence	0	14
Value of holdings under control or significant influence, calculated by equity method	0	-14
Adjusted unconsolidated equity	**7,496**	**4,829**

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SIGNATURES OF THE MANAGEMENT BOARD TO THE ANNUAL REPORT 2012

The Annual Report 2012 of Versobank AS is signed by:

Riho Rasmann	Chairman of the Management Board		04.03.2013
Sven Raba	Member of the Management Board		04.03.2013
Mart Veskimägi	Member of the Management Board		04.03.2013
Marija Sutirina	Member of the Management Board		04.03.2013

KPMG Baltics OÜ
Narva mnt 5
Tallinn 10117
Estonia

Telephone +372 6 268 700
Fax +372 6 268 777
Internet www.kpmg.ee

Independent Auditors' Report

(Translation from Estonian)

To the shareholders of Versobank AS

We have audited the accompanying financial statements of Versobank AS, which comprise the statement of financial position as at 31 December 2012, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information, as set out on pages 11 to 69.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Tallinn, 27 March 2013

Taivo Epner
Authorized Public Accountant
Licence No 167

KPMG Baltics OÜ
Licence No 17
Narva mnt. 5
Tallinn 10117

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THE MANAGEMENT BOARD PROPOSAL TO COVER LOSSES

The Management Board of Versobank AS approved the loss of Versobank AS for the financial year 2012 in the amount of 3,536,294 euros. The Management Board's proposal to the General Meeting of Shareholders' is to record the loss for the financial year 2012 in the amount of 3,536,294 euros under the balance sheet heading "Accumulated deficit".

Riho Rasmann	Chairman of the Management Board		04.03.2013
Sven Raba	Member of the Management Board		04.03.2013
Mart Veskimägi	Member of the Management Board		04.03.2013
Marija Sutirina	Member of the Management Board		04.03.2013