Versobank AS

ANNUAL REPORT 2013

(TRANSLATION FROM ORIGINAL IN ESTONIAN)

Beginning of reporting year	01.01.2013
End of reporting year	31.12.2013

Registry code	10586461
Address	Pärnu mnt 12, 10148 Tallinn, Estonia
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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)
Legal Entity Identifier	549300S6Q5X9GKYK5R57 (LEI-code)
VAT registration number	EE100684313
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	31.12.2013
Report period	01.01.2013 – 31.12.2013
Report currency and units	Euro (EUR), in thousands of euros

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

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 a principal member of Visa Europe. Bank has joined SEPA (Single Euro Payments Area) systems as an indirect member and a cross-border clearing system TARGET2-Eesti.

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 owners of Versobank AS, as of the report date 31.12.2013 and date of report compilation are:
85.2622% of shares are owned by UKRSELHOSPROM PCF LLC (location Dnepropetrovsk, Ukraine);
9.8327% of shares are owned by Mr. Nikolaos Sarros (place of residence Athens, Greece);
1.9177% of shares are owned by Sigma Real Estate OÜ (location Tallinn, Estonia), a private limited company under control of Mr. Nikolaos Sarros;
1.4824% is owned by Frösundaviksparken AB (location Stockholm, Sweden);
0.7563% of shares are owned by Mirage Investments OÜ (location Tallinn, Estonia) and
0.7487% is owned by Mr. Emmanouil Karavelakis (place of residence Athens, Greece).

Extraordinary Meeting of Shareholders decided on 04.12.2013 to increase the share capital of the Bank by EUR 4,000,000.80, i.e. from EUR 14,088,775.20 to EUR 18,088,776.00 by issuing new shares. The majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full on 05.12.2013 and the payment for the new shares must be credited on 15.03.2014 the latest. Appropriate payment depends on receiving the permit from the National Bank of Ukraine. Bank plans to apply for a permit of Financial Supervision Authority for a premature repayment of EUR 4,000,000 subordinated loan to the majority shareholder and is scheduling another share capital increase in year 2014.

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, Mr. Härmo Värk and Mr. Vladimirs Fogels. Mr. Vladimirs Fogels was elected to member of the Supervisory Board on 27.05.2013, Mrs. Steinunn Kristin Thordardottir was called back from the Supervisory Board as of the same date.

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. 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

First positive signs of economic growth outlook recovery of the European Union emerged in spring 2013 and the eurozone economy started to grow again in the second quarter, following six quarters of recession. The influences brought by the general improvement of financial markets since the summer of 2012 and progress in consolidations of budgets and structural reforms started to affect the real economy. Lower prices of energy had positive impact on real income. The unemployment stays at high level in the eurozone and the need for corrections in the public sector balances continuously hinders the economic activity at the same time. The below expectations growth of Finland influenced Estonia the most of other eurozone countries.

The statements of central banks regarding the possibility of tightening of extraordinary monetary policy measures or their prolongation affected the cash flows and income levels of the financial markets. Inflation rate of the eurozone stood stable below the 2% long-term target of the European Central Bank and due to this the European Central Bank has announced, that the base interest rates remain at the current or lower level for longer periods. Governing Council of the European Central Bank lowered the interest rate of main refinancing operations to the lowest in history, 0.25% level in the beginning of November. Short-term interbank money market interest rates remained at low levels following the Central Bank's policy, thus easing the interest burden of borrowers but also setting pressure on profitability of banks and forcing banks into lowering deposit interest rates. Economic growth and employment of the United States of America has recovered fairly quickly, differently from the other developed countries, and the Federal Reserve of the USA started the contraction of stimulative monetary policy measures in year 2013. Treasury bonds of developed countries responded to the developments in macro economy and measures of central banks with a general interest growth. The peripheral countries of the debt crises eurozone stood out with rather lowering debt securities interests emerging from the drop in risk premiums asked for keeping these treasury bonds. The growth of developing markets in year 2013 did not meet the estimates. The capability of governments of most developing countries to support the economies through budget policies is also depleting wherefore the expectations of stricter monetary policy of developed markets, especially the USA, are adding pressure to them. The significantly below expectations economical growth of Russia influenced Estonia the most.

The economic growth of Estonia remained at a modest 1% level in year 2013, influenced primarily by lesser demand caused by the below expectations economic growth of its major trade partners Sweden, Finland and Russia. Economic growth was supported by internal demand, backed by increase in employment and rise of average salary. Estonian governmental sector was characterised, as opposed to most other eurozone countries, by balanced budget and low debt burden. The interest rates of Estonian loan market stood also low following the interest policy of the European Central Bank. The loan demand was low in year 2013 regardless of this and despite the high liquidity and capitalisation of banks. The investment necessities of companies were hindered by insufficient application of production capacities, purchased earlier in expectation of recovery of external demand. More active real estate market supported a little bit increased volumes of housing loans. Loan repayment ability of both, the companies and households remained high despite of the modest growth of economy. The quality of banks' loan portfolios improved too. Differently from the loan portfolio, the deposits of real sector continued quick growth, enabling the banks to finance loan portfolio growth almost fully from deposits. Growth in deposits is mainly caused by the increase in overnight and current deposits of households.

Major Economic Events

Year 2013 was the most successful year in Bank's history so far. Bank reached stable profitability in the 2nd quarter. Most of the targets set for business lines were significantly exceeded by number of customers and operational volumes, reaching also the highest yearly profit so far, primarily supported by record increase in fee and commission income.

Number of customers of the Bank increased 16.5% during the last year (year earlier 9.3%), the number of active depositors increased 16.4% (year earlier 3.0%). The growth of deposits was very fast: 2.5 times in year 2013, compared with a 54.6% increase year earlier. Foreign currency balances on current accounts of non-resident customers have grown the most. Customer deposits with the Bank totalled 126.9 million euros as of 31.12.2013 (50.8 million euros as of 31.12.2012). Total balance sheet of the Bank has increased 2.3 times during the year (year earlier 46.3%), reaching 142.6 million euros as of 31.12.2013 (as of 31.12.2012 the balance sheet total was 62.1 million euros).

Gross loan portfolio (excluding deposits with financial institutions) comprised 27.8 million euros, growing 10.7% during the last year (19.3% decrease year earlier) and forming 19.5% of total assets as at year-end (31.12.2012: 40.4%). Gross loan portfolio amounted 25.1 million euros as of 31.12.2012. 1.2 million euros of non-performing claims were written off during year 2013 (5.1 million euros during year 2012). The quality of the loan portfolio has improved significantly, expressed also by the reversals of allowances for loan losses, which improved the net result by 0.7 million euros (2012: -2.1 million euros). Bank had continuously much more deposits than loans – deposits ratio to loans stood at 4.57 as of 31.12.2013 (2.02 at year-end 2012).

Net profit of year 2013 comprised 1.0 million euros (net loss of year 2012 was 3.5 million euros). Portfolio of debt securities, initially purchased with intention to hold until maturity was liquidated in May 2013 due to beneficial market situation, realising 0.5 million euro profit. Bank has significantly increased investments in debt securities, disclosed under available-for-sale financial assets, to diversify sources of interest income and maintain a liquidity buffer.

Net interest income of the reporting period was 1.1 million euros (2012: 0.9 million euros), earned mostly on loans. Net fees and commissions income totalled 1.7 million euros (2012: 0.2 million euros), mainly due to the increase in foreign payment volumes of customers. 0.6 million euros were earned on foreign exchange transactions (2012: 0.1 million euros). Total operating income from banking activities (excluding loan provisions) comprised 3.8 million euros in year 2013 compared with 1.0 million euros year earlier. Administrative expenses of year 2013 and 2012 were 2.8 million euros and 2.3 million euros correspondingly.

Bank's equity totalled 9.9 million euros as of 31 December 2013 and the regulatory capital adequacy stood at 28.26% (31.12.2012: 7.5 million euros, capital adequacy 26.60%). Share capital increase by 4.0 million euros is scheduled to finalise in March 2014, the latest, via monetary payment for new shares.

No new branch offices were opened in year 2013, but Bank's representative offices were opened in Dnepropetrovsk, Ukraine and Riga, Latvia after receiving appropriate licenses. The Bank additionally received a license from the Estonian Financial Supervision Authority on 6 November 2013 to start offering cross-border financial services in the Republic of Latvia. The Bank is going to continue its expansion to Ukraine and other CIS countries and is planning to open a representative office in Moscow during year 2014. Management of the Bank believes that the subsequent events in Ukraine after the balance sheet date do not have significant impact on the Bank.

Bank paid a lot of attention to correspondent banking (incl. offering service to a few selected foreign banks also itself) and liquidity management last year. Bank has opened several new correspondent accounts (incl. accounts with KBC Bank NV, UBI BANCA (UNIONE DI BANCHE ITALIANE) S.C.P.A., OJSC Promsvyazbank) aiming at better and faster service to customers, increased the speed of foreign payment settlements and added some Eastern-European currencies (PLN, CZK, HUF, BGN, RON) to the list of currencies serviced. Fiduciary deposits have been added to new products, and the start of the VISA bank card issuing has been planned for summer of year 2014, for which implementation Versobank AS became a principal member of Visa Europe last year.

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 2013 (in year 2012: 3). Total of 97 thousand euros of membership fees was calculated in year 2013 (total of 81 thousand euros in year 2012).

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, stock options or other similar rights.

Calculated salaries of the members of the Management Board totalled 249 thousand euros in year 2013, of employees 958 thousand euros. Calculated salaries of the members of the Management Board totalled 217 thousand euros in year 2012, of employees 718 thousand euros. No performance fees nor resignation compensations (redundancy payments at amounts higher than mandatory by law) have been paid in 2013 and 2012, no payments have been made in connection with employment commencement either. There are no accrued unpaid performance fees. Average number of employees was 48 in year 2013 (39 year earlier), number of employees at the end of year 2013 was 65 (42 at the end of 2012). 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

		2013	2012
Return on equity	ROE	12.01%	-57.39%
Equity multiplier	EM	11.76	8.49
Profit margin	PM	20.45%	-162.20%
Asset utilisation	AU	4.99%	4.17%
Return on assets	ROA	1.02%	-6.76%
Net interest margin	NIM	1.11%	2.05%
Basic earnings per share	Basic EPS	0.05	-0.21
Diluted earnings per share	Diluted EPS	0.05	-0.21
Spread	SPREAD	1.07%	2.03%
Yield on interest-earning assets	YIEA	1.71%	3.72%
Cost of interest-bearing liabilities	COL	0.64%	1.69%

Explanations to ratios

ROE	Net profit (loss) / Average equity * 100
Average equity	(Equity of current end year as at 31.12.2013 + Equity of previous year end as at 31.12.2012)/2
EM	Average assets / Average equity
Average assets	(Assets of current year end as at 31.12.2013 + Assets of previous year end as at 31.12.2012)/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

Total income:
Interest income
Fee and commission income
Income from foreign exchange
Income from dividends
Income from financial investments
Other income

Interest earning assets:
Balances with central bank
Due from other credit institutions

Due from customers
(all without accrued interest)

Interest bearing liabilities:
Due to credit institutions
Due to customers
Subordinated debt
Borrowed funds from government and foreign aid
(all without accrued interest)

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 sureties and execution proceedings are taking place with regard to pledged collateral assets and private person debtors.

Total of six court actions have been filed against the Bank as of the date of compiling the report.

Harju County Court has rendered a judgment in civil case no. 2-11-37160 in favour of the plaintiff on 28.06.2013, and the Bank has formed a provision of 243 thousand euros in the annual report 2013 to cover it. After the balance sheet date, on 12.02.2014 the Tallinn Circuit Court allowed the appeal of the Bank, whereby annulled the Harju County Court judgment mentioned above. The judgment enters into force in March 2014, unless the plaintiff appeals in cassation to the Supreme Court. As the management estimates that it is probable, that the proceedings continue in the Supreme Court, the already existing provision has not been cancelled in the annual report and therefore it has a potentially positive financial impact of 243 thousand euros on the results of the Bank in next periods.

After the balance sheet date, on 24.01.2014 Harju County Court has accepted an action filed against the Bank for ordering compensation of damages in amount of 75 thousand euros. The Bank has not formed a provision to cover the action in the annual report 2013, as the management believes it to be an unfounded action.

There are no other cases pending in courts or arbitration bodies that might cause significant proprietary damage to the Bank.

Financial Statements 2013

Statement of Comprehensive Income

	Note	EUR ths. 2013	EUR ths. 2012
Interest income	1	1,707	1,722
Interest expense	2	-598	-773
Net interest income		**1,109**	**949**
Fee and commission income	3	2,104	222
Fee and commission expense	4	-390	-57
Net fees and commissions income		**1,714**	**165**
Net trading gains	5	**1,230**	**120**
Other operating income	6	**69**	**116**
Other operating expenses	7	**-294**	**-345**
Total operating income		**3,828**	**1,005**
Administrative expenses		**-2,784**	**-2,269**
Personnel expense	8	-1,390	-1,067
Payroll related taxes	9	-469	-363
Other administrative expenses	10	-925	-839
Depreciation and amortisation of tangible and intangible assets	11	**-68**	**-79**
Provisions (+/-)		**-85**	**142**
Operating profit/loss before allowances		**891**	**-1,201**
Impairment loss on assets	13	**155**	**-2,335**
NET PROFIT/LOSS FOR THE PERIOD		**1,046**	**-3,536**
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified to profit or loss			
Net change in revaluation reserve of available-for-sales financial assets		**-481**	**94**
COMPREHENSIVE PROFIT/LOSS FOR THE PERIOD		**565**	**-3,442**
Basic earnings/loss per share	37	0.05 EUR	-0.21 EUR
Diluted earnings/loss per share	37	0.05 EUR	-0.21 EUR

The accounting policies on pp. 15-29 and notes to the financial statements on pp. 30-68 form an integral part of the Financial Statements.

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Statement of Financial Position

	Note	EUR ths. 31.12.2013	EUR ths. 31.12.2012
ASSETS			
Cash	14	**110**	**130**
Loans and advances		**131,172**	**48,183**
Balances with central bank	15	48,228	4,545
Due from other credit institutions	16	57,622	22,979
Due from customers	17	25,322	20,659
Financial assets held for trading	18	**16**	**19**
Available-for-sale financial assets	19	**7,282**	**4,404**
Held-to-maturity investments	20	**0**	**5,039**
Property and equipment	21	**180**	**129**
Investment properties	22	**3,353**	**3,938**
Intangible assets	23	**99**	**96**
Other assets	24	**431**	**204**
TOTAL ASSETS		**142,643**	**62,142**
LIABILITIES			
Financial liabilities held for trading	18	**10**	**16**
Financial liabilities measured at amortised cost		**131,808**	**54,161**
Due to credit institutions	25	1,559	276
Due to customers	25	126,930	50,755
Subordinated debt	26	3,067	2,931
Borrowed funds from government and foreign aid	27	252	199
Provisions	12	**315**	**230**
Tax liabilities	28	**212**	**143**
Other liabilities	29	**373**	**96**
TOTAL LIABILITIES		**132,718**	**54,646**
SHAREHOLDERS' EQUITY			
Share capital	30	14,089	12,089
Other equity instruments	26	933	1,069
Statutory reserve capital	30	36	36
Fair value reserve of available-for-sale financial assets	19	-398	83
Accumulated deficit		-4,735	-5,781
TOTAL SHAREHOLDERS' EQUITY		**9,925**	**7,496**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**142,643**	**62,142**

The accounting policies on pp. 15-29 and notes to the financial statements on pp. 30-68 form an integral part of the Financial Statements.

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Statement of Cash Flows

	Note	EUR ths. 2013	EUR ths. 2012
Cash flows from operating activities		**74,310**	**17,548**
Interests received		2,008	1,466
Interests paid		-730	-704
Fee and commission received		1,936	206
Fee and commission paid		-390	-57
Administrative expenses		-2,751	-2,227
Trading income received	5	1,230	120
Other operating income		69	116
Other operating expenses		-294	-345
Change in due from other credit institutions		-553	211
Change in due from customers of credit institution		-4,895	2,849
Change in due to credit institutions		1,450	94
Change in due to customers		76,307	17,865
Change in assets and liabilities connected with other operational activities		923	-2,046
Cash flows from investing activities		**1,557**	**-8,497**
Purchase of property and equipment	21	-109	-16
Purchase of intangible assets	23	-14	-8
Purchase of investment properties	22	-78	0
Investment properties sold	22	302	382
Debt securities purchased	19,20	-5,169	-10,815
Debt securities sold	19,20	6,625	1,960
Cash flows from financing activities		**1,886**	**5,240**
Increase of share capital	30	2,000	5,040
Other borrowings received	25,27	152	295
Borrowings repaid		-266	-95
Total cash flows		**77,753**	**14,291**
Cash and cash equivalents at the beginning of year		**27,268**	**12,977**
Net change in cash and cash equivalents		**77,753**	**14,291**
Cash and cash equivalents at the end of the year *		**105,021**	**27,268**

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

	Note	EUR ths. 2013	EUR ths. 2012
Cash	14	110	130
Balances with the central bank without mandatory reserve	15	47,289	4,159
Deposits with credit institutions with original maturity of less than 3 months	16	57,622	22,979
Total		**105,021**	**27,268**

The accounting policies on pp. 15-29 and notes to the financial statements on pp. 30-68 form an integral part of the Financial Statements.

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Statement of Changes in Equity

	Note	EUR ths. 2013	EUR ths. 2012
Share capital			
Balance at the beginning of period		12,089	7,049
Share capital increase		2,000	5,040
Balance at the end of period		**14,089**	**12,089**
Other equity instruments			
Balance at the beginning of period		1,069	0
Equity component of subordinated debt	26	-136	1,069
Balance at the end of period		**933**	**1,069**
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		83	-11
Revaluation	19	-481	94
Balance at the end of period		**-398**	**83**
Accumulated deficit			
Balance at the beginning of period		-5,781	-2,245
Comprehensive profit/loss for the period		1,046	-3,536
Balance at the end of period		**-4,735**	**-5,781**
	30		
Total shareholders' equity:			
at the beginning of period		**7,496**	**4,829**
at the end of period		**9,925**	**7,496**

Additional information in Note 30.

The accounting policies on pp. 15-29 and notes to the financial statements on pp. 30-68 form an integral part of the Financial Statements.

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Accounting Policies

Accounting Policies

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 annual report, which includes financial statements on 10 March 2014. 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 Bank 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 Bank is Euro (EUR). Numeric data in the financial statements is presented in thousands of monetary units.

The annual report 2013 of the Bank is unconsolidated, as the only subsidiary of the Bank Osito Casa OÜ was liquidated in year 2012 (economic activities brought under Bank in year 2011).

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.

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:

Reclassification of the held-to-maturity debt securities portfolio. The Management Board of the Bank decided in May 2013 to reclassify to whole held-to-maturity debt securities portfolio (carrying value in balance sheet prior to reclassification 5.0 million euros) to available-for-sale debt instruments due to beneficial market situation, after which the debt securities were sold realising profit of 0.5 million euros in year 2013. The fair value of debt securities portfolios is disclosed in Note 44, balance sheet balances' analytics and movements in Notes 19 and 20.

Impairment losses on loans and advances. The Bank 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 Bank 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 Bank 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 Bank 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. Bank utilises the services of authorised real estate valuators.

Effects of Changes in Economic Environment

Events in global and Estonian financial markets

The majority of signs of earlier financial crises have started to disappear in year 2013 and the eurozone economies turned to growth again with the financial markets largely restored. European Central Bank has lowered the interest rate of main refinancing operations to the lowest level in history due to the low rate of inflation. Interbank money market rate EURIBOR, which acts as a base interest rate for majority of loan contracts, stabilised on a very low level from beginning of 2013. Low interest rates on the interbank market forced the banks to lower also the interest rates of deposits and loans. At the same time the interest margins stood at higher levels than earlier despite of the good capitalisation and high liquidity of banks. Stabilisation of economies of developed countries brought an expectation of stricter monetary policy by central banks, which started to pressure long-term interest rates (especially US dollar) to a rise and thus influenced corresponding bond markets. Section "Description of Economic Environment" of the Management Report gives a more detailed overview of current economic situation. Directly applicable legal framework (CRDIV/CRR) is in force for the banks of the European Union, introducing new requirements on capital and risk management. Activities of Estonian banks are also affected by directly applicable EMIR framework and transition to the STEP2 payment system (SEPA) from the domestic retail payment system ESTA, which took place on 01.02.2014.

Management of the Bank believes that all measures have been taken to guarantee the sustainability and growth of the Bank under current conditions. Major challenges for the future include ensureing the growth of the Bank in changing regulatory environment.

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 signs of growth, the liquidity is still low for certain types of assets. As a result, the actual realisable value on foreclosure may differ from the value ascribed in estimating allowances for impairment.

Impact on customers

Customers (borrowers) of the Bank 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 Bank has not been significantly affected by the changes in economic environment. The record growth of deposits has enhanced the general liquidity position.

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 gains". 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 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 Bank acquires or loses ownership of the financial asset.

Financial assets at fair value through profit or loss

Fair value is the price that would be received on the measurement date to sell an asset or paid to transfer a liability in a transaction between market participants under normal conditions, a so-called exit price. Bank uses as much market information as possible in its fair value valuation of assets and liabilities. If no information is available on market prices, the generally accepted valuation models like discounting of cash flows are used. Different methods are used in fair value valuation of financial instruments depending on the rate of observable market data usage. Classification is based on Levels (1, 2, 3).

Levels used in hierarchy:

Level 1 – the price quoted on active market;

Level 2 – price based on market price indication of similar transactions, rates of interest curves;

Level 3 – other valuation methods (e.g. method of discounted cash flows).

Bank has applied IFRS 13 from 01.01.2013. In accordance with the transitional provisions of IFRS 13, the Bank has not provided any comparative information for new disclosures.

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 Bank 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".

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 Bank 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 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 Bank 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 Bank's investments in equity securities and certain debt securities established by a decision of the Management Board 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 when the Bank'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".

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Impairment of Financial Assets

Valuation and Impairment of Loans and Advances

Loans to customers are recognised in the balance sheet under "Due from customers" and funds held at other banks are recognised under "Due from other credit institutions". Bank 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 Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Bank 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.

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%

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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 Bank does not use for its own business, also assets which the Bank 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.

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 Bank 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.

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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 Bank 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.
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 Bank'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 Bank'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 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 Bank 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 Bank 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.

Standards, Interpretations and Amendments to published Standards that are not yet effective

The following new Standards and Interpretations are not yet effective for the annual reporting period ended 31 December 2013 and have not been applied in preparing these financial statements: *[IAS 8.30 (a)]*:

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 Bank does not expect the new standard to have any impact on the financial statements of the Bank, since there is no group.

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 their consolidated financial statements.

The Bank does not expect IFRS 11 to have an impact on the financial statements of the Bank since the Bank is not a party to any joint arrangements.

IFRS 12 *Disclosure of Interests in Other Entities*

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively, except not required to present comparative information for unconsolidated structured entities for any periods before the first annual period for which IFRS 12 is applied. 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 Bank does not expect the new Standard will have a material impact on the financial statements of the Bank.

IAS 27 (2011) *Separate Financial Statements*

(Effective for annual periods beginning on or after 1 January 2014. Earlier application is permitted if IFRS 10, IFRS 11, IFRS 12 and IAS 28 (2011) are also applied early.)

IAS 27 (2011) carries forward the existing accounting and disclosure requirements of IAS 27 (2008) for separate financial statements, with some minor clarifications. As well, the existing requirements of IAS 28 (2008) and IAS 31 for separate financial statements have been incorporated into IAS 27 (2011). The Standard no longer addresses the principle of control and requirements relating to the preparation of consolidated financial statements, which have been incorporated into IFRS 10, *Consolidated Financial Statements*.

The Bank does not expect IAS 27 (2011) to have material impact on the financial statements of the Bank, since it does not result in a change in the Bank's accounting policy.

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 Bank does not expect the amendments to Standard to have impact on the financial statements of the Bank since it does not have any investments in associates or joint ventures that will be impacted by the amendments.

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 Bank 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.

Amendments to IFRS 10, IFRS 12 and IAS 27 – *Investment Entities*

(Effective for annual periods beginning on or after 1 January 2014; early adoption is permitted; to be applied retrospectively subject to transitional provisions)

The Amendments provide an exception to the consolidation requirements in IFRS 10 and require qualifying investment entities to measure their investments in controlled entities – as well as investments in associates and joint ventures – at fair value through profit or loss, rather than consolidating them.
The consolidation exemption is mandatory (i.e. not optional), with the only exception being that subsidiaries that are considered as an extension of the investment entity's investing activities, must still be consolidated.

An entity qualifies as an investment entity if it meets all of the essential elements of the definition of an investment entity. According to these essential elements an investment entity

(1) obtains funds from investors to provide those investors with investment management services;

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(2) commits to its investors that its business purpose is to invest for returns solely from appreciation and/or investment income; and

(3) measures and evaluates the performance of substantially all of its investments on a fair value basis.

The amendments also set out disclosure requirements for investment entities.

The Bank does not expect the new standard to have any impact on the financial statements.

Amendments to IAS 36 – *Recoverable Amount Disclosures for Non-Financial Assets*

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted, however an entity shall not apply the amendments in periods (including comparative periods) in which it does not also apply IFRS 13)

The Amendments clarify that recoverable amount should be disclosed only for individual assets (including goodwill) or cash-generating units for which an impairment loss was recognised or reversed during the period.

The Amendments also require the following additional disclosures when an impairment for individual assets (including goodwill) or cash-generating units has been recognised or reversed in the period *and* recoverable amount is based on fair value less costs of disposal:

- the level of IFRS 13 'Fair value hierarchy' within which the fair value measurement of the asset or cash-generating unit is categorised;
- for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation techniques used and any changes in that valuation technique together with the reason for making it;
- for fair value measurements categorised within Level 2 and Level 3, each key assumption (i.e. assumptions to which recoverable amount is most sensitive) used in determining fair value less costs of disposal. If fair value less costs of disposal is measured using a present value technique, discount rate(s) used both in current and previous measurement should be disclosed.

The Bank does not expect the new Standard to have a material impact on the financial statements.

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Amendments to IAS 39 – *Novation of Derivatives and Continuation of Hedge Accounting*

(Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted, however an entity shall not apply the amendments in periods (including comparative periods) in which it does not also apply IFRS 13).

The Amendments allows hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws and regulations, when the following criteria are met:

- the novation is made as a consequence of laws or regulations;
- a clearing counterparty becomes a new counterparty to each of the original counterparties of the derivative instrument;
- changes to the terms of the derivative are limited to those necessary to replace the counterparty.

The Bank does not expect the new Standard to have a material impact on the financial statements of the Bank.

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Notes to the Financial Statements

Note 1: Interest Income

	EUR ths. 2013	EUR ths. 2012
From loans	1,157	1,464
From demand deposits with other credit institutions	67	23
From time deposits with other credit institutions	24	23
From debt securities	459	212
Total	**1,707**	**1,722**
Interest income by geographical areas		
Estonia	972	1,478
OECD countries (excl. Estonia)	735	244
Total	**1,707**	**1,722**

Note 2: Interest Expense

	EUR ths. 2013	EUR ths. 2012
On demand deposits	2	7
On time deposits	590	793
On borrowings	5	-32
Other interest expense	1	5
Total	**598**	**773**
Interest expense by geographical areas		
Estonia	590	797
OECD countries (excl. Estonia)	8	-24
Total	**598**	**773**

Note 3: Fee and Commission Income

	EUR ths. 2013	EUR ths. 2012
Account opening and maintenance fees	356	68
Bank transaction fees	1,666	134
Securities' transaction fees	20	5
Letters-of-credit fees	19	5
Other fees and commissions income	43	10
Total	**2,104**	**222**
Fees and commissions income by geographical areas		
Estonia	93	31
OECD countries (excl. Estonia)	2,011	191
Total	**2,104**	**222**

Note 4: Fee and Commission Expense

	EUR ths. 2013	EUR ths. 2012
Securities' transactions expenses	32	11
Bank transaction expenses	209	24
S.W.I.F.T. expenses	35	16
Other fee and commission expenses	114	6
Total	**390**	**57**

Note 5: Net Trading Gains

	EUR ths. 2013	EUR ths. 2012
From foreign exchange	610	76
From financial assets and liabilities held for trading	8	8
From available-for-sale financial assets	57	36
From held-to-maturity investments	555	0
Total	**1,230**	**120**

Note 6: Other operating income

	EUR ths. 2013	EUR ths. 2012
Rental income from investment properties	57	85
Operating expenses from properties generating rental income	12	7
Other operating income	0	24
Total	**69**	**116**

Rental income from investment properties by due dates

	EUR ths. 2013	EUR ths. 2012
Rental income during next reporting period from uninterruptable contracts:		
up to 1 year	39	50
1 to 5 years	6	13
over 5 years	0	9

Versobank AS had concluded 14 rent agreements as as of 31.12.2013 (25 rent agreements as of 31.12.2012).

Note 7: Other Operating Expenses

	EUR ths. 2013	EUR ths. 2012
Guarantee Fund payments	130	65
Financial Supervision Authority fees	57	56
Stock Exchange fees	0	14
Other operating expenses *	107	210
Total	**294**	**345**

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Note 7 continued:

* Other operating expenses include investment properties expenses, property evaluation expenses and membership fees. Direct costs from non-profit real estate investments in year 2013 EUR 17 ths. (2012: EUR 13 ths).

Note 8: Personnel Expense

	EUR ths. 2013	EUR ths. 2012
Salaries	1,263	947
Compensation to the Supervisory Board members	97	81
Fringe benefits	23	24
Income tax on fringe benefits	8	8
Change in vacations pay accrual	-1	7
Total	**1,390**	**1,067**

Note 9: Payroll Related Taxes

	EUR ths. 2013	EUR ths. 2012
From salaries	423	321
From compensation to the Supervisory Board members	32	27
From fringe benefits	14	12
Social insurance tax from change in vacations pay accrual	0	3
Total	**469**	**363**

Note 10: Other Administrative Expenses

	EUR ths. 2013	EUR ths. 2012
Rent of premises	439	380
Other professional services purchased	185	180
Advertising expenses	25	42
Office expenses	49	52
Transportation expenses	75	69
Other expenses	34	16
Post and telecommunication expenses	39	49
Training and business trip expenses	32	27
IT expenses	47	24
Total	**925**	**839**

Note 11: Depreciation and Amortisation of Tangible and Intangible Assets

	Note	EUR ths. 2013	EUR ths. 2012
Depreciation of tangible assets	21	58	62
Amortisation of intangible assets	23	10	17
Total		**68**	**79**

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Note 12: Provisions

	EUR ths. 2013	EUR ths. 2012
Provisions for pending court actions	243	0
Provision to cover potential liabilities *	72	230
Total	**315**	**230**

* Bank has formed a short-term provision both as of 31.12.2013 and 31.12.2012 to cover potential liabilities in connection with the sale contracts of assets disclosed as property investments.

Note 13: Impairment Loss on Assets

	EUR ths. 2013	EUR ths. 2012
Available-for-sale financial assets (Note 19):		
Impairment loss on available-for-sale financial assets	-66	0
Loans (Note 17):		
Impairment loss on claims	-437	-2,537
Recoveries of impaired loans	1,111	410
Total loans	**674**	**-2,127**
Impairment on investment properties	-323	-98
Impairment on other assets *	-130	-110
Total	**155**	**-2,335**

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

Note 14: Cash

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
In Euros	98	117
In foreign currency	12	13
Total	**110**	**130**

Note 15: Balances with Central Bank

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Mandatory reserve with the Bank of Estonia	939	386
Surplus of the mandatory reserve with the Bank of Estonia	47,289	4,159
Total	**48,228**	**4,545**

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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.	EUR ths.
	31.12.2013	**31.12.2012**
Correspondent accounts	**57,622**	**22,979**
Receivables by country		
Estonia	16,968	8,431
OECD countries (excl. Estonia)	40,654	14,548
Total	**57,622**	**22,979**
Due from other banks by bank ratings		
A1	16,969	8,421
A2	15,542	4,387
A3	15,973	7,706
Ba3	1,863	0
Baa2	3,096	0
Baa3	473	0
Caa1	0	2,002
Caa2	2,031	0
Not rated *	1,675	463
Total	**57,622**	**22,979**

* Claims to credit institutions registered in Denmark and Ukraine, which have no foreign rating have been disclosed as not rated.

Note 17: Due from Customers

	EUR ths.	EUR ths.
	31.12.2013	**31.12.2012**
Due by customer types (gross)		
Due from financial institutions	397	242
Loans:		
Loans to private companies	21,535	20,081
Loans to private persons	5,632	4,152
Total loans	**27,167**	**24,233**
Accrued interest receivable	650	882
Total due from customers (gross)	**28,214**	**25,357**
Specific loan loss allowances	-2,750	-4,583
General loan loss allowances	-116	-100
Unamortised transaction fees	-26	-15
Total due from customers (net)	**25,322**	**20,659**

Note 17 continued:

Loans by collaterals (gross)		
Mortgage	22,069	22,365
Commercial pledge	788	1,337
Deposit	1,457	35
Other security over movables	16	12
Security	1,458	0
Other	1,515	285
Without collateral	514	1,081
Total	**27,817**	**25,115**

Due by remaining maturity (gross)		
On demand	397	242
Up to 3 months	2,217	2,021
3 to 12 months	1,070	1,506
1 to 2 years	5,079	1,331
2 to 5 years	6,184	4,293
over 5 years	7,959	6,589
past due	391	437
impaired loans	4,267	8,056
Accrued interest receivable from past due and impaired loans	605	848
Accrued interest receivable from other loans	45	34
Total	**28,214**	**25,357**

Loans by categories (gross)		
category 1 – low risk	20,455	13,317
category 2 – moderate risk	495	476
category 3 – medium risk	704	351
category 4 – high risk	6,163	10,971
Total	**27,817**	**25,115**

Incl. working loans by categories (gross)		
category 1 – low risk	19,827	13,130
category 2 – moderate risk	318	340
category 3 – medium risk	655	236
category 4 – high risk	1,294	2,068
Total	**22,094**	**15,774**

Due by countries (gross)		
Estonia	22,639	24,603
OECD countries (excl. Estonia)	5,575	754
Total	**28,214**	**25,357**

Past Due and Impaired Claims and Loans

Overdue loans by customer type (gross)		
Loans to private companies	3,515	7,093
Interest claims to private companies	564	805
Loans to private persons	1,143	1,400
Interest claims to private persons	41	43
Total	**5,263**	**9,341**
No. of non-performing loans	25	37

Note 17 continued:

incl. impaired loans by customer type (gross)		
Loans to private companies	3,273	6,834
Accrued interest receivable from private companies	562	804
Loans to private persons	994	1,222
Accrued interest receivable from private persons	40	43
Total	**4,869**	**8,903**

Fair Value of Collaterals of Past Due and Impaired Claims

	EUR ths. **31.12.2013**	EUR ths. **31.12.2012**
Collaterals of past due loans	896	581
Collaterals of impaired loans	1,941	4,777
Total	**2,837**	**5,358**
Specific Loan Loss Allowances by Customer Type		
Private companies		
Loan loss allowances at beginning of period	-4,200	-6,518
New loan loss allowances during period	-234	-2,293
Claims written off	1,215	4,398
Deductions of allowances during period	921	213
Loan loss allowances at end of period	**-2,298**	**-4,200**
Private persons		
Loan loss allowances at beginning of period	-383	-1,033
New loan loss allowances during period	-240	-156
Claims written off	0	700
Deductions of allowances during period	171	106
Loan loss allowances at end of period	**-452**	**-383**
Total specific loan loss allowances	**-2,750**	**-4,583**

All under-collaterised loans and overdrafts, where the payments are overdue by more than 90 days, are reported as non-performing loans. 10 claims have been written off in year 2013 (31 claims have been written off in year 2012).

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 46 ths. (2012: EUR 741 ths.) (see Note 34).

Issued but unused letters of credit comprised EUR 950 ths. as of 31.12.2013 (EUR 100 ths. as of 31.12.2012), disclosed as off-balance sheet commitments. Letters-of-credit were covered with deposits in same amount.

Management has disclosed its opinion on fair value of loans in Note 44.

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Note 17 continued:

Overdue financial assets maturity structure

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Private companies		
Up to 90 days	244	525
91 days to 1 year	138	376
1 to 2 years	149	2,530
over 2 years	3,548	4,467
Total	**4,079**	**7,898**
Private persons		
Up to 90 days	351	438
91 days to 1 year	335	357
1 to 2 years	266	387
over 2 years	232	261
Total	**1,184**	**1,443**
Total overdue financial assets	**5,263**	**9,341**

incl. maturity structure of unimpaired financial assets

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Private companies		
Up to 90 days	244	273
91 days to 1 year	138	345
1 to 2 years	121	0
over 2 years	949	98
Total	**1,452**	**716**
Private persons		
Up to 90 days	302	335
91 days to 1 year	0	104
Total	**302**	**439**
Total unimpaired financial assets	**1,754**	**1,155**

Restructured loans

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Loans to private companies	3,820	7,530
Loans to private persons	402	644
Total	**4,222**	**8,174**

Bank has restructured 15 loans, as of 31.12.2013, where the payment difficulties have temporary nature. 24 loans were restructured as of 31.12.2012.

There were no restructured loans during year 2013. Claim balances as of 31.12.2013 were accordingly EUR 3,820 ths. and EUR 402 ths.

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 644 ths.

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Note 17 continued:

Financial effect of collateral of overdue loans

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Over-collaterised loans		
Loan balance	1,352	4,555
Fair value of collateral	2,164	5,309
Under-collaterised loans		
Loan balance	1,161	203
Fair value of collateral	673	49

Note 18: Financial Assets/Financial Liabilities Held for Trading

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Financial assets held for trading		
Derivatives *	15	16
Financial assets in fair value through profit and loss		
shares listed on a stock exchange (active market)	1	3
Total	**16**	**19**

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Financial liabilities held for trading		
Derivatives *	10	16
Total	**10**	**16**
Total financial assets/financial liabilities held for trading	**6**	**3**
Shares and other securities by countries		
OECD countries (excl. Estonia)	1	3
Total	**1**	**3**

*** Derivatives**

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Currency related derivatives:		
claims (in contract value) (Note 34)	15,743	12,739
commitments (in contract value) (Note 34)	15,738	12,739
fair value	5	0

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Note 19: Available-for-Sale Financial Assets

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Debt securities and other shares by issuer		
Debt securities of central goverment	527	690
Debt securities of credit institutions	2,292	2,211
Debt securities of private companies	4,460	1,500
Shares and fund units of private companies	3	3
Total	**7,282**	**4,404**

Movements in debt securities and other shares	**2013**	**2012**
Balance at beginning of year	4,404	124
Purchases	5,169	5,865
Sold	-2,175	-1,960
Reclassification of securities *	488	0
Impairment charge (Note 13)	-66	0
Amortised premium discount	-142	202
Fair value revaluation	-481	83
Interest accruals	85	90
Total	**7,282**	**4,404**

* Reclassification of securities held-to-maturity in year 2013 – please refer to Accounting Policies, page 15.

Debt securities and other shares by ratings		
A3	549	0
Baa1	527	0
Baa2	1,962	2,115
Baa3	3,335	0
Ba1	906	0
Caa1	0	1,564
Without ratings	3	725
Total	**7,282**	**4,404**

Debt securities and other shares by countries		
Estonia	3	69
OECD countries (excl. Estonia)	7,279	4,335
Total	**7,282**	**4,404**

Impairment charges of available-for-sale financial assets

	EUR ths. 2013	EUR ths. 2012
Debt securities of private companies	-66	0
Total	**-66**	**0**

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Note 20: Held-to-Maturity Investments

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Debt securities and other shares by issuer		
Debt securities of central goverment	0	1,543
Debt securities of credit institutions	0	2,746
Debt securities of private companies	0	750
Total	**0**	**5,039**

Movements in debt securities and other shares	**2013**	**2012**
Balance at beginning of year	5,039	0
Purchases	0	4,950
Sold *	-4,450	0
Reclassification of securities **	-488	0
Amortised premium discount	35	-49
Interest accruals	-136	138
Total	**0**	**5,039**

* Held-to-maturity debt securities had carrying value of 4,419 thousand euros and profit of 555 thousand euros.

** Reclassification of securities held-to-maturity in year 2013 – please refer to Accounting Policies, page 15.

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

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

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

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Note 21: Property and Equipment

EUR ths.

	Capitalised construction expenses *	Computers	Furniture	Other tangible assets	Total
Balance as of 01.01.2013					
At cost	**83**	**80**	**43**	**207**	**413**
Accumulated depreciation	-40	-67	-36	-141	**-284**
Net value	**43**	**13**	**7**	**66**	**129**
Changes in 2013					
Purchases during period	10	22	2	75	**109**
Depreciation expense (Note 11)	-17	-11	-3	-27	**-58**
Property and equipment write-offs (at cost)	-1	-14	-1	-25	**-41**
Accumulated depreciation of property and equipment write-offs	1	14	1	25	**41**
Balance as of 31.12.2013					
At cost	**92**	**88**	**44**	**257**	**481**
Accumulated depreciation	-56	-64	-38	-143	**-301**
Net value	**36**	**24**	**6**	**114**	**180**

EUR ths.

	Capitalised construction expenses *	Compu-ters	Furni-ture	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**

* Reconstruction expenses of rented premises.

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Note 22: Investment Properties

	EUR ths. 2013	EUR ths. 2012
Investment properties at beginning of year	3,938	4,557
Investment properties acquired	78	0
Investment properties sold	-302	-382
Fair value revaluation	-361	-237
Total	**3,353**	**3,938**

Bank 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 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 1,828 thousand euros as of 31.12.2013 (2,286 thousand euros as of 31.12.2012).

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

Note 23: Intangible Assets

Software and licenses	EUR ths. 2013	EUR ths. 2012
Balance as of 01.01.		
At cost	**392**	**384**
Accumulated amortisation	-296	-279
Net value	**96**	**105**
Changes during report year		
Purchases during period	14	8
Amortisation expense (Note 11)	-10	-17
Write-offs (at cost)	-26	0
Accumulated amortisation of assets written-off	-25	0
Balance as of 31.12.		
At cost	**380**	**392**
Accumulated amortisation	-281	-296
Net value	**99**	**96**

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Note 24: Other Assets

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Fees and commissions receivable	39	19
Prepaid supervision fees *	71	56
Other prepaid expenses **	154	109
Other receivables	167	20
Total	**431**	**204**

* 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. 31.12.2013	EUR ths. 31.12.2012
Deposits from credit institutions	1,559	276
Other deposits	126,930	50,755
Total	**128,489**	**51,031**
Demand deposits	97,530	22,650
Time deposits	30,675	27,799
Other borrowings	0	166
Accrued interests	284	416
Total	**128,489**	**51,031**
Demand deposits by customer groups		
Companies	93,281	19,923
Private persons	2,470	2,384
Non-profit organisations	213	233
Financial institutions	7	0
Credit institutions	1,559	110
Total	**97,530**	**22,650**
Time deposits by customer groups		
Private persons	19,082	18,888
Companies	8,340	6,651
Non-profit organisations	3,253	2,260
Total	**30,675**	**27,799**
Deposits by maturities		
On demand	97,530	22,650
Up to 3 month	7,000	7,981
3 to 12 months	16,954	17,553
1 to 2 years	4,959	1,608
2 to 5 years	2,046	1,239
Total	**128,489**	**51,031**

Note 26: Subordinated Debt

	EUR ths. 2013	EUR ths. 2012
Debt balance at beginning of period	2,931	4,033
Effective interest rate correction	136	-1,102
Total	**3,067**	**2,931**

Bank 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 933 ths. as of 31.12.2013) 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. 2013	EUR ths. 2012
Debt balance at beginning of period	199	166
Borrowings received	152	128
Borrowings repaid	99	95
Balance at end of period	**252**	**199**
Debts by maturities		
Up to 3 months	44	43
3 to 12 months	49	41
1 to 2 years	62	63
2 to 5 years	97	52
Total	**252**	**199**

Borrowings from Estonian Rural Development Foundation are reported under borrowed funds from government and foreign aid. Borrowings bear a fixed interest rate 1.25% and 1.5% p.a.

Note 28: Tax Liabilities

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Social tax	64	39
Income tax withheld	32	19
Fringe benefits' income tax	2	1
Value added tax	114	84
Taxes payable	**212**	**143**

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.

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Note 29: Other Liabilities

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Payments in transmission *	270	15
Payables to employees	56	55
Payables to suppliers	30	20
Prepaid expenses	15	5
Other liabilities	2	1
Total	**373**	**96**

* 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.), which can differ significantly on report date due to few single payments.

Note 30: Shareholders' Equity

Share capital

Paid-in share capital comprised 14,088,775.20 euros as of 31.12.2013, divided into 23,481,292 common shares with nominal value of 0.60 euros (as of 31.12.2012: share capital 12,088,774.20 euros, 20,147,957 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.

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. Payment for new shares was credited on 27.02.2013.
Extraordinary Meeting of Shareholders decided on 04.12.2013 to increase the share capital of the Bank by EUR 4,000,000.80, i.e. from EUR 14,088,775.20 to EUR 18,088,776.00 by issuing new shares. The majority shareholder UKRSELHOSPROM PCF LLC subscribed the issue in full on 05.12.2013 and the payment for the new shares must be credited on 15.03.2014 the latest.

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.

Fair Value Reserve of Available-for-Sale Financial Assets

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

Note 30 continued:

Statutory Reserve Capital
Statutory reserve capital has been formed in accordance with the Estonian Commercial Code. Statutory reserve capital 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 reserve capital, until the statutory reserve capital is at least 1/10 of share capital. Statutory reserve capital can be used to cover losses, also to increase share capital. No payments can be made to the owners from the statutory reserve capital.

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 the Supervisory Board;
d. close relatives of the persons mentioned previously and the companies related to them;
e. subsidiary company 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. **2013**	EUR ths. **2012**
Loans:		
Balance of loans at beginning of period 01.01	15	19
Disbursed loans	5	0
Repaid loans	-4	-4
Balance of loans at end of period 31.12	16	15
Interest income	1	1
Liabilities:		
Deposits	84	72
Salaries of the members of the Management Board	249	217

Shareholders of the credit institution and their related parties, also companies controlled jointly of privately by these persons:	EUR ths. **2013**	EUR ths. **2012**
Loans:		
Balance of loans at beginning of period 01.01	165	180
Repaid loans	-14	-15
Balance of loans at end of period 31.12	151	165
Interest income	5	6
Interest receivable	0	1
Fees receivable	1	0
Due from credit institutions	446	352
Prepayments for services	1	0

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Note 31 continued:

Liabilities:		
Deposits	767	193
Fees and commission income	42	9
Administrative and other operating expenses	35	0
Letter-of-credit	950	0

Company belonging to the consolidation group	EUR ths. **31.12.2013**	EUR ths. **31.12.2012**
Payment of the liquidation proceeds *	0	11

* Osito Casa OÜ was deleted from the Commercial Register on 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. **31.12.2013**	EUR ths. **31.12.2012**
Claims:		
Deposits	48	1
Prepayments for services	16	0
Fees and commission income	5	2
Administrative and other operating expenses	13	0
Compensation to the members of the Supervisory Board	97	81

Parent company of the Bank: UKRSELHOSPROM PCF LLC	EUR ths. **31.12.2013**	EUR ths. **31.12.2012**
Payment to share capital	2,000	5,040
Subordinated debt (gross)	4,000	4,000
Including disclosed under equity	-933	-1,069
Fees and commission income	2	1
Fees receivable	4	1

Loans to related parties have no loan loss allowances.

The contracts with the members of the Management Board of the Bank include one-time compensation in the salary amount of 6-10 calendar months in case the agreement is terminated on the initiative of the Bank.

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Note 32: Geographical Concentration of Customers' Debts

EUR ths., as of 31.12.2013

		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		84,543	3,599	17	9,433	60.95%
United States of America		8,261	0	342	0	5.58%
United Kingdom		521	0	1	5,841	4.13%
Denmark		212	0	0	0	0.14%
Latvia		2	0	0	0	0.00%
Germany		6,575	0	1	469	4.57%
Ukraine		3,954	0	0	0	2.56%
Russia		4,959	0	435	0	3.50%
Austria		6,825	0	0	0	4.43%
Switzerland		2,226	0	0	0	1.44%
Belgium		7,628	0	0	0	4.95%
Israel		1,453	0	0	0	0.94%
Panama		552	0	0	0	0.36%
British Virgin Islands		1,458	0	0	0	0.95%
Italy		473	0	745	0	0.79%
Luxembourg		0	0	1,408	0	0.91%
United Arab Emirates		0	0	549	0	0.36%
Netherlands		0	0	514	0	0.33%
Australia		0	0	179	0	0.12%
Bermuda		0	0	395	0	0.26%
Brazil		0	0	762	0	0.49%
Ireland		0	0	508	0	0.33%
Slovenia		0	0	527	0	0.34%
Turkey		0	0	915	0	0.59%
Cyprus		1,530	0	0	0	0.99%
Total		**131,172**	**3,599**	**7,298**	**15,743**	**100.00%**

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Note 32 continued:

EUR ths., as of 31.12.2012

Area		Balance sheet claims				
		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%**

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

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Note 33: Concentration of Customers' Debts by Economic Sector

EUR ths., as of 31.12.2013	Balance sheet claims				
Economic sector	**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	2,946	706	0	0	1.91%
Mining and quarrying	53	0	181	0	0.15%
Manufacturing	978	6	203	0	0.76%
Electricity, gas, steam and air conditioning supply	0	0	549	0	0.36%
Construction	521	180	0	0	0.34%
Wholesale and retail trade	1,101	69	0	9,071	6.60%
Transportation and storage	94	5	0	362	0.29%
Accommodation and food service activities	884	45	0	0	0.57%
Information and communication	0	0	1,304	0	0.84%
Financial and insurance activities	106,243	0	3,607	6,310	75.32%
Real estate activities	8,570	2,320	0	0	5.56%
Professional, scientific and technical activities	70	0	0	0	0.05%
Administrative and support service activities	44	0	0	0	0.03%
Public administration and defence; compulsory social security	0	0	527	0	0.34%
Human health and social work activities	996	0	0	0	0.65%
Arts, entertainment and recreation	1,538	0	0	0	1.00%
Other service activities	2,059	1	927	0	1.94%
Private persons	5,075	267	0	0	3.29%
Total	**131,172**	**3,599**	**7,298**	**15,743**	**100.00%**

EUR ths., as of 31.12.2012	Balance sheet claims				
Economic sector	**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%**

* Includes claims on credit institutions, financial institutions and customers.

** Comprises financial assets held for trading, available-for-sale financial assets and held-to-maturity investments.

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Note 34: Contingent Assets and Liabilities

		31.12.2013
	EUR ths.	EUR ths.
	Claims	**Liabilities**
Irrevocable transactions	**15,743**	**16,747**
Guarantees and similar irrevocable transactions	0	13
Unused loan limits (Note 17, 36, 41)	0	46
Letters of credit granted but not utilised	0	950
Currency forward transactions (Note 18, 36)	15,743	15,738

		31.12.2012
	EUR ths.	EUR ths.
	Claims	**Liabilities**
Irrevocable transactions	**12,739**	**13,580**
Unused loan limits (Notes 17, 36, 41)	0	741
Letters of credit granted but not utilised	0	100
Currency forward transactions (Notes 18, 36)	12,739	12,739

Note 35: Funds Under Trust Management

	31.12.2013	31.12.2012
	EUR ths.	**EUR ths.**
Fiduciary deposits with other credit institutions		
up to 1 month	7,976	0
3 to 12 months	6,593	0
TOTAL	**14,569**	**0**

Fiduciary deposits are assets of customer placed under authorisation agreement, disclosed off-balance sheet by the Bank.

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Note 36: Liquidity (Assets and Liabilities by Remaining Maturities)

EUR ths., as of 31.12.2013

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		**88,287**	**986**	**18,859**	**2,405**	**1,272**	**5,207**	**6,247**	**15,748**	**139,011**
Cash and claims to credit institutions		87,832	0	18,128	0	0	0	0	0	**105,960**
Claims to customers	17	397	972	653	2,227	1,149	5,207	6,247	8,470	**25,322**
Securities		5	0	15	0	0	0	0	7,278	**7,298**
Other claims	24	53	14	63	178	123	0	0	0	**431**
Liabilities of the Bank		**98,115**	**0**	**3,618**	**3,741**	**17,003**	**5,021**	**2,143**	**4,000**	**133,641**
Amounts owed to credit institutions	25	1,559	0	0	0	0	0	0	0	**1,559**
Amounts owed to clients	25	95,971	0	3,300	3,700	16,954	4,959	2,046	0	**126,930**
Subordinated debt	26	0	0	0	0	0	0	0	4,000	**4,000**
Other borrowings	27	0	0	3	41	49	62	97	0	**252**
Other liabilities		585	0	315	0	0	0	0	0	**900**
Net		**-9,828**	**986**	**15,241**	**-1,336**	**-15,731**	**186**	**4,104**	**11,748**	**5,370**
Contingent:										
assets (Note 18,34)		**0**	**0**	**15,743**	**0**	**0**	**0**	**0**	**0**	**15,743**
liabilities (Note 18, 34)		**46**	**0**	**15,738**	**0**	**963**	**0**	**0**	**0**	**16,747**

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**

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Note 37: Earnings/Loss Per Share

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Net profit/loss for the reporting period	1,046	-3,536
Weighted average no. of shares (ths. pcs.)	22,952	16,728
Basic earnings/loss per share	**0.05**	**-0.21**
Diluted earnings/loss per share	**0.05**	**-0.21**

Versobank AS has not issued convertible securities.

Note 38: Operating Lease Liabilities

Rental payments for vehicles

Versobank AS has concluded operating lease agreements for four vehicles as of 31.12.2013. Longest contract ends on 15.12.2015, i.e. no agreement exceeds 5 years. Operating lease agreements for four vehicles were concluded as of 31.12.2012 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. 2013	EUR ths. 2012
Rental payment paid and expensed during reporting year	30	30
Rental payments payable:		
up to 1 year	30	30
1 to 5 years	13	40

Rental payments for bank premises

Versobank AS has concluded agreements for renting premises in Tallinn, in Riga and Dnipropetrovsk. Tallinn rent agreement ends on 31.05.2021, Riga rent agreement ends on 31.12.2016 and Dnipropetrovsk rent agreement ends on 31.12.2014.

Rental payments for bank premises by due dates

	EUR ths. 2013	EUR ths. 2012
Rental payment paid and expensed during reporting year	389	347
Rental payments payable during next reporting period:		
from uninterruptable contract:		
up to 1 year	528	344
1 to 5 years	2,052	1,718
over 5 years	494	830

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

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Note 39: Risk and Capital Management

Key developments in 2013

Year 2013 was a year of fast growth of the Bank, primarily due to growth in volumes on demand deposits and rapid growth of payment volumes. The balance sheet structure of the Bank changed substantially during the year, total assets of the bank have increased 2.3 times. The overall proportion of loan portfolio decreased in balance sheet structure (17.7% as of 31.12.2013; 33.2% as of 31.12.2012). Risk exposure to credit institutions and correspondingly liabilities related to demand deposits increased significantly. The market risk exposure related to available-fo-sale trading portfolio of debt securities increased too. Due to the big share of highly volatilitile liabilities, the Bank directs special attention to liquidity management and availability of highly liquid assets. As of 31.12.2013 the liquidity buffer formed 71.5% of total assets of the Bank (44.0% as of 31.12.2012).

The Bank continued efforts in further strengthening its framework to risk, capital and liquidity management in year 2013. The Bank proceeded implementing new risk policies approved by Supervisory Board on 2012. The Supervisory Board of the Bank approved a new Policy for Market Risk Management in September 2013. Supervisory Board of the Bank also reviewed and updated existing Operational Risk Policy and made minor changes to the Credit Policy.

The Bank makes preparations for the implementation of the new regulatory requirements. As the application of these is not yet fully clear, the Bank takes steps to align its internal risk framework with the regulatory initiatives and drafts in process.

Risk and Capital Management Policy

The Policy for Risk and Capital Adequacy Management sets out overall aim and framework of the risk taking activities of 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 determines general risk and capital management principles, formulates risk strategy and appetite for main risk categories, formulates general requirements for internal risk limits system, determines capital adequacy and capital planning principles and determines 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 perspectives. 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 organisational structure, the roles and responsibilities of the Bank's risk management and internal control system are defined under "three lines of defence" concept. The first line of defence (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 defence (independent risk control) is control and monitoring functions which include risk management (risk control) function and compliance function. The third line of defence 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 monitoring risk positions, capital adequacy and limit utilisation both on a regular and ad-hoc basis.

Note 39 continued:

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 counterparty, borrower or obligator exist. Within credit risk country and concentration risk are also 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 risk strategy and limits system for management of credit risk in bond portfolio is set out in the Policy for Market Risk 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 repayment ability assessment;
- requirements for self-financing;
- requirements for collaterals.

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 the creditworthiness of the 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.
Note 17 discloses a 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 loan collaterals, 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.
Note 17 discloses overview of value of positions exposed to credit risk by collateral type.

Impaired loans
The loan is considered impaired if it is overdue for more than 90 days. The loan may also be considered impaired if there is objective evidence that a loss event has occurred and such loss event has an impact on future estimated cash flows. The Bank writes off claims when the Bank determines that the loan is uncollectible and proceeds from collateral are not sufficient to pay pack the entire exposure. The credit committee reviews loans in arrears weekly. 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.

Note 39 continued:

Counterparty credit risk
The Bank has a limit system for counterparty credit risk management. All counterparty risk limits, including total exposure, maximum maturity of deposits, acceptable foreign exchange risks, are approved by the Management Board of the Bank. The counterparty analysis depends on the counterparty´s rating, country of origin, size of limit requested and other important factors affecting counterparty 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 the Credit Policy shall not exceed 10%. All exemptions to this limit shall be approved by the Supervisory Board. The Bank credit exposure with related persons shall not exceed 4.5% of the Bank net own funds.
Note 32 discloses value of positions exposed to credit risk by type and geographical area.
Note 33 discloses value of positions exposed to credit risk by sector of economy.
Note 17 discloses value of positions exposed to credit risk by remaining maturity.
Note 43 discloses overview of customers with high risk concentration.

Portfolios of debt securities
According to Bank's new strategy for liquidity management the Bank continued to hold and develop available-for-sale portfolio of debt instruments purchased in year 2012. The objectives of debt security portfolios are to provide liquidity, help interest rate management and earn additional income. The objective of the available-for-sale portfolio of debt securities is to warehouse liquidity of the Bank in order to earn interest income and capital gain in instruments that can be sold quickly if needed to meet Bank´s liabilities. The objective of the held-to-maturity portfolio of debt securities (investment 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 portfolios of debt securities are set out by the Policy for Liquidity Management. The portfolios of debt securities are managed by Treasury Department according to Policy for Liquidity Management and trading strategy approved by the Management Board. Held-to-maturity portfolio of debt securities does not exist from May 2013.
Note 19 for discloses information on available-for-sale portfolio of debt securities.

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 risk 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 and counterparties. 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 structure risk. This includes the mitigation of currency risk, interest rate risk and maturity risk 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.

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Note 39 continued:

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.

During the whole year 2013 the Bank held strong liquidity position as set by the Policy for Liquidity Management.

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) 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

The liquidity risk management framework used is designed to identify, measure and manage the liquidity risk position of the Bank. Liquidity risk management approach starts at the intraday liquidity management. The Bank monitors and actively 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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Note 39 continued:

The Bank uses liquidity risk mitigation tools, including system of limits and liquidity buffers. The liquidity buffers' size and composition principles as well as liquidity limits are set by Policy for Liquidity Management.
Note 36 discloses Bank's assets and liabilities by remaining maturities.

Market risk

Market risk can arise from adverse changes in interest rates, foreign exchange rates, equity prices, commodity prices and other relevant parameters, primarily such as market volatility. 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 portfolios of debt securities and for open net foreign currency exposures. The Money and Capital Markets Division has primary responsibility for market risk management.

Interest rate risk
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 +100 and + 200 basis points parallel shift of all interest curves and its affect on profits. Assets´ and liabilities´ interest sensitivity gaps are 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 has adopted additional interest rate risk measurement method based on duration gap analysis.
Note 41 discloses interest positions and interest rate sensitivity analysis.

Foreign currency risk
The Bank's 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.
Note 40 discloses open currency positions and foreign currency risk 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 customer 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.

Operational risk management organization
The Management Board of the Bank is guiding and coordinating the operational risk management. The day-to-day operational risk management lies with the Bank business divisions and infrastructure functions (operational risk owners). Risk management function monitors 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 developing and updateing internal regulations. The internal audit is responsible for evaluating the current internal control system, the sufficiency and efficiency of the control mechanisms, making recommendations for improvements of the system and test its operability.

Note 39 continued:

Operational risk management process

The Bank uses several techniques for measurement, mitigation and monitoring 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.
- Existance of business continuity plans.

The Bank has not registered any serious operational risk incidents in year 2013. Overall level of operational risk increased in year 2013 through to growth of business volumes and opening new offices in Dnepropetrovsk and Riga (with the permit for cross-boarder business). Realised operational losses remained at the low level (EUR 3.4 ths. in year 2013 and EUR 1.5 ths. in year 2012).

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. During 2013 the Bank has maintained stable and strong capital ratios. As of 31.12.2013 the level 1 own fund (Tier 1) ratio was 19.0 % (17.7% as of 31.12.2012).

Own funds

In the year 2013, the Bank strengthened its Tier 1 capital by issuing new shares in the amount of EUR 2.0 million, paid in on 27.02.2013. At the end of 2013 a new issue in the amount of EUR 4.0 million was decided, which was also subscribed by the main shareholder and for which the payment due date is 15.03.2014. The Bank's Tier 2 own funds mainly consists of subordinated debt. There are no Tier 3 funds within the composition of own funds of the Bank.

Note 42 discloses the summary of information concerning the principles of calculating own funds, main components of own funds presented by the tiers and deductions made from own funds.

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 the Bank and the Financial Supervision Authority on the risks and capital needs.

The Bank uses standard method for calculating regulatory capital requirements for credit risk. Based on written application of a Bank, the 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 1 and 2) and treat the risk positions of the trading portfolio as risk positions of the bank portfolio. As the Bank trading portfolio from 30.11.2012 exceeds the limits set by Credit Institutions Act § 79 clause 3 the Financial Supervision Authority exemption expired and the Bank is calculating trading portfolio capital requirements by general rules from 30.11.2012 and during 2013.

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 Moody´s, Standard & Poor´s,

Note 39 continued:

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 own funds ratio to risk-weighted assets must be above 10% based on the requirements of the regulatory body. The Bank capital adequacy remained strong and was 28.26 % as of 31.12.2013 (26.60% as of 31.12.2012).
Note 42 discloses the Bank's regulatory capital and risk-weighted assets. Assets are presented by methods used, credit quality classes and capital requirements broken down by credit risk, market risk and operational risk.

Note 40: Foreign Currency Risk

31.12.2013
EUR ths.

	Balance sheet position assets	Balance sheet position liabilities	Off-balance sheet position assets	Off-balance sheet position liabilities	Net position
EUR position	81,961	71,917	7,770	7,924	9,890
USD position	60,095	60,201	7,930	7,816	8
RUB position	27	27	44	44	0
SEK position	162	160	0	0	2
GBP position	380	380	0	0	0

31.12.2012
EUR ths.

	Balance sheet position assets	Balance sheet position liabilities	Off-balance sheet position assets	Off-balance sheet position liabilities	Net 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

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

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
Actual openness of Bank to foreign currency risks is continuously very small. Simultaneous 10% change of all exchange rates in adverse direction would cause additional expense in amount of EUR 3.8 ths. (31.12.2012: EUR 1.3 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 approximate 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.

Note 41: Interest-Bearing Assets and Liabilities by Interest Repricing Period

EUR ths., as of 31.12.2013

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		**106,457**	**2,677**	**3,134**	**6,335**	**6,464**	**12,206**	**1,314**	**138,587**
Claims to credit institutions	14, 15, 16	105,850	0	0	0	0	0	110	**105,960**
Claims to customers		607	2,677	3,134	6,335	6,464	4,927	1,204	**25,348**
Securities		0	0	0	0	0	7,279	0	**7,279**
Bank's liabilities		**100,843**	**3,691**	**16,864**	**4,972**	**2,133**	**4,000**	**284**	**132,787**
Due to banks		1,559	0	0	0	0	0	0	**1,559**
Deposits	25	99,235	3,650	16,815	4,910	2,036	0	284	**126,930**
Subordinated debt	26	0	0	0	0	0	4,000	0	**4,000**
Other borrowings	27	3	41	49	62	97	0	0	**252**
Unused loan limits	34	46	0	0	0	0	0	0	**46**
Net		**5,614**	**-1,014**	**-13,730**	**1,363**	**4,331**	**8,206**	**1,030**	**5,800**

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**

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

Sensitivity analysis of interest rate risk

The Bank uses three methods for interest rate risk analysis and assessment. Based on interest rate sensitivity analysis by Basel standardised methodology the effect of a +200 bps movement of interest rates to economic value of equity was -46,084 EUR as of 31.12.2013 (-158,383 EUR as of 31.12.2012). According to the interest rate risk duration GAP analysis, the +200 bps change of interest rates result in a change of economic value -50,255 EUR of the Bank or 0.4% of net own funds of the Bank (-147,690 EUR or 1.6% as of 31.12.2012). Both results are considered to be relatively low risk level.

Interest rate risk stress test was also performed as of 31.12.2013, where the effect of a 200 bps deposits 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 one 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 totaled 23,728 thousand euros in one year (24,984 thousand euros as of 31.12.2012). 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

Note 41 continued:

interest rate totalled 3,791 thousand euros as of 31.12.2013 (4,274 thousand euros as of 31.12.2012), by which the deposit volumes open to interest rate risk were adjusted during the stress test, and the appropriate effect of 200 bps interest curve rise was 222,356 EUR (239,121 EUR as of 31.12.2012).

Note 42: Capital Adequacy

	EUR ths. 31.12.2013	EUR ths. 31.12.2012
Share capital paid-in	14,089	12,089
Other reserves	36	36
Accumulated deficit of the previous years	-5,781	-2,245
Intangible assets	-99	-96
Net loss of the period	0	-3,536
Total tier 1 own funds	**8,244**	**6,248**
Subordinated debt	4,000	4,000
Available-for-sale financial instruments	0	37
Tier 2 own funds, which exceed the limits	0	-876
Second level equity	**4,000**	**3,161**
Minimum own funds	12,244	9,409
Tier 1 own funds after deductions	8,244	6,248
Tier 2 own funds after deductions	4,000	3,161
Own funds for capital adequacy calculations	**12,244**	**9,409**
Central governments and central banks under standard method	0	55
Credit institutions and investment companies under standard method	1,162	689
Companies under standard method	497	313
Mass claims under standard method	977	889
Claims backed by mortgages under standard method	170	162
Overdue claims under standard method	263	461
Other assets under standard method	397	427
Total capital requirement for credit risk and counterparty credit risk	**3,466**	**2,996**
Capital requirement for interest rate position risk	572	314
Total capital requirements for currency risk, commodity risk and trading portfolio position risk	**573**	**314**
Operational risk base method	294	227
Total capital requirement for operational risk	**294**	**227**
Capital requirements for adequacy calculations	**4,333**	**3,537**
Capital adequacy	**28.26%**	**26.60%**

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

EUR ths., 31.12.2013

	Balance sheet								Off-balance sheet						
	Initial value (gross)			Allowances and corrections (-)			Substitution effects of the credit protection (-)								
	Claims	Loans	Bank's portfolio	Unamortised fees	Loan provisions	Debt security provisions	Credit risk mitigation	Financial collaterals simple method	Loan limits	Letters of credit	Financial guarantees	Derivatives *	Credit risk mitigation	Risk weight	Risk-adjusted amount
Note:	15, 16, 17	17		17	17				34	34	34				
Central government and central banks	**48,228**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**		**0**
I rate credit quality	48,228													0%	0
Credit institutions and investment firms	**58,019**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**950**	**0**	**65**	**-950**	0%	**11,617**
I rate credit quality	58,019											65		20%	11,617
II rate credit quality										950			-950	50%	0
Companies	**0**	**7,285**	**1**	**0**	**0**	**0**	**-2,420**	**0**	**0**	**0**	**0**	**108**	**0**	0%	**4,974**
III and IV rate credit quality		7,285	1				-2,420					108		100%	4,974
Retail claims	**0**	**13,217**	**0**	**-26**	**-165**	**0**	**0**	**-10**	**0**	**0**	**13**	**0**	**-13**	0%	**9,762**
Claims up to EUR 1 mln		13,217		-26	-165			-10					0	75%	9,762
Guarantees											13		-13	100%	0
Claims with real estate collaterals	**0**	**2,648**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0%	**1,702**
Claims, fully covered by mortgage to residential real estate, covered claims up to 70% of the real estate collateral value		1,455												35%	509
Claims, fully covered by mortgage to residential real estate, covered claims over 70% of the real estate collateral value		1,193												100%	1,193
Claims in arrears	**0**	**4,668**	**0**	**0**	**-2,701**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0%	**2,631**
III and IV rate credit quality		3,311			-2,671									100%	640
V and VI rate credit quality		1,357			-30									150%	1,991
Other assets	**4,073**	**0**	**6**	**0**	**0**	**-3**	**0**	**0**	**46**	**0**	**0**	**0**	**0**	0%	**3,975**
Cash	110													0%	0
Property and equipment	3,532													100%	3,532
Prepayments and prepaid expenses	431													100%	431
Investments to shares of other companies, not deducted from own funds			6			-3								100%	3
Loan limits and overdraft limits with contractual maturity up to 1 year (can not be terminated by one party)									46					20%	9
Total	**110,320**	**27,818**	**7**	**-26**	**-2,866**	**-3**	**-2,420**	**-10**	**46**	**950**	**13**	**173**	**-963**		
														TOTAL RISK-WEIGHTED ASSETS	**34,661**

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

EUR ths., 31.12.2012

	Balance sheet								Off-balance sheet			
	Initial value (gross)				Allowances and corrections (-)			Substitution effects of the credit protection (-)				
	Claims	Loans	Bank's portfolio	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, 20	17	17	19		34			
Central government and central banks	**4,544**	**0**	**0**	**1,543**	**0**	**0**	**0**	**0**	**0**	**0**		**549**
I rate credit quality	4,544			994							0%	**0**
IV rate credit quality				549							100%	**549**
Credit institutions and investment firms	**23,222**	**0**	**0**	**2,747**	**0**	**0**	**0**	**0**	**0**	**71**	0%	**6,886**
I rate credit quality	23,222									71	20%	4,659
II rate credit quality				1,039							50%	520
III, IV and V rate credit quality				1,708								1,708
Companies	**0**	**2,377**	**0**	**750**	**0**	**-31**	**0**	**0**	**0**	**38**	0%	**3,134**
III and IV rate credit quality		2,377		750		-31				38	100%	3,134
Retail claims	**0**	**11,951**	**0**	**0**	**-15**	**-254**	**0**	**-33**	**0**	**0**	0%	**8,737**
Claims up to EUR 1 mln		11,951			-15	-254		-33			75%	8,737
Claims with real estate collaterals	**0**	**2,409**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	0%	**1,625**
Claims, fully covered by mortgage to residential real estate, covered claims up to 70% of the real estate collateral value		1,205									35%	422
Claims, fully covered by mortgage to residential real estate, covered claims over 70% of the real estate collateral value		1,203									100%	1,203
Claims in arrears	**0**	**8,378**	**0**	**66**	**0**	**-4,398**	**0**	**0**	**0**	**0**	0%	**4,607**
III and IV rate credit quality		7,234				-4,310					100%	2,924
V and VI rate credit quality		1,144		66		-88					150%	1,683
Other assets	**4,401**	**0**	**6**	**0**	**0**	**0**	**-3**	**0**	**741**	**0**	0%	**4,422**
Cash	130										0%	0
Property and equipment	4,067										100%	4,067
Prepayments and prepaid expenses	204										100%	204
Investments to shares of other companies, not deducted from own funds			6				-3				100%	3
Loan limits and overdraft limits with contractual maturity up to 1 year (can not be terminated by one party)									741		20%	148
Total	**32,167**	**25,115**	**6**	**5,106**	**-15**	**-4,683**	**-3**	**-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 42 continued:

Information Disclosed on Capital Adequacy

Bank follows 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 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 Financial Supervision Authority. If two credit assessments are available, the higher risk weight shall be assigned. 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 comprehensive method, calculating the effect 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 31.12.2013 and 31.12.2012 were all financial collaterals of cash deposited with the Bank and eligible financial collateral used in reverse repo transactions. Bank has not used unfunded credit protection facilities nor credit derivatives as of 31.12.2013 and 31.12.2012.
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 the standard 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 calculating capital requirement for interest rate risk and equity position risk associated with trade portfolio.

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Note 42 continued:

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

Note 43: Concentration of Risks

			31.12.2013
	no.	**EUR ths.**	**% of net own funds**
Number of customers (customer groups) with high risk concentration *	18		
Due from customers with high risk concentration		63,622	519.61%
Due from persons related with credit institution		493	4.03%

			31.12.2012
	no.	**EUR ths.**	**% of net own funds**
Number of customers (customer 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%

* 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 customers as of 31.12.2013 and as of 31.12.2012.

Note 44: Fair value of financial assets and liabilities

Financial instruments not measured at fair value

					as of 31.12.2013
	EUR ths.	EUR ths.	EUR ths.	EUR ths.	EUR ths.
	Level 1	**Level 2**	**Level 3**	**Total fair values**	**Total carrying amount**
ASSETS					
Cash	110	0	0	110	110
Balances with central bank	48,228	0	0	48,228	48,228
Due from other credit institutions	57,622	0	0	57,622	57,622
Due from customers	397	0	26,699	27,096	25,322
Held-to-maturity investments	0	0	0	0	0
Other assets	0	0	431	431	431
TOTAL ASSETS	**106,357**	**0**	**27,130**	**133,487**	**131,713**

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Note 44 continued:

LIABILITIES					
Due to credit institutions	1,559	0	0	1,559	1,559
Due to customers	95,972	0	31,328	127,300	126,930
Subordinated debt	0	0	3,413	3,413	3,067
Borrowed funds from goverment and foreign aid	0	0	245	245	252
Other liabilities	0	0	900	900	900
TOTAL LIABILITIES	**97,531**	**0**	**54,630**	**152,161**	**132,708**

	as of 31.12.2012	
	EUR ths.	EUR ths.
	Total fair values	**Total carrying amount**
ASSETS		
Cash	130	130
Balances with central bank	4,545	4,545
Due from other credit institutions	22,979	22,979
Due from customers	20,659	20,659
Held-to-maturity investments	5,489	5,039
Other assets	204	204
TOTAL ASSETS	**54,006**	**53,556**
LIABILITIES		
Due to credit institutions	276	276
Due to customers	50,755	50,755
Subordinated debt	2,931	2,931
Borrowed funds from goverment and foreign aid	199	199
Other liabilities	469	469
TOTAL LIABILITIES	**54,630**	**54,630**

Assets and Liabilities Measured at Fair Value

	as of 31.12.2013			
	EUR ths.	EUR ths.	EUR ths.	EUR ths.
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets at fair value trough profit and loss				
Financial assets held for trading				
Equity securities	1	0	0	1
Derivative financial instruments	15	0	0	15
Available-for-sale financial assets				
Debt securities	7,279	0	0	7,279
Equity securities	0	0	3	3
Total assets	**7,295**	**0**	**3**	**7,298**
Financial liabilitics at fair value trough profit and loss				
Derivative financial instruments	10	0	0	10
Total liabilities	**10**	**0**	**0**	**10**

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Note 44 continued:

	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**
Financial liabilities at fair value trough profit and loss				
Derivative financial instruments	16	0	0	16
Total liabilities	**16**	**0**	**0**	**16**

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)

Valuation techniques used in measuring Level 3:

Type	Valuation technique	Significant unobservable inputs
Available-for-sale financial assets	Discounted cash flows	Discount rates

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.

Note 45: Subsequent Events

Changes in court actions have occurred after the balance sheet date, with potential financial impact on the financial statements of the Bank for next periods in the amount of -75 ths. to +243 ths. euros.

Harju County Court has rendered a judgment in civil case no. 2-11-37160 in favour of the plaintiff on 28.06.2013, and the Bank has formed a provision of 243 thousand euros in the annual report 2013 to cover it. After the balance sheet date, on 12.02.2014 the Tallinn Circuit Court allowed the appeal of the Bank, whereby annulled the Harju County Court judgment mentioned above. The judgment enters into force in March 2014, unless the plaintiff appeals in cassation to the Supreme Court. As the management estimates that it is probable, that the proceedings continue in the Supreme Court, the already existing provision has not been cancelled in the annual report and therefore it has a potentially positive financial impact of 243 thousand euros on the results of the Bank in next periods.

After the balance sheet date, on 24.01.2014 Harju County Court has accepted an action filed against the Bank for ordering compensation of damages in amount of 75 thousand euros. The Bank has not formed a provision to cover the action in the annual report 2013, as the management believes it to be an unfounded action.

Management of the Bank believes that the subsequent events in Ukraine after the balance sheet date do not have significant impact on the Bank.

SIGNATURES OF THE MANAGEMENT BOARD TO THE ANNUAL REPORT 2013

The Annual Report 2013 of Versobank AS is signed by:

Riho Rasmann	Chairman of the Management Board		10.03.2014
Sven Raba	Member of the Management Board		10.03.2014
Mart Veskimägi	Member of the Management Board		10.03.2014
Marija Sutirina	Member of the Management Board		10.03.2014

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Independent Auditors' Report

(Translation of the Estonian original)

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 2013, 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 68.

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 2013, 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, 11 March 2014

/signature/

Taivo Epner
Authorized Public Accountant
Licence No 167

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

PROFIT DISTRIBUTION PROPOSAL OF THE MANAGEMENT BOARD

The Management Board of Versobank AS approved the profit of Versobank AS for the financial year 2013 in the amount of 1,045,947.84 euros. The Management Board's proposal to the General Meeting of Shareholders is not to pay dividends, appropriate 52,297.39 euros to the statutory reserve capital and record 993,650.45 euros under the balance sheet heading "Accumulated deficit".

Riho Rasmann	Chairman of the Management Board		10.03.2014
Sven Raba	Member of the Management Board		10.03.2014
Mart Veskimägi	Member of the Management Board		10.03.2014
Marija Sutirina	Member of the Management Board		10.03.2014