AS LHV Group
Consolidated Annual Report 2019

(Translation of the Estonian original)

Consolidated Annual Report 01.01.2019 – 31.12.2019

Legal name	**AS LHV Group**
Commercial Registry no.	**11098261**
Legal address	**Tartu mnt 2, 10145 Tallinn**
Phone	**(372) 6800400**
Fax	**(372) 6800410**
E-mail	**lhv@lhv.ee**
Main activities	**Activities of holding companies**
	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	**Madis Toomsalu**
Supervisory Board	**Rain Lõhmus**
	Andres Viisemann
	Tiina Mõis
	Heldur Meerits
	Raivo Hein
	Tauno Tats
	Sten Tamkivi
Shares	**Listed on the Nasdaq Tallinn Stock Exchange**
Auditor	**AS PricewaterhouseCoopers**

Table of contents

Statement of Managing Director

Dear LHV investor,

We have every reason to be pleased with the year 2019. 2019 was a year characterised by good results, rapid growth in assets and customer base, various new products and recognitions. Once again, LHV was declared the bank with the best service in Estonia. LHV was also declared the best bank by the international financial magazines Euromoney and the Banker.

Our customer numbers reached 200,000 by the end of the year, growing by nearly 41,000. Asset volumes doubled, amounting to a total of EUR 3 billion. Rapid growth has boosted the bank's market share to 10%, making LHV the third largest bank in Estonia, with regard to daily banking. The growth in customer numbers and activity was facilitated by the quintupling of LHV's ATMs to 125 in Q3.

The highlight of the year was the purchase of the Danske private customer loan portfolio, which doubled the bank's loan volume. By the end of the year, LHV's loan portfolio amounted to EUR 1.7 billion. Even though the Danske transaction was completed and started generating interest income only at the end of November, we made a previous effort to assure financing early on. The previous large-scale engagement of deposits incurred greater expenses, affecting the costs of the transaction already from the spring of 2019. The expenses on deposits engaged within the framework of the transaction will remain high until the middle of 2020. Then we intend to replace deposits with covered bonds, which have a lower cost.

Technology is the cornerstone of our services. It serves as a link between the relatively different business areas pursued in Estonia and the United Kingdom. From a strategic point of view, both businesses are characterised by our ability to build technological solutions, regardless of the customer or location. This is the reason why we concentrated on building the best Mobile Bank during the year. As a result of our efforts, the application now allows, in addition to becoming a customer, investing in securities, applying for loans, entering into loan agreements and ordering bank cards.

In the United Kingdom, we technically connected to the GBP payment system already in the middle of the year, but could not actually open payments to customers before January 2020. By allowing GBP payments, we offer our financial intermediation customers real-time EUR and GBP payments via the application program interface LHV Connect. LHV Connect is the bank's first API, which provides such options. Furthermore, customers can exploit the API for using services such as the bank account, virtual IBAN, currency exchange and liquidity services. All in all, we offer banking infrastructure and services to more than a hundred of our payment intermediation customers, including TransferWise, Coinbase, Paysafe and Trustly.

The year was also characterised by amendment of the regulations on pension funds. In September, the fixed management fees for pension funds were lowered. Nonetheless, we can still earn performance pay, if we generate a strong yield from the funds. We did not earn performance pay in 2019. Nonetheless, against the backdrop of the growth in our expectations with regard to the return on investment and the fluctuating nature of the benchmark of the social tax designated for pensions, we believe we will earn performance pay over a longer period of time. Any shorter-term forecasts prove difficult.

LHV posted record-breaking results in all business areas in 2019. Loan volumes grew by EUR 0.8 billion to EUR 1.7 billion and deposit volumes by EUR 1.3 billion to 2.7 billion. Pension funds grew by EUR 160 million, amounting to EUR 1.4 billion as at the end of the year. We also achieved record levels of customer activity in payments, card transactions and conclusion of new investment agreements.

We financed the growth in business volumes through capital engagement. We engaged a total of EUR 65 million from three different instruments during the year. The successful outcome and over-subscription of all issues attests to our trustworthiness in the eyes of investors. All these transactions also contributed to the rise in LHV's investor numbers. As at the end of the year, nearly 7,000 shareholders and 3,000 bond investors had invested in LHV.

LHV posted a net profit of EUR 27.1 million in 2019. This is EUR 0.1 million less than in the previous period, but the comparison base is compromised by the single transactions which had a positive effect (disposal of the Lithuanian business unit), as well as the expenses related to the Danske transaction (previous engagement of deposits, transaction costs, portfolio write-downs, capital engagements) and the lowering of the pension fund management fee. We exceeded the financial plan for July by EUR 1.5 million, mainly due to lower-than-planned write-downs, lower costs of the Danske transaction and higher income from the organisation of securities issues for customers.

Activities of business areas

Corporate banking witnessed a one-third growth in business loans in 2019. The growth in business volumes has exceeded market growth. Our market share thus reached 10% of the corporate loan market volume by the end of the year. We witnessed a broad-based growth, both with respect to customers and activity areas. Furthermore, we also acquired Versobank's portfolio in the spring of 2019. By the end of the year, the corporate loan portfolio amounted to EUR 853 million. The economic environment has remained favourable, but the growth outlook of companies operating on export markets has deteriorated. Loan portfolio remains strong, with a very low share of outstanding debts.

In retail banking, we focused on home loans, raising awareness of investment services and developing customer-tailored services. We upgraded our Mobile Bank, added the option of viewing alternative investments in the Internet Bank and increased the number of ATMs. As regards home loans, we focused on process automation and introduced fully automated decision-making. In the spring of 2019, we launched our cooperation with KredEx in the provision of home loans. If we leave out the purchase of the Danske portfolio, the housing loan portfolio grew by EUR 115 million during the year. The total portfolio, with Danske included, amounts to EUR 499 million. As at the end of the year, the home loan portfolio totalled EUR 638 million.

In financial intermediation, we focused on searching new customers and expanding the product portfolio. We launched several additional services and prepared for connecting to the GBP flash payment system. We continued building our customer base, and significantly improved the anti-money laundering systems, adopting three new information systems. We also started legal preparation for implementing the regulatory changes to be applied to the UK branch in connection with the UK's exit from the European Union. The market of FinTech companies is highly active and the demand for services is growing. Our business in United Kingdom is profitable and the revenue base is growing, with revenue generated mainly from payments, currency exchange, card payment mediation, credit services and maintenance fees.

The total volume of investment funds under the management of LHV Asset Management reached EUR 1.4 billion in 2019. The investment strategy of our largest funds L and XL is unique among competitors, with a long-term outlook and focus on OTC assets. The year proved highly successful for stock markets, with index funds relying heavily on stocks showing the best yield among Estonian pension funds. The annual yield of the LHV Pension Fund Index was more than 25%, with the yield of the largest pension funds L and XL amounting to 5.8%. In addition to market dynamics, the investment decisions of LHV Asset Management will be affected, in the upcoming years, by the planned pension reform. When making investments, more and more attention must be paid to the potential shrinking of fund volumes and the consequent need for liquidity.

Strategy and the future

LHV's home markets are Estonia and the United Kingdom. From a strategic point of view, both markets are characterised by our ability to build technological solutions, regardless of the customer or location. We aim at maximising growth in line with the previously determined return on equity (20%) and the risks identified. This means that, despite aggressive growth ambitions, we do not intend to grow at the expense of profitability and risks.

We have made an effort to ensure growth through our strong positions. In Estonia, we are currently able to finance any Estonian company. We make decisions quickly and on site. We are able to issue home loans all over Estonia, making decisions quickly and with extra conditions tailored to the customer. We also offer free-of-charge payments, the most integrated investment services, the quickest and the most flexible loan products and high-long-term-yield pension funds. We are able to provide a bulk of our services, including securities trading, private customer loan applications and loan agreement conclusion, through our mobile app.

We desire to become Estonia's largest bank. If we exploit our strengths wisely, growth will be the natural consequence of our efforts. We will continue focusing on efficiency, profitability, innovation and provision of the best possible service. We are unlikely to achieve our goal within the 5-year financial horizon. Nonetheless, 2020 will be the year we take a step closer.

As regards private customers, we will focus on expanding the customer base and enhancing customer activity. Our focus lies on major Estonian cities, targeting active customers who prioritise electronic channels. We wish to engage customers who have opened a current account in LHV, whose salary is transferred to the LHV account and who use the LHV bank card for their daily financial affairs. We focus on boosting our market share in home loans. We will launch ApplePay and other card payments via smart devices, we will upgrade the Mobile Bank and start offering the pension investment account.

As regards corporate customers, we will focus on boosting the loan portfolio and the share of trade financing. We target customers in search of a bank who understands the nature of their business and is able to provide the required financing structure. We will continue the single-level decision-making process, where all decisions are made locally, swiftly and in a flexible manner. We will continue the multi-year IRB project with the aim of enhancing the return on equity through efficient capital allocation.

We have become an exporter of financial services. Financial intermediation is the bank's third business area, with expectations of 2020 serving as the breakthrough year. In the United Kingdom, we have completed the key product – real-time GBP payments – and will develop the GBP system indirect member service in 2020. We are already witnessing how this is fuelling the interests of new customers. Furthermore, we will continue providing account services, payments, card payment acceptance, working capital loans and currency exchange services. We will add to our sales capacity in the upcoming year and will analyse the need for developing new products, including card-related products. This will make us highly competitive in e-trading, opening a completely different market over the horizon. Even though our office is located in London, the business of financial institutions often has a cross-border nature. We will therefore also seek out customers in other countries.

As regards pension funds, our priority is to generate a strong long-term yield. We will continue implementing our updated investment strategy, focusing more on OTC private capital and investment properties. We are recruiting new staff for our organisation and bringing the remuneration system in line with the objective of achieving high long-term yield.

On a more practical scale, we have established our goals for the next few years as follows:

- we endeavour to serve as the best financial service provider to private customers and SMEs;
- we endeavour to be the most collaborative financial service provider for international financial intermediaries;
- we endeavour to serve as an attractive and recognised employer, offering progress, self-fulfilment and growth;
- we endeavour to do business in such a way as to ensure a 20% return on equity;
- we endeavour to become Estonia's most valuable publicly traded company.

To sum up, LHV's success relies on three keywords: best service, best investor relations, high employee satisfaction. If we add the fact that LHV is a domestic enterprise which makes decisions quickly and on site, the fact that our services rank among the best and we are able to offer services through strong electronic channels, we have all the prerequisites for a profitable growth in the upcoming years.

Madis Toomsalu

Business environment

Similarly to the beginning of the year, second half was a pleasant surprise in most of the world's regions. In many places, economic output outperformed the analyst expectations; there were fewer unpleasant surprises. Both in the US and Europe, private consumption was the driver behind the economic growth, with trade remaining in a slump. Of the major economic regions, only China's growth fell short of expectations, and even there it was only marginally subpar. Economic growth in China was curtailed by the trade war and the months of unrest in Hong Kong.

At the end of the year, the growth rate slowed, at least in Europe. The main brakes on growth continue to be the decline in industrial output in Germany and the battle of wills between China and US on protective tariffs and the resulting uncertainty in shaping decisions regarding the future. December's preliminary agreement on the agricultural purchases and use of technology and intellectual property led to the US slightly easing the existing tariffs and holding off on implementing new ones. That sent an immediate positive signal to the markets, but next year will show whether the truce holds and what the actual consequences will be.

The dark clouds surrounding the departure of the United Kingdom from the European Union have not been dispelled, either. The Conservatives' victory in the December general elections is highly likely to mean that Brexit will become a reality by the end of January, however. A minimum of 1-2 years of negotiations on new trade agreements and other understandings will follow. The UK will also have to devote more attention to Scotland and Northern Ireland's strengthening bids for independence. For businesses, it will mean more chaos and a more complicated environment for development.

Economic growth in the Eurozone has remained at the same level for the whole year (1.2% y-o-y growth in Q3). The powerhouse of the European economy, Germany, surprised in Q3 with 1% economic growth, at a time when many analysts expected it to slip into technical recession. In Germany, which has historically relied on exports, the economy has been kept afloat by consumer spending been stimulated by various government subsidies and tax incentives. Looking ahead, there is nevertheless little reason for optimism – survey data show that order books (particularly for export orders) are deteriorating and that the lack of confidence in the industrial sector is now spreading to the services sector. In the longer perspective, a determining factor will be how Europe's car industry embraces new trends in the sector (electric cars, self-driving cars), trends in which it has been in more of an onlooker's role so far.

Although wage growth remained quite brisk in the Eurozone compared to years past (2.5-3%), it was not able to generate enough pressure on inflation. Inflation in the Eurozone fell to 0.7% in the early part of the Q4, but bounced again to higher than 1% in the year end.

To contend with low inflation, the European Central Bank is continuing a dovish monetary policy – the ECB's deposit facility rate is at a historic low of -0.5% and asset purchases are also continuing in order to increase the money supply. Low interest rates have undoubtedly stimulated the economy over the last years, but it is becoming harder and harder to obtain a lasting effect. Negative rates on deposits have delivered a blow to banks' profitability but only in very rare cases has the effect been passed on to end depositors. The new President of the ECB, Christine Lagarde, has mentioned the need to review the whole monetary policy strategy, and this should start in the first half of 2020. She does not see the need for a dramatic change of direction, however, being a supporter of a dovish monetary policy herself.

The Estonian economy grew by 4.2% in Q3, which clearly exceeded expectations. Growth was driven by the services sector (information and communications, retail and business services) and the influence of the agriculture and industry sectors was also noteworthy. In spite of the weakening external environment, Estonia's export sector has stood up well and export volumes were up 7% in Q3. True, some of the growth can be attributed to last year's relatively low comparison base. Approximately one-quarter of the economic growth came from net taxes on products, which is directly the outcome of government tax policy. The lowering of the alcohol excise duty in July made businesses postpone replenishing their warehouse stocks until the last minute and thus excise duty receipts in July and all through Q3 were very high. The actual growth in value-added generated in the economy was 3%, and slower compared to previous quarters, which is a logical trend considering the backdrop of uncertainty and lower confidence.

The growth of industrial output slowed in the beginning of the year and even reached the zero mark in April. This was caused mainly by the concentration of production in the energy sector, which is grappling with high CO_2 allowance prices. Until the end of the summer, the processing industry was able to gradually increase its output, but it nevertheless fell to near zero in the end of Q3. The drop in machinery and equipment production output played a major role. The clothing and paper industry and the production of metal products also stood out on the negative side. The chemical and oil industry fared better.

Overall for the year 2019, economic growth in Estonia should be around 3.5%. In the years ahead, growth will slow, because external demand is softening and the economy is already performing at the maximum level with its existing resources and has little capacity for additional rapid growth. The shortage of available resources means that businesses' ability to adapt and success in increasing productivity are increasingly important, so there will have to be an energetic commitment to continuing smart investments. Above all, it will be important to achieve long-term sustainable economic growth balanced between different sectors. By economic sector, the risks are higher than average in the construction sector, where the market will be saturated for some time, and in low-productivity branches of the processing industry, where businesses find it increasingly hard to keep up with rapidly growing wages. LHV maintains a conservative outlook on the real estate market, keeping an eye on the local and Scandinavian market and devoting increased attention to developments in Sweden. As to rental cash flow projects, there is a danger that there may not be enough demand for absorbing the volume being developed and that there may be corrections in rent prices or vacancy rates. A positive that can be highlighted is that the financing environment remains favourable, allowing loan balances to enjoy reasonable growth. Household demand for loans remains strong, driven by housing loans and car leasing. The average interest rate on new home loans issued has started rising, which is a sign of lower confidence in society but also of low competition on the loan market. Interest rates are at historic lows, which for local businesses represent opportunities that they should seize more actively in thinking about the future. LHV is looking to be actively involved in finding and supporting new sources of growth, offering businesses a long-term partnership and value-generating advisory services.

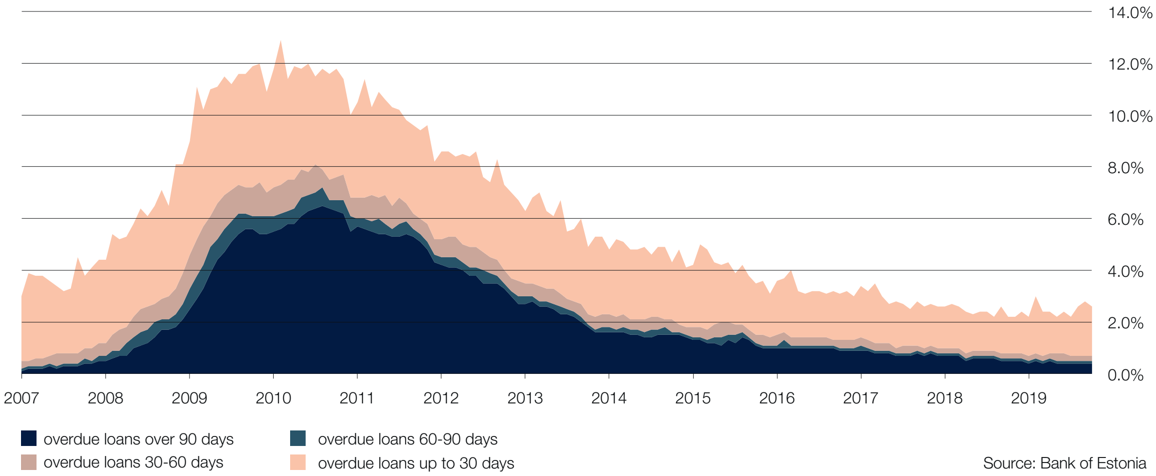
Key economic indicators of Estonia* **Bank of Estonia forecast**

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Nominal GDP (EUR billion)	18,89	19,76	20,25	21,10	23,62	26,04	27,98	29,54	30,93
GDP volume**	1,4%	2,8%	1,4%	2,1%	4,9%	4,8%	3,4%	2,3%	2,0%
Private consumption expenditures***	3,8%	3,3%	4,7%	4,4%	2,6%	4,3%	3,2%	4,3%	3,9%
Government consumption expenditures	1,9%	2,7%	3,4%	1,9%	0,6%	0,9%	1,3%	-0,5%	-0,6%
Fixed capital formation	-2,8%	-8,1%	-3,3%	-1,2%	12,5%	1,7%	15,5%	0,2%	1,6%
Exports	2,3%	3,1%	-0,6%	4,1%	3,5%	4,3%	3,8%	1,3%	2,5%
Imports	3,2%	2,2%	-1,4%	5,3%	3,6%	5,7%	4,2%	2,0%	3,0%
CPI	2,8%	-0,1%	-0,5%	0,1%	3,4%	3,4%	2,4%	2,2%	1,8%
Unemployment rate (% of the labour force)	8,6%	7,4%	6,2%	6,8%	5,8%	5,4%	4,7%	5,7%	6,2%
Current account (% of GDP)	-0,4%	0,9%	2,2%	1,9%	3,3%	1,8%	1,2%	1,1%	0,6%
Budget balance (% of GDP)****	-0,2%	0,7%	0,1%	-0,3%	-0,4%	-0,5%	-0,2%	-0,2%	-0,2%

"* Numbers reported are annual rates of change in per cent, if not noted otherwise; ** GDP and its components are chain-linked; *** including NPISH; **** the budget balance forecast considers only those measures on which sufficient information was availanble at the date of the forecast.

Sources: Bank of Estonia, Statistics Estonia

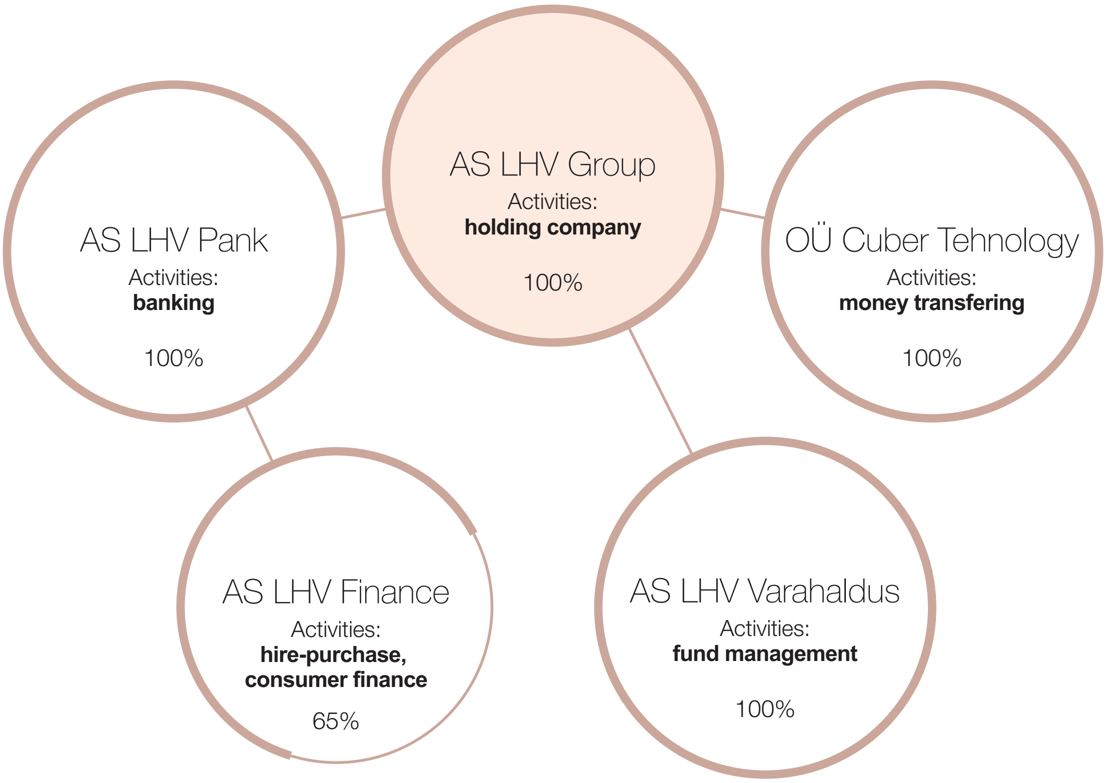
Overdue loans share in loan portfolio



Source: Bank of Estonia

Management report

AS LHV Group (hereinafter: the Group or LHV) is the biggest domestic finance group and capital provider in Estonia. The main subsidiaries of AS LHV Group are AS LHV Pank (hereinafter: the Bank) and AS LHV Varahaldus (hereinafter: LHV Varahaldus). LHV was established in 1999 by people with long experience in investing and entrepreneurship. LHV-s offices for client servicing are located in Tallinn and Tartu, also London office was opened in 2018. Over 430 people work in LHV. Over 198 000 customers use banking services offered by LHV and the LHV's pension funds have over 177 000 active clients.



Operating principles

The mission of LHV is to help create local capital and to support the development of local entrepreneurship.

LHV concentrates on active and independent customers with an entrepreneurial mind-set. For private consumers LHV offers high quality universal banking services. For corporate clients LHV offers flexible and suitable financing and managing of everyday financial operations.

The products and services provided by LHV are simple, transparent and appropriate. Client interaction is mainly conducted using modern electronic communication channels. Costs avoided will reach the clients of LHV through affordable cost of everyday service.

LHV was created as a partnership and partnership is the central way of growing LHV's business. New initiatives will be implemented faster and more successfully when partners have same interests and long-term support of each other.

LHV is public company, which is listed on the Tallinn Stock Exchange since May 2016, so all clients and partners of LHV may be owners of LHV.

Key events in 2019:

- **LHV Bank**

In November LHV purchased Danske Bank's Estonian branch retail portfolio, increasing the retail loan portfolio by EUR 393 million.

- **LHV Varahaldus**

Mobile application "Minu Pension" was launched, making information about pension funds and pension system more accessible.

- **Three capital layer transactions**

During the year LHV issued 3 different capital instruments to the market in total amount of EUR 65 million. All transactions were oversubscribed several times.

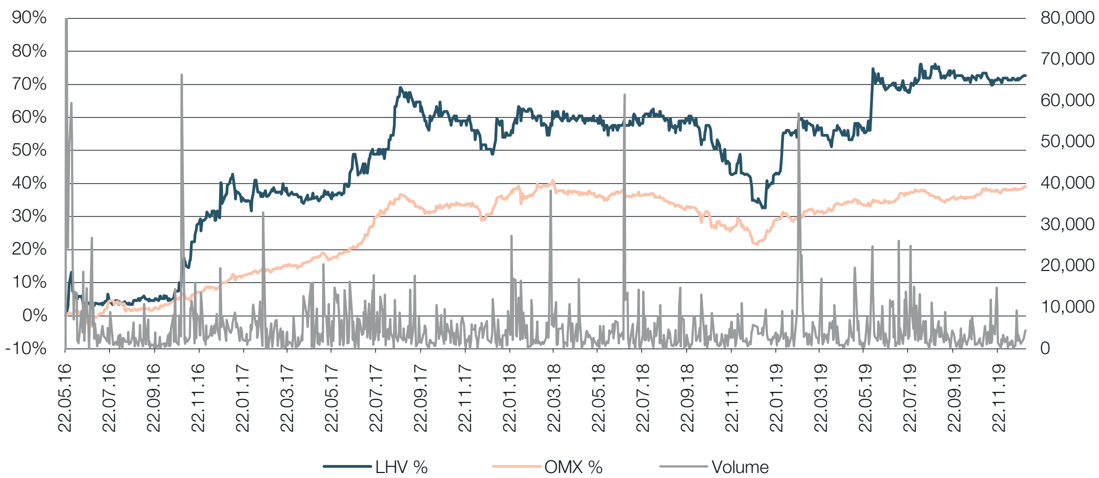
Shares and bonds issued by LHV

Over the last years LHV has been capitalized, being a rapidly growing local retail bank with clear niche towards financial intermediates. The profits and investments of LHV are not only contributable to the share price, but also part of the dividends and interest paid to subordinated bonds. LHV has several securities outstanding:

Name	ISIN	Issuer	Outstanding amount	Maturity	Listing
Common share	EE3100073644	AS LHV Group	28 454 079	-	Nasdaq Tallinn main list
Tier 1 subordinated bond	EE3300111780	AS LHV Group	20 000 000	21/06/2029	
Subordinated bond	EE3300110741	AS LHV Group	15 000 000	29/10/2025	Nasdaq Baltic bond list
Subordinated bond	EE3300111558	AS LHV Group	40 000 000	28/11/2028	Nasdaq Baltic bond list

There is only one class of shares issued by LHV, each share gives 1 voting right. The shares of LHV Group is traded on NASDAQ Tallinn main list since May 2016. Since then, the share price has risen by 72%. During the year 2019 the share price has risen by 27%, reaching EUR 12.0 by the end of 2019. In 2019, the lowest traded price was 9.16 euros and the highest 12.2 euros. Based on the stock price, LHV's market value was EUR 341 million. In respect of dividend policy, LHV strives to achieve long-term dividend growth without negatively impacting the group's targeted capital ratios. The annual dividend together with dividend related taxes shall correspond to 25 per cent of pre-tax profit including dividend related taxes. Each year's dividend is assessed in the light of prevailing economic conditions and the Group's earnings, growth possibilities, regulatory requirements and capital position. In addition, LHV has made a conservative decision not to have trading positions in LHV shares nor take them as collateral. In case of exercising share option programs, the shareholders have delegated the right of issuing new shares to the Supervisory Board.

LHV share price development



During 2019, 1.1 million shares in the amount of EUR 12.89 million changed the owner on the stock exchange, which makes 11.4 euros for the average trading price.

At the end of 2019, LHV Group had 6 950 shareholders, of whom 84.6% were also customers of LHV Bank. The number of shareholders has grown by 1 335 during a year. They were followed by Swedbank customers (11.1%) and SEB customers (3.7%). 75.2% of the shares belonged to companies and 24.8% to private individuals. Among the shareholders, the Estonian residents or their related companies, who own 98.5% of the shares, are clearly dominant.

LHV has had two subordinated debt issues on Nasdaq Tallinn Stock Exchange. The maturity of the first bond is in 2025, another with maturity in 2028. In 2019 LHV issued one subordinated bond to in market in amount of EUR 20 million. The new bond issued, together with two other capital raising in form of additional Tier1 bons and issuing 2.1 million of new shares allowed LHV to strengthen the

LHV Group capitalisation for supporting LHV Bank growth. Regarding bond listings LHV wants to state that bond trading in Nasdaq Baltics bond list is very limited, as most of investors have "invest and keep" strategy. The total turnover in 2019 was EUR 3.5 million.

At the end of the year 2019, LHV Group had more than 3 000 bondholders, 75% of them were also customers of LHV Pank. They were followed by the customers of Swedbank at 15% and SEB at 10%. 99.9% of bond investors were Estonian residents or their related companies.

AS LHV Group has 28 454 079 common shares with par value of 1 euro. As at 31.12.2019, the distribution of shares was as follows:

- 13 942 232 shares (49%) belonged to the members of the Supervisory Board and Management Board and to their related parties.
- 14 511 847 shares (51%) belonged to Estonian entrepreneurs and investors and to their related parties.

Ten biggest shareholders as at 31.12.2019:

Number of shares	Percentage	Name of the shareholder
3 618 920	12.7%	AS Lõhmus Holdings
2 538 367	8.9%	Rain Lõhmus
2 186 432	7.7%	Viisemann Investments AG
1 728 589	6.1%	Ambient Sound Investments OÜ
1 210 215	4.3%	Krenno OÜ
1 082 744	3.8%	AS Genteel
1 031 310	3.6%	AS Amalfi
782 488	2.8%	Kristobal OÜ
688 199	2.4%	SIA Krugmans
638 276	2.2%	Bonaares OÜ

Market share

Estonian banking market has in unique situation where Scandinavian owned banks are not very active and allowing local banks to increase their position. LHV has not set a specific target for market share, the goal is profitable growth combined with taking advantage of opportunities offered by the market. Every year, LHV has set the goal to grow faster than the market and thereby increase its market share. In terms of new clients, the goal is to increase the client portfolio that the growth would be higher than the number of children born each year. In recent years, we have almost doubled this target.

In 2019 after purchasing Danske bank retail portfolio LHV has achieved around 10% of market-share in banking market. Similar market share we have in most of the products, except payments as the majority of payments are still done by largest bank in the market. In Pension products LHV keeps 27% market share, which has not changed significally during the year.

Remuneration policy

The remuneration principles for LHV Group and its affiliated companies are described in the internal Remuneration Policy.

In LHV, there are no regional differences in the remuneration principles. The most significant difference between group companies is that LHV Varahaldus has no remuneration committee and has separate disclosure requirements.

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law. A broader goal of the remuneration policy is the recruitment of employees with the capabilities, skills and experience necessary to implement the strategy, to reconcile the interests of employees and shareholders, to motivate the employees and to ensure effective risk management for growing business activities. The remuneration system consists of basic remuneration, compensations and employee benefits. LHV does not provide employees with services at a lower than the market price, does not make payments to a third pillar pension fund at the expense of the employer and does not provide benefits such as a company car, a mobile phone or a laptop for personal use.

The general remuneration strategy is to ensure a motivating pay to achieve long-term goals, creating a strong link between remuneration and the financial results of LHV. When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

- Performance criteria are in line with sound and effective risk management principles. The performance criteria established by LHV must keep in mind the long-term interests of LHV, including not stimulate excessive risk-taking or sale of unsuitable products.
- The performance criteria must not merely contain performance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield)

but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).

- The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's professional behaviour. In the interest of long-term goals, the assessment and control of risk behaviour will take place at an individual employee level.
- A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.
- Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.
- Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, creativity, motivation and co-operation with other business units and the internal control function.

LHV's recruitment strategy is to find, engage and keep the best people of the labour market. In determining remuneration, LHV is rather willing to make exceptions than restrict its choices with strict remuneration intervals for a specific position. To keep its employees, LHV will develop its benefits and compensations in cooperation with its employees. In determining remuneration, the following is taken into account:

- Commitment and results of the employee,
- Workload,
- Responsibility,
- The required level of education,
- Management level,
- Intensity of work,
- The necessary knowledge and experience for the position,
- The existence of additional benefits,
- The situation in the labour market,
- The pay level of the geographical location,
- The level of criticality of the position

The determination of the amount of remuneration must be objective. The remuneration is paid according to the work done and its value, not according to the personality, gender, age, origin, etc. of the employee.

LHV applies a general principle that employees should not use personal hedging strategies or remuneration and liability insurance, which would undermine the effectiveness of the hedging of risks integrated into the Remuneration Policy. In the decisions made on remuneration policy, the financial situation and sustainability of the capital base of LHV are taken into account.

LHV carries out regular self-assessment, the purpose of which is to identify all employees whose professional activities affect or may affect the risk profile of LHV significantly. These specified groups of employees are listed in the table below together with ratios between variable and basic remuneration in 2019.

Specified group of employees	Ratio in 2019
Senior management	1.14
Staff performing control functions	0.26
Employees with significant impact on the credit risk position (the nominal value of transactions made by the employee is at least 0.5% of LHV Tier 1 own funds and is in the amount of at least EUR 5 million)	0.51

Self-assessment is carried out once a year at the beginning of the financial year. The assessment covers both the past period (including financial results, risk analysis) and takes into account the forthcoming financial year. The specified group of employees that are determined in the course of the self-assessment are required, within one calendar year after exercising the options, to keep the underlying LHV shares in their own possession and to not sell them, or to encumber in any form (including pledge). The specified group of employees are forbidden to transfer the risk of the decline of the share price to other parties, for example, through insurance or certain type of financial instruments. Self-assessment is carried out by taking into account the degree of complexity, performance indicators and structure of LHV. The competence lies on the Management Board, who will conduct the analysis in the form of a discussion at a board meeting. The self-assessment is initiated by the Human Resources department, the compliance of the process and results are assessed by the department of Compliance Control, whose representative is also present at the self-assessment. The Remuneration Committee reviews annually the qualitative and quantitative criteria related to the employee and the self-assessment process, which is used for decision-making. The results of the self-assessment are independently reviewed by the internal audit, the results are summarised and presented to the Supervisory Board.

Share options

In 2014, the general meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the Management Board members and key employees. The aim of issuing share options is to align the interests of Management Board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labour market that is equal to competitors.

As part of the program, there is an annual performance pay added to basic salary, the amount or issue of which corresponds to the fulfilment or non-fulfilment of individual and LHV objectives. The objectives of the program are:

- ensuring a competitive remuneration, to be attractive in the labour market;
- keeping and motivating key personnel through creating a relationship of ownership;
- reconciling the interests of shareholders and employees;
- increasing company value through performance management.

The instruments of performance pay under the option program are 100% equity options. The term of share options is 3 years from the moment the options were granted. Additional criteria has apllied to options issued from 2018 onwards for Management Board members – they are not allowed to sell these shares after for another year after executing the rights under option. The three-year vesting period before issuance of shares gives the opportunity to evaluate the results in the long run. It is not possible to take the specified amount in cash in lieu of share options. Share options are issued annually in the amount of up to maximum 2% of the total number of LHV shares. LHV has the right to refuse to exercise and issue equity options to the entitled person, in whole or in part, if:

- LHV General Meeting or the Supervisory Board under the instructions from the General Meeting does not adopt the decision on the increase of LHV share capital and issuance of shares;
- the Management Board member agreement or the employment relationship of the person entitled to receive options has ceased at the initiative of the person entitled to receive options or in pursuant to § 88 of the Employment Contracts Act or, if the Employment Contracts Act is amended, on an analogous basis, however, based on the decision of the Supervisory Board it is possible to make exceptions to the applicability of this paragraph;
- the financial results of LHV or its relevant subsidiary have substantially deteriorated compared to the previous period;
- the person entitled to receive options no longer meets the performance criteria or does not meet the requirements prescribed by law to the head or an employee of a credit institution or a fund management company;
- LHV or its relevant subsidiary no longer meets the prudential regulations or the company's business risks are not adequately covered by own funds;
- the issuance of options has been determined based on information, which proved to be substantially misstated or incorrect.

Similarly to 2014, share options were annually issued from 2015 to 2019. In 2019, the options issued in 2016 were fully exercised. Next share options issue could be in 2020 based on Supervisory Board decision.

The granting and size of share options was dependent upon the successful achievement of operational targets of the overall company and the targets of individual Management Board members and employees. In the beginning of 2019 the share options were granted for 86 people in the amount of 2 209 thousand euros. In the beginning of 2018 the share options were granted for 72 people in the amount of 1 458 thousand euros. In the beginning of 2017 the share options were granted for 69 people in the amount of 1 573 thousand euros. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options.

Share options issued in 2017 can be exercised between the period of 01.04.2020-30.04.2020 and shares with nominal value of 1 euro can be acquired for 4.65 euros per share. Share options issued in 2018 can be exercised between the period of 01.04.2021-30.04.2021 and shares with nominal value of 1 euro can be acquired for 5.33 euros per share. Share options issued in 2019 can be exercised between the period of 01.04.2022-30.04.2022 and shares with nominal value of 1 euro can be acquired for 4.90 euros per share.

Governance of the Group

Supervisory board

Rain Lõhmus is one of the founders of LHV and the chairman of the supervisory board of AS LHV Group. He is a member of the supervisory boards of AS LHV Pank and AS LHV Finance. In addition, he belongs to the supervisory boards of AS Arco Vara, Kodumaja AS and Thermory AS. He is the owner and member of the management board of AS Lõhmus Holding, Lohmus Capital OÜ and LHV CAPITAL I PTE. LTD and the owner of OÜ Merona Systems. Additionally, he is the management board member and one of the owners of Zerospotnrg OÜ and Umblu Records OÜ. Rain Lõhmus graduated from the Tallinn University of Technology (TalTech) and the management program of Harvard Business School. Rain Lõhmus and the persons related to him (Lõhmus Holdings OÜ, OÜ Merona Systems) own altogether 6 739 005 shares, representing 23.68% of all shares.

Raivo Hein is a member of the supervisory boards of AS LHV Group and AS LHV Pank. Also, he belongs to the supervisory board of AS Puumarket and is the owner and a member of management board of OÜ Kakssada Kakskümmend Volti and a management board member of OÜ Saarte Sillad, Zerospotnrg OÜ, E-FINANCE OÜ and several other companies established for the management of personal investments. Raivo Hein graduated from the Tallinn University of Technology (Tal Tech). Raivo Hein does not own shares of AS LHV Group. The persons related to him, OÜ Kakssada Kakskümmend Volti, Lame Maakera OÜ, Astrum OÜ, Kuu On Päike OÜ, Higgsi Boson OÜ, Kõver Aegruum OÜ and Desoksüribonukleiinhape DNA OÜ own altogether 535 286 shares of AS LHV Group.

Heldur Meerits is a member of the supervisory boards of AS LHV Group and AS LHV Pank. He is also a member of the supervisory boards of Kodumaja AS and AS Smart City Group and the foundations SA Põltsamaa Ühisgümnaasiumi Toetusfond and Audentese Koolide SA. Heldur Meerits is also the owner and a member management board of the companies established for the management of personal economic interests, AS Amalfi, SIA Valdemara Group and AS Altamira. Heldur Meerits graduated from the Faculty of Economics and Business Administration of the University of Tartu. Heldur Meerits does not own shares of AS LHV Group. AS Amalfi owns 1 031 310 shares of AS LHV Group.

Tiina Mõis is a member of the supervisory boards of AS LHV Group and AS LHV Pank. She also belongs to the supervisory boards of AS Baltika and Rocca al Mare Kooli SA. She is the owner and management board member of AS Genteel. Tiina Mõis graduated from the Tallinn University of Technology (TalTech). Tiina Mõis does not own any shares of AS LHV Group. AS Genteel owns 1 082 744 shares of AS LHV Group.

Sten Tamkivi is a member of the supervisory board of AS LHV Group. He belongs to the supervisory boards of ASI Private Equity AS and Kistler-Ritso Eesti SA. In addition, he is the owner and management board member of Seikatsu OÜ and Osaluste Hellalt Hoidmise OÜ and a management board member of Topia OÜ and Eesti Startupi Juhtide Klubi MTÜ. Sten Tamkivi graduated from the Stanford University Graduate School of Business. Sten Tamkivi and the person related to him, Seikatsu OÜ, own altogether 15 534 shares of AS LHV Group.

Andres Viisemann is one of the founders of LHV and the manager of LHV pension funds. He is a member of the supervisory boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus. He also belongs to the supervisory boards of AS Fertilitas and Rocca al Mare Kooli SA. He is also the owner and member of the management board of Viisemann Holdings OÜ. Andres Viisemann graduated from the University of Tartu and obtained a Master's degree at INSEAD in International Business Management. Andres Viisemann and the persons related to him (Viisemann Investments AG, Viisemann Holdings OÜ) own altogether 2 774 514 shares, representing 9.75% of all shares. Due to his position as the head of LHV pension funds, Andres Viisemann is entitled to a total of 34 269 shares of AS LHV Group for the options issued in 2017, 2018 and 2019.

Tauno Tats is a member of the supervisory board of AS LHV Group. Also, he is a member of the supervisory boards of EfTEN Kinnisvarafond AS, AS Ecomet Invest and OÜ Eesti Killustik and a member of management board of Ammende Hotell OÜ and MTÜ Plate torn. He is a management board member and one of the owners at Ambient Sound Investments OÜ as well as a management board member of companies established for the management of investments of the aforementioned companies. Tauno Tats graduated from the Tallinn University of Technology (TalTech). Tauno Tats does not own shares of AS LHV Group. Ambient Sound Investments OÜ owns 1 728 589 shares of AS LHV Group.

Management board

Madis Toomsalu is a member of the management board of AS LHV Group and the chairman of the supervisory boards of AS LHV Pank and AS LHV Varahaldus. He is also member of the management board of MTÜ FinanceEstonia. Madis Toomsalu has obtained a Bachelor's degree in business management from the Tallinn University of Technology (TalTech) in 2009 and a Master's degree in 2011 in public sector finance. Madis Toomsalu owns 34 940 shares of AS LHV Group. Madis Toomsalu is entitled to a total of 72 429 shares of AS LHV Group for the options issued in 2017, 2018, 2019.

Committees formed on Supervisory Board level

Audit Committee

Kristel Aarna works as CFO of AS TV Play Baltics since 2011 and before that was the chief controller of Swedbank Baltic Banking. Previously she has been the head of financial advisory services at KPMG Baltics AS and worked also at Eesti Pank and CVS Caremark Corporation. She is also the owner and the member of the management board of IKA Konsult OÜ. Kristel Aarna on has a Bachelor's degree from the Faculty of Economics of the University of Tartu and Master's degree in Business Administration from the Bentley University Graduate School of Business. Kristel Aarna does not own any shares of AS LHV Group.

Urmas Peiker was the head of Compliance at AS LHV Pank from May 2013 until October 2014. Previously, Urmas Peiker has worked as the head of Business Development in an Estonian start-up Funderbeam, as the head of Market Supervision Department of the Financial Supervision Authority, also in the European Bank for Reconstruction and Development and Morgan Stanley's. Urmas Peiker is the owner and management board member of OÜ Vesilind, OÜ PT Arendus, OÜ Bintous, OÜ Pioneer Engineering Group and OÜ Estcap and also belongs to the management boards of FBM SPV1 OÜ and MTÜ Tööstuse Ekspordi ja Innovatsiooni Klaster. Urmas Peiker has a Bachelor's degree from the University of Tartu and Master's degree in Law from the Duke University in the USA. Urmas Peiker does not own any shares of AS LHV Group.

Tauno Tats (Supervisory Board member of AS LHV Group)

Remuneration Committee

Madis Toomsalu (Management Board member of AS LHV Group, chairman of the Supervisory Board of AS LHV Pank and AS LHV Varahaldus)

Rain Lõhmus (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)

Andres Viisemann (member of the Supervisory Board of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

Risk and Capital Committee (AS LHV Group; until 18.12.2019)

Rain Lõhmus (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)

Andres Viisemann (member of the Supervisory Boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

Tiina Mõis (member of the Supervisory Boards of AS LHV Group and AS LHV Pank)

Risk and Capital Committee (AS LHV Pank; from 18.12.2019)

Rain Lõhmus (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)

Andres Viisemann (member of the Supervisory Boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

Tiina Mõis (member of the Supervisory Boards of AS LHV Group and AS LHV Pank)

Madis Toomsalu (Management Board member of AS LHV Group, chairman of the Supervisory Board of AS LHV Pank and AS LHV Varahaldus)

Nomination Committee (AS LHV Pank)

Madis Toomsalu (Management Board member of AS LHV Group, chairman of the Supervisory Board of AS LHV Pank and AS LHV Varahaldus)

Rain Lõhmus (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)

Andres Viisemann (member of the Supervisory Boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

Supervisory and management boards of the subsidiaries

AS LHV Pank

Supervisory board: Madis Toomsalu (chairman, until 05.12.2021), Rain Lõhmus (until 31.12.2024), Andres Viisemann (until 20.09.2022), Tiina Mõis (until 31.12.2024), Heldur Meerits (until 05.12.2021), Raivo Hein (until 20.09.2022)

Management board: Erki Kilu (chairman, until 20.09.2022), Indrek Nuume (until 20.09.2022), Jüri Heero (until 20.09.2022), Andres Kitter (until 20.09.2022), Meelis Paakspuu (until 20.09.2022), Martti Singi (until 20.09.2022), Kadri Kiisel (until 20.09.2022)

AS LHV Finance

Supervisory board: Erki Kilu (chairman, until 24.08.2023), Rain Lõhmus (until 24.08.2023), Veiko Poolgas (until 24.08.2023), Jaan Koppel (until 24.08.2023)

Management board: Kadri Kiisel (until 05.02.2023)

AS LHV Varahaldus

Supervisory board: Madis Toomsalu (chairman, until 04.12.2021), Erki Kilu (until 28.04.2022), Andres Viisemann (until 28.04.2022)

Management board: Vahur Vallistu (chairman, until 05.06.2024), Joel Kukemelk (09.10.2022)

Cuber Tehnology OÜ

Management board: Jüri Laur (without a term)

Financial results

EUR million	2014*	2015*	2016*	2017*	2018*	2019
Volume of deposits	**457**	**633**	**778**	**1 543**	**1 444**	**2 727**
incl. financial intermediates deposits	**0**	**0**	**32**	**607**	**194**	**376**
Volume of net loans	**316**	**410**	**538**	**732**	**919**	**1 687**
Volume of assets	**556**	**757**	**935**	**1 773**	**1 677**	**3 032**
Volume of funds	**504**	**570**	**974**	**1 103**	**1 214**	**1 374**
Volume of custody accounts	**586**	**1 253**	**1 072**	**1 287**	**1 486**	**1 565**
Net interest income	20.3	23.2	30.0	35.5	39.8	47.3
Net fee income	12.8	14.7	19.2	22.2	26.0	25.7
Net financial income	0.5	0.4	1.3	1.0	3.4	0.7
Net income	33.6	38.3	50.5	58.7	70.0	73.8
Expenses	**21.7**	**24.1**	**28.9**	**31.9**	**33.8**	**39.3**
Profit before credit losses	**11.9**	**14.3**	**21.7**	**26.6**	**36.2**	**34.6**
Loan provision	**2.6**	**1.4**	**1.5**	**3.2**	**5.3**	**3.2**
Tax expense	**0.5**	**0.9**	**0.3**	**1.2**	**3.8**	**4.2**
Profit	**9.7**	**14.8**	**19.9**	**22.2**	**27.2**	**27.1**
net profit attributable to owners of the parent	9.2	13.7	17.8	19.6	25.2	24.8

**includes discontinued operations*

The Group's pre-tax profit for 2019 amounted to EUR 31.3 million and net profit totalled EUR 27.1 million. Pre-tax profit is 1% more than a year before. Net interest income grew 24% and net fee income increased 3%. Financial income increased by 49%. The Group's income was EUR 73.8 million and increased by 16% compared to the previous year. Operating expenses amounted to 39.3 million euros and increased by 16% over the year. Most of the cost increase has been related higher business volumes and increased number of employees to offer that. Comparison data above does not include discontinued operations. The Group achieved the financial forecast published at the beginning of 2019 and also the financial forecast updated in summer.

By the end of December, the total volume of the Group's loan portfolio less impairments amounted to EUR 1 687 million (December 2018: EUR 919 million). The volume of portfolio increased 84% in a year. In the loan portfolio, the majority is corporate loans that increased 33% in a year to EUR 880 million (2018: EUR 664 million). The portfolio of retail loans increased 207% in a year, amounting to EUR 813 million (2018: EUR 265 million).

The volume of Group's deposits increased 89% in a year and totalled EUR 2 727 million by the year-end (2018: EUR 1 444 million). The share of demand deposits of all deposits remained the same and was 81% (31.12.2018: 92%).

AS LHV Bank's as largest business units net proft for 2019 was EUR 22.2 million, growing 3.8 million compared with previous year. Loans to clients increased by EUR 768 million reaching EUR 1 687 million. During the year, payment intermediates deposits increased by EUR 182 million, whereby core banking customers' deposits increased by EUR 391 million reaching EUR 2 698 million by the end of year.

In 2019 LHV Asset Management earned net profit in amount of EUR 6.1 million, which is EUR 0.7 million less than previous year. Number of second pillar pension funds clients decreased by 1.0 thousand to 177 thousand. Net fee income decreased by EUR 1.0 million to EUR 12.9 million. Business expenses increased by EUR 0.3 million to EUR 6.1 million in 2019. In addition LHV Asset Management increased the share capital by EUR 1.5 million from the profit of the previous periods and then decreased share capital by EUR 1.5 million (2018: 1.2) million and paid dividends for 2018 in amount of EUR 4.4 (2018: 4.4) million. LHV Group as a separate entity earned a profit of EUR 5.5 (2018: 11.7) million, due to the fact that the subsidiary LHV Varahaldus and LHV Pank paid dividends to LHV Group.

Key figures

	2014	2015	2016	2017	2018	2019
Common equity Tier 1%	17.58	15.97	15.10	14.02	13.65	12.39
Tier 1 %	17.58	15.97	15.10	14.02	13.65	13.88
CAD %	22.82	23.36	20.70	18.30	20.91	17.97
MREL %	15.72	14.49	12.25	7.78	11.43	8.70
leverage ratio %	6.92	6.84	6.96	5.01	6.56	6.18
LCR %	190.0	271.6	221.5	121.3	148.5	144.8
NSFR %	-	-	-	140.8	147.6	152.9
return on equity (ROE) % *	21.4	21.8	20.7	17.6	18.4	14.0
return on assets (ROA) %	2.00	2.3	2.4	1.6	1.6	1.15
CFROI %	26.4	25.9	23.9	22.6	25.4	19.0
cost to income ratio %	67.5	62.8	57.2	54.4	48.3	53.19
net interest margin (NIM) %	3.50	3.62	3.60	2.66	2.34	2.04
spread %	3.44	3.55	3.52	2.62	2.32	1.99
loan to asset %	57.42	54.54	57.86	41.61	55.24	55.64
loan to deposits %	69.68	66.91	69.68	48.00	65.14	62.52
price to earnings ratio	-	-	13.29	13.56	9.75	13.77
dividend to net profit ratio %	-	-	26.7	21.0	21.6	20.17
dividend per share	-	-	-	0.15	0.16	0.21

Explanations

* Return on equity is calculated based on LHV Group net profit and equity attributable to owners of the parent and does not include non-controlling interest.

capital adequacy levels are calculated as reported in COREP report as at end of each year

MREL = (own funds + qualifying liabilities) / total liabilities * 100

LCR, NSFR are calculates as reported in COREP report as of end of each year

return on equity (ROE) = net profit (attributable to owners of the parent) / average equity (attributable to owners of the parent) * 100

return on assets (ROA) = net profit / average assets * 100

CFROI = Operating profit / capital (average)

cost to income ratio = total operating expenses / total income * 100

net interest margin (NIM) = net interest income/average interest earning assets * 100

spread = yield on interest earning assets – cost of interest bearing liabilities

loan to asset = net loans / total assets * 100

loan to deposits = net loans / deposits * 100

price to earnings ratio = share price/net profit/number of shares (average)

dividend to net profit ratio = dividend/net profit

dividend per share = dividend payment during calendar year / number of shares at moment of payment

Liquidity and capitalisation

The liquidity coverage ratio (LCR) of the Group, calculated according to the definitions of the Basel Committee, was 144.8% at the end of December (31.12.2018: 148.5%). The liquidity situation of the Group has not changed, as the depletion of the LCR is caused by deposits made by financial intermediaries, which are 100% covered by liquid funds. As at 31.12.2019, the Group's LCR is 223.7%, if the deposits from financial intermediaries are not taken into account. The Group considers cash in the central bank and in other credit institutions and bond portfolios to be included in its liquidity buffer, that accounted for 43% of the total of the statement of financial position (31.12.2018: 43%). The Group's loan-to-deposit ratio at the end of 2019 was 62% (31.12.2018: 64%).

The Group's level of own funds as at 31.12.2019 was EUR 241.8 million (31.12.2018: EUR 171.6 million). Compared to the internal capital adequacy target of 15.50%, the Group is well capitalised as at the end of the reporting period. The level of capital adequacy was 17.97% (31.12.2018: 20.91%) and Tier 1 capital ratio was 13.88% (31.12.2018: 13.65%), well above the regulatory requirement of 11.3% (31.12.2018: 11.3%).

The Group uses the standard method for the calculation of credit risk and market risk capital requirements and the basic indicator approach for the calculation of operational risk capital requirements. The Group has complied with all capital requirements during the financial year and in previous year.

Each year, an internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential capital needs in addition to regulatory capital requirements.

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2019 was 6.18% (31.12.2018: 7.31%). Leverage ratio is calculated as Group's total Tier 1 own funds divided by Group's total risk exposure measure (incl. risk position on assets and off the balance sheet liabilities). As at the end of the reporting period, the leverage ratio is the arithmetic mean of the monthly leverage ratios over the last quarter.

On December 2017, the Financial Supervision Authority introduced a new prudential regulation for LHV Group, a minimum requirement for own funds and eligible liabilities (MREL). The ratio is a part of the crisis resolution plan and obliges LHV to have sufficient own funds and unsecured long-term liabilities that can be used to cover losses under the crisis resolution plan. The minimum requirement for MREL ratio is set at 5.79% and it is reviewed annually by the Financial Supervision Authority. At the end of the year, LHV Group had the ratio at the level of 8.70% (2018: 11.43%) and it contains an adequate buffer for the growth plans of 2020. On the other hand, it forces LHV to change its existing policy of financing by deposits and the Group will also include liabilities in the form of bonds or loans, which qualify for MREL, in order to manage the ratio.

Capital base

(in EUR thousands)	31.12.2019	31.12.2018
Paid-in share capital	28 454	26 016
Share premium	70 136	46 653
Statutory reserves transferred from net profit	4 713	3 451
Other reserves	212	78
Accumulated profit/(deficit)	69 452	50 193
Intangible assets (subtracted)	-18 319	-19 084
Profit for accounting period (COREP)	12 186	13 605
Deductions	-33	-194
Dividend offer (including income tax)	0	0
Tier 1 capital	**166 801**	**120 718**
Additional Tier 1 capital	20 000	0
Total Tier 1 capital	**186 801**	**120 718**
Subordinated debt	55 000	50 900
Total Tier 2 capital	**55 000**	**50 900**
Exceeding limitations of subordinated debts and preference shares	0	0
Net own funds for capital adequacy calculation	**241 801**	**171 618**

Capital requirements

Central governments and central bank under standard method	920	938
Credit institutions and investment companies under standard method	4 183	5 376
Companies under standard method	818 918	579 836
Retail claims under standard method	167 276	133 250
Public sector under standard method	2	125
Housing real estate under standard method	208 693	39 903
Overdue claims under standard method	5 242	10 142
Investment funds' shares under standard method	8 052	7 973
Other assets under standard method	17 875	10 557
Total capital requirements for covering the credit risk and counterparty credit risk	**1 231 161**	**788 090**
Capital requirement against foreign currency risk under standard method	4 211	3 957
Capital requirement against interest position risk under standard method	0	32
Capital requirement against equity portfolio risks under standard method	959	704
Capital requirement against credit valuation adjustment risks under standard method	22	41
Capital requirement for operational risk under base method	109 546	91 575
Total capital requirements for adequacy calculation	**1 345 899**	**884 399**
Capital adequacy (%)	**17.97**	**19.41**
Tier 1 Capital Ratio (%)	**13.88**	**13.65**
Core Tier 1 Capital Ratio (%)	**12.39**	**13.65**

Financial plan

As one of very few listed companies LHV publishes yearly five year financial plan. As the forecast horizon is long, then only the first year should be taken as commitment, remaining four years as guideline where LHV sees it's business to develop.

Assumptions behind the financial plan

Biggest assumption is regarding the macroeconomic situation, where we knowledable to not plan major changes to present the actual development of LHV without significant effects of economic environment. In addition, we consider competition to remain similar to current situation. Two largest changes taken into account: already known changes in legislation and market view regarding interest rates. Biggest changes in legislation are related to II Pillar pension reform and growing regulations. From interest rates side we see that interest rates will continue to be negative during the whole forecasting horizon ending with 0 in 2024.

This plan continues the approach of LHV having three business arms, from which Estonian banking and asset management two arms are solid already now, where the share of payment intermediates business line will increase.

Profit and loss statement

EURm	2020	2021	2022	2023	2024
Net interest income	70	86	104	125	144
Net fee and commission income	25	30	35	41	47
Net gains from financial assets	0	0	0	0	0
Other income	0	1	1	0	0
Total revenue	**95**	**117**	**140**	**166**	**191**
Total operating expenses	**-41**	**-47**	**-52**	**-58**	**-64**
Amortisation	-8	-5	-6	-6	-6
Impairement losses on loans and advances	-7	-11	-13	-15	-17
Earning before income tax	**39**	**54**	**69**	**87**	**104**
Income tax	-2	-2	-1	-1	-2
Advance income tax	-4	-6	-8	-10	-11
Net profit	**33**	**46**	**60**	**76**	**91**
Profit attributable to non-controlling interest	3	3	3	4	5
Profit attributable to owners of the parent	**30**	**43**	**57**	**72**	**86**

Balance sheet

EURm	2020	2021	2022	2023	2024
Cash and cash equivalents	1512	2095	2 242	2 542	2 865
Financial assets at fair value	107	102	102	102	100
Loans granted (net)	2 165	2 706	3 229	3 754	4 304
Long-term financial investments	7	7	8	8	9
Other assets	33	34	34	34	35
Total assets	**3 824**	**4 944**	**5 615**	**6 440**	**7 313**
Deposits from customers	-3 377	-4 330	-4 927	-5 709	-6 504
Loans received	-98	-193	-212	-208	-207
Subordianted loans	-93	-123	-123	-103	-103
Other liabilities	-22	-22	-23	-24	-24
Total liabilities	**-3 590**	**-4 668**	**-5 285**	**-6 044**	**-6 838**
Equity	**-234**	**-276**	**-330**	**-397**	**-475**
Total liabilities and equity	**-3 824**	**-4 944**	**-5 615**	**-6 441**	**-7 313**

Financial and operational ratios	2020	2021	2022	2023	2024
ROE from profit attributable to the owners of parent	14.0%	17.4%	19.2%	20.2%	20.2%
ROE from pretax profit attibutable to the owners of the parent	16.7%	20.3%	22.1%	23.3%	23.3%
C/I	52%	45%	41%	38%	36%
L/D	64%	62%	66%	66%	66%
Risk cost	0.4%	0.4%	0.4%	0.4%	0.4.%
EPS (EUR)	1.04	1.48	1.91	2.38	2.84
Dividend (EURt)	5 975	6 628	9 027	11 472	14 404
DPS (EUR)	0.21	0.23	0.31	0.39	0.48
T1	13.4%	13.0%	13.9%	14.8%	15.8%
CAD	17.8%	17.9%	18.3%	18.9%	19.5%

Sensitivity analyses

LHV has three major business lines: universal banking in Estonia, servicing payment intermediates in UK and asset management. These business lines are very different in their sensitivities to different risk factors.

Universal banking is clearly procyclical, meaning that it's results are directly affected by macroeconomic developments. In general, there are three major components effecting Bank's results:

- **Interest rate**
- **Credit losses**
- **Personnel cost**

Every 100 bps increase in interest rates will increase LHV interest income by EUR 1.5 million within first 12 months. Interest rate decrease by similar level will reduce LHV interest income by EUR 0.5 million.

Credit losses are dependent on economic situation. LHV has knowledable credit risk management and does not allow excess risk in any of the economic sectors. Still quick growth hides the credit losses as significant part of portfolio is not matured yet. For understanding the actual levels of credit losses, LHV calculates the credit risk in addition to current portfolio also to 12 month old portfolio. LHV has had very few defaults in history and only real credit losses bank has had have been related rather with fraud, not with wrong credit decisions.

Personnel cost is the biggest cost base for the bank and equals around 50% of the total costs. LHV has the internal policy to follow the market leveles in compensation packages. LHV offers its services mainly through electronic channels. To offer these services effectively LHV has made a decision to develop systems in-house. As a result the IT team is almost 25% of the total personnel. Salary levels for IT personnel has been increasing and seems to increase in nearest future more than for other personnel segments, then LHV has forecasted higher salary growth than competitors.

Servicing payment intermediates is volume business and it is sensitive to macroeconomic developments, but quite differently compared to banking. In general, there are three major components effecting payment intermediates business results:

- **Trading activities between countries**
- **FX rates volatility**
- **Regulations**

First two are very much similar, most payment intermediates offer transferring/converting certain currency to another region/currency within short time frame. The need for such business grows when there are either solid business relationships between countries or quite opposite one currency becomes very volatile and businesses need to hedge their positions quickly. The third area is related to regulations, the financial intermediaries business models are moving towards more regulations, which affect most of the participants.

Asset management is almost insensitive to macroeconomic developments. The results are depending on two major items:

- **Pension fund manangement**
- **Political risk**

Pension fund manangement is key for results. Starting from Q4 2019 the calculation of fund manangement fees changed to performance bonus principle. LHV has targeted to beat the agreed benchmark over longer period, but not in nearest years. LHV has outperformed all our competitors over the last 10 years.

Another large risk side of the asset management is political risk. In every year during the last 5 years there has been some changes in the pension funds management fee calculation. LHV has been successful of managing these changes and being able to deliver good result despite of the constant changes in legislation.

Overview of the Group's subsidiaries in 2019

AS LHV Pank consolidation group

LHV's mission is to help raise Estonian capital. LHV's vision is focused on Estonia, where people and businesses dare to think big, engage in enterprise and invest in the future. LHV values: simple, supportive, effective.

LHV Pank (hereinafter the bank) is the largest Estonian domestic bank. The bank focuses on active and independent customers with an entrepreneurial mindset. For private customers, the bank provides the management of daily financial affairs, along with housing loans, and it specialises in providing the best services for growing customers' savings. For business customers, the bank offers flexible and appropriate financing, along with the management of daily financial affairs. The bank's products and services are simple, transparent and relevant. Modern electronic means of communication are used for customer relations. The resultant reduced costs are reflected in the affordable prices of our everyday banking services.

LHV Pank has representative offices in Tallinn, Tartu and London. The bank has more than 400 staff members, with more than 202 000 customers using the bank's services. LHV Pank consolidates a 65% subsidiary AS LHV Finance, which is engaged in consumer financing (hereinafter the Group).

Business activities

The bank's rapid growth continued in 2019. By the end of the year, the bank achieved a near 10% market share in Estonia, with regard to daily banking, deposits and corporate loans. With regard to daily banking and deposits, the bank is now the third largest bank in Estonia. At the beginning of the year, Eesti Pank classified LHV Pank as a provider or vital service, the fourth bank in Estonia to be classified as such.

The bank's customer numbers grew by more than 40,000 during the year. By the end of the year, customer numbers reached 202,000, having grown by 25%, year-over-year. The year saw a record-breaking growth in customer activity and business volumes. The number of customers actively using the daily banking services grew by nearly a third. The bank participated in the IPO of Coop Bank as a financial consultant, with a half of the subscribers originating from LHV Pank.

Deposit volumes grew by 87% to EUR 2,713 million. Deposits of standard customers grew by 58% to EUR 1,961 million, deposits of financial intermediaries by 94% to EUR 376 million, and deposits engaged through deposit platforms to EUR 373 million. The bank launched an active cooperation with both of the major deposit platforms in Europe (Raisin and Deposit Solutions), mainly engaging one-year term deposits. Deposits were engaged through the platforms in Q2 and Q3 with the aim of ensuring sufficient financing for purchasing the Danske Bank private customer loan portfolio.

The bank's loan volumes grew by 84% to EUR 1,687 million during the year. Corporate loans grew by 32% to EUR 851 million and retail loans by 202% to EUR 836 million. The retail loan portfolio consisted of housing loans (70%), leasing (11%) and other loans (19%). In January, the bank acquired the loan portfolio of Versobank with a total value of EUR 13 million for a price of EUR 12 million. In November, the bank acquired the private loan portfolio of Danske Bank with a total value EUR 432 million for a price of EUR 393 million. Versobank's loan portfolio contained 20 business customers and 47 private customers. Danske Bank's loan portfolio contained approximately 10,800 private customers, with home loans contributing 97%. The bank considers the credit portfolio to be strong and well-secured. As the interest rates of these housing loans were relatively close to cost price, the portfolio could only be purchased at a discount. The transaction significantly improved and diversified the entire structure of the bank's loan portfolio. The bulky corporate loan portfolio is now balanced out by the home loan portfolio.

Net profit for the year amounted to EUR 22.1 million. A quicker growth in net profit was curbed by the increase in interest expenses on both the deposits engaged from deposit platforms and the funds kept with the European Central Bank. The bank incurred interest expenses on the Danske Bank private customer loan portfolio in Q2, but only started to generate interest income at the end of the year. Net profit grew significantly after the takeover of the Danske Bank private customer loan portfolio. Net profit was negatively affected by additional loan write-downs made during the takeover of the loan portfolio, as well as the notary's fees and state fees related to re-registration of the collateral.

The quick organic growth in the bank's loan portfolio and purchase of the Danske Bank private customer loan portfolio conditioned the need to engage, in addition to deposits, a significant volume of additional capital through three different capital instruments. During the year, the bank engaged additional share capital from AS LHV Group and issued additional Tier 1 securities (AT1) and subordinated bonds.

With the aim of financing the bank's housing loan portfolio through covered bonds in the future, the bank submitted to the Financial Supervision Authority the application for additional authorisation for covered bonds. The issue of covered bonds is scheduled for 2020 and serves the purpose financing the bank's home loan portfolio via a more favourable, long-term financial instrument.

In Q4, the bank decided to continue pursuing the internal ratings-based (IRB) approach to credit risk, a project which was suspended two years ago. The decision was conditioned by the fact that the new Capital Requirements Regulation (CRR), which entered into force in the middle of the year, has not taken into account the latest Basel guidelines regarding amendment of the capital requirements for the standard approach to credit risk.

At the beginning of 2020, Moody's Investors Service re-confirmed the previous credit rating assigned to the bank: investment-grade credit rating with a stable outlook. In assigning the rating, Moody's took account of the bank's strong capitalisation and profitability, which helps to balance the bank's rapid growth.

The auditor has provided other assurance services to the bank in 2019, as required by the Credit Institutions Act and the Securities Markets Act.

Development activities

New accounts were opened more actively than in previous periods. This was facilitated by both the upgraded Mobile Bank and the expanded ATM network. The Mobile Bank was significantly improved during the year, providing the options of opening an account, ordering a bank card, making investments and applying for various loan products. In addition to Baltic shares, the upgraded Mobile Bank also provides the option of making transactions with shares of foreign stock exchanges and exchange-traded funds. Investment-making via the Mobile Bank is convenient and swift – a highly important factor in transactions. Furthermore, the Mobile Bank also provides an overview of the price information charts. More than a half of the bank's customers, who use investing services, hold foreign shares or index funds. Therefore, the creation of the new service was very important for many customers.

While at the beginning of the year, the bank installed additional ATMs, significantly expanding its pan-Estonian ATM network, the middle of the year saw the conclusion of a contract with Luminor Bank, Danske Bank and Worldline. The transaction partnered the bank with Luminor Bank in the management of a shared ATM network, replacing the former partner Danske Bank. The shared network is operated by LHV Pank. For the bank's customers, the ATM network was expanded five times, from 25 ATMs to 125 ATMs. The ATM network expansion significantly improved our customer's access to cash withdrawal.

We also launched several value-added services for our customers. At the beginning of the year, we launched real-time EUR-payments. We were the first bank to offer the Entrepreneur Account. With regard to major settlements, the state treasury's cash pool account was introduced, with accounts opened for the bank's customers in the Ministry of Finance and the Tax and Customs Board for making payments and paying taxes. A co-operation agreement was concluded with KredEx to provide housing loan surety to young people. Virtual IBAN and API services were launched for financial intermediaries. At the beginning of 2020, the bank opened real-time GBP payments to its customers engaging in financial intermediation.

As an upgrade, the bank now provides an overview of alternative investments in the summary view of the Internet Bank. We were also the first bank to provide information on EstateGuru and Coinbase investments. An overview of alternative investments, i.e. investments in crowd-funding and crypto-assets, provides the customer with convenient access to information on both stock exchange investments and OTC investments, as well as a quick and comprehensive overview of the investment portfolio. Customers can also view the funds available on the platform. We are working towards adding the overview of the accounts opened in other major alternative investment platforms.

The new Payment Services Directive entered into force in the middle of September, with the bank allowing third parties access to customer accounts for making and accepting payments, provided that the customer has previously agreed to the same. The first service providers have already interfaced with the bank. The Directive also established restrictions for contactless payments. The new regulation allows to make either five contactless payments or contactless payments in the total amount of up to EUR 150 without strong authentication.

Two internationally acknowledged and widely used IT systems were implemented for preventing money laundering and terrorist financing: Fico-Tonbeller for KYC in account opening and payment monitoring, and Accuity for payment screening. The bank actively supported the development of the new IT system Salv, and its adoption as one of Salv's first customers.

Organisation

The bank's organisational structure is divided into six areas, each with their own departments. Business areas include retail banking, corporate banking and financial intermediation, supporting areas include IT, financial management and support services, and risk management. Human resource management, marketing and communication, and compliance are activities covering the entire bank. The bank's UK branch is covered by the financial intermediation area. Management of the compliance function and department was transferred from the area of risk management to the sphere of responsibility of the Chairman of the Management Board in the middle of the year.

The Risk and Capital Committee and the Nomination Committee were established at the end of the year on the level of the Supervisory Board. The purpose of the Risk and Capital Committee is to advise and support the Supervisory Board with regard to supervision of the general, actual and future risk appetite and strategy, considering all types of risk and ensuring their compliance with the business strategy, objectives, business practice and values. The purpose of the Nomination Committee is to support the Supervisory Board in issues concerning the selection process and fit-and-proper requirements.

The Money Laundering and Terrorist Financing Prevention Committee was established on the Management Board level, and the Risk and Capital Committee was renamed Assets and Liabilities Management Committee. The purpose of the Money Laundering and Terrorist Financing Prevention Committee is to advise and support the Management Board in issues concerning the prevention of money laundering and terrorist financing and implementation of international sanctions. Within the framework of performance of its duties, the committee analyses the information regarding the services provided by the bank, as well as the dynamics in the market, legal and supervisory environment. Based on the information gathered, the committee assesses compliance of the bank's activities with its strategy and risk appetite, as well as the relevance of the planned audit procedures, and gives instructions regarding additional actions to be taken.

In connection with the United Kingdom's exit from the European Union, the Financial Supervision Authority provided the bank with the authorisation for the UK branch as a third-country branch. However, the authorisation process was delayed by the UK supervisory authority in connection with the postponement of the Brexit date and lack of clarity, and will be continued at the beginning of 2020.

Year-over-year, the bank's employee numbers grew by 57 to 434 (including passive employees and part-time staff members), including 31 staff members of LHV Finance. In full time equivalents, the number of active employees amounts to 396.

The bank received several recognitions during the year. Once again, the bank was elected the bank with the best customer service in Estonia. The bank's marketing team was elected Estonia's marketing team of the year. The staff satisfaction survey conducted within the bank showed high satisfaction with both the employer and the job. The bank won the Estonian Banking Association's innovation prize for the third year in a row, this time for the Entrepreneur Account. The bank also received the golden award of the Family-friendly Employer, issued by the Ministry of Social Affairs. For the second year in a row, Euromoney declared LHV Pank the best bank in Estonia. At the end of the year, the Banker magazine of the Financial Times elected LHV Pank the best bank in Estonia.

Sponsorship

The bank takes its social responsibility seriously. Within the limits of our available resources, we support enterprises and initiatives that contribute to the development of the Estonian society. When it comes to sponsorship projects, the bank prefers long-term dedication and cooperation. The bank stands ready to contribute to the pursuit of innovative ideas which help to advance Estonian life.

The bank's long-term partners include Estonian Football Association, Estonian Optimist Class Association, Estonian Gazelle Movement, Estonian Entrepreneur of the Year competition, Estonian Music Days and the Enn Soosaar Foundation.

At the end of the year, the bank extended its cooperation agreement with the Estonian Football Association for the next five-year period. The scale of the sponsorship for the next five years amounts to a total of one million euros, subject to further expansion, depending on the active use of the Football Card and the national team making it to the finals.

Financial results

EUR million	2019	2018	change
Net interest income	47.91	39.02	23%
Net fee and commission income	12.81	11.10	15%
Net gains from financial assets	0.21	0.47	-56%
Total net operating income	60.93	50.59	20%
Other income	0.18	0.95	-81%
Operating expenses	-32.52	-25.74	26%
Income tax expense	-3.28	-2.51	30%
Credit losses	-3.21	-4.88	-34%
Net profit	22.10	18.41	20%

Volumes

EUR million	31.12.2019	31.12.2018	change
Loan portfolio	1 687.0	918.8	84%
Bond portfolio	32.9	39.0	-16%
Deposits	2 713.0	1 448.0	87%
Equity	171.7	125.6	27%
Number of customers holding assets in the bank	202 186	161 357	25%

AS LHV Varahaldus

AS LHV Varahaldus is a fund management company with emphasis on active investment strategies. As of the end of 2019, funds under management consist of one UCITS fund, seven mandatory and two voluntary pension funds. Investment management unit is supported by risk management, operations and sales units.

In 2019, assets under management grew from EUR 1 214 million to EUR 1 374 EUR million. Majority of the growth came from organic growth and investment returns of mandatory pension funds, as they constitute about 98% of all assets managed. While less impactful for the overall results of the company, it should still be noted that assets under management in voluntary pension system also grew by 22%. Assets managed outside of pension system decreased, as a UCITS fund Persian Gulf Fund was closed in June 2019. In November company also revealed plans to merge two mandatory pension funds into one, merger is subject to regulatory approval.

LHV offers a wide range of investment strategies to its clients within mandatory pension system, including passively managed index fund and six actively managed funds with varying risk classes. In recent years actively managed funds have concentrated more on alternative asset classes and non-listed securities with the belief that over long investment horizon average annual expected return will exceed that of publicly traded securities. Growing size of funds as well as changes in regulation have allowed LHV to invest more into local non-listed assets, such as real estate, as well as provide financing to Estonian companies through debt securities. LHV pension funds are among the biggest and most active institutional investors in Estonia with investments of close to EUR 60 million in 2019 to local economy.

2019 was a very good year for publicly traded equities. All the biggest markets and indices showed strong returns after a negative 2018; return of S&P 500 in Euros was 31,4%, that of MSCI World 30%, Euro Stoxx 50 grew by 28.2%. As equities outperformed other asset classes, the best performances in Estonian pension system were also delivered by index funds concentrating on equity market indices. Return of LHV Pensionifond Indeks in 2019 was 25.7%. Proportion of listed securities in LHV actively managed funds is lower, thus return was also not at the level of funds with equity strategies. Biggest funds L and XL showed returns of 5.8% in 2019.

LHV with its seven funds in the mandatory pension system is the chosen fund manager for close to 177 thousand people. Compared to 2018 number of clients decreased slightly, but the company still manages assets for 24.3% of pension system participants and holds market share of 28.4% in terms of assets under management.

In June 2019, in order to provide a better overview of pension system and available funds to market participants, mobile application "Minu pension" was launched. In December 2019 joining with the voluntary LHV pension funds was also made easier, as applications for joining can now be submitted via electronic channels.

Last year important developments to regulatory rules regarding mandatory pension system in Estonia were both implemented and discussed. In September investment rules were relaxed, enabling the pension funds to invest more freely and in bigger scope to alternative, non-listed asset classes. At the same time fixed management fee was reduced significantly and a possibility to earn performance fee based on actual returns of the funds was introduced. One of the reasons for such a change was to encourage pension funds to be more active in finding profitable investment opportunities in local economy. The impact of those regulatory changes was diminished by proposed pension reform, wherein people can decide to opt out of the mandatory pension system, pay the income tax on the collected amount, and remain solely reliable on state pension. For pension funds this makes estimations for future assets under management difficult to predict and will limit the investments into asset classes with long investment period and low liquidity.

Net profit of LHV Varahaldus was EUR 6.1 million in 2019, a 10% decrease compared to 2018. While the positive changes in investment returns and decrease of marketing expenses compared to 2018 more than offset increased personnel and other costs over the same period, lower fixed management fees starting from September reduced revenues for the company by close to EUR 1 million. Returns of actively managed funds were lower than increase of social tax revenue, a benchmark index, meaning no performance fee in 2019.

The profit was affected by dividend income tax in amount of EUR 1.0 million (EUR 1.1 million in 2018). Net fee and commission income decreased by EUR 1.0 million to EUR 12.9 million. Operating expenses increased by EUR 0.3 million and amounted to EUR 6.1 million. LHV Varahaldus paid EUR 4.4 million in dividend.

Financial results

EUR million	2019	2018	change
Net fee income	12.9	13.9	-7%
Other financial income	0.3	-0.2	-
Total net operating income	13.2	13.7	-4%
Operating expenses	-6.1	-5.8	5%
Income tax expemses	-1.0	-1.1	-9%
Net profit	6.1	6.8	-10%
Assets under management	1 374	1 214	13%
Number of clients in pension funds (thousands)	200	201	0.5%

Corporate Governance report

This report is presented in accordance with the Accounting Act of the Republic of Estonia and provides an overview of the governance of AS LHV Group (hereinafter: LHV) and compliance of governance with the advisory guidelines Corporate Governance Recommendations of the Financial Supervision Authority and Nasdaq Tallinn Stock Exchange. LHV adheres to the Corporate Governance Recommendations, unless specified otherwise in this report.

1. General meeting

LHV is a public limited company, with its governing bodies being the General Meeting of Shareholders, the Supervisory Board and the Management Board.

The General Meeting, where shareholders can exercise their rights, is the highest governing body of LHV. The primary duties of the General Meeting include amendment of the Articles of Association, increase and decrease of share capital, decisions on issuance of convertible bonds, election of and extension of the powers of Supervisory Board members, premature removal of Supervisory Board members, approval of the annual report and profit allocation, approval of the share option programme and establishment of terms and conditions for the realisation of options, determination of the number of auditors, appointment and recall of auditors and other decisions within the competence of the General Meeting, as provided by law and the Articles of Association.

A resolution on amendment of the Articles of Association shall be adopted if at least two-thirds of the votes who participate in the meeting are in favour. A resolution on amendment of the Articles of Association shall enter into force as of the making of a corresponding entry in the commercial register. The resolution of the General Meeting on the amendment of the Articles of Association, minutes of the General Meeting and the new text of the Articles of Association shall be attached to the application filed with the commercial register.

A shareholder has the right to participate in the General Meeting, address the General Meeting with regard to items on the agenda, ask relevant questions and make proposals.

The Management Board calls the General Meeting. The annual General Meeting, with the approval of the annual report on the agenda, is held at least once a year. The Management Board calls the annual General Meeting within six months after the end of the financial year at the latest. The Management Board gives at least three weeks' notice of the annual or special General Meeting.

The agenda of the General Meeting, proposals of the Management Board and Supervisory Board, draft resolutions and other relevant materials are made available to the shareholders prior to the General Meeting. Materials are made available on LHV's website. Shareholders are given the opportunity to ask questions about items on the agenda before the General Meeting.

The list of shareholders entitled to participate in the General Meeting is established based on the share register seven days before the General Meeting.

One Annual General Meeting and one Special General Meeting of Shareholders were held in 2019. The Annual General Meeting of shareholders was held on 13 March 2019, where the Annual Report for 2018 was approved and profits for the 2018 financial year were distributed, with a decision also reached on the payment of dividends. In addition, an overview of the financial results and the business environment for the first two months of 2019 was given, along with a financial forecast for the next five years, and an auditor was appointed for the financial years 2020 – 2022. Also, a decision was reached regarding remuneration for Members of the Supervisory Board. At the Special General Meeting, held on 21 August 2019, the decision was made to increase share capital and an overview of the economic results for the first seven months, along with an adjusted long-term financial forecast, was provided. The General Meetings were held in the Estonian language.

The Annual General Meeting for 2019 was chaired by Daniel Haab, Head of Legal Department of AS LHV Pank, who introduced the procedure for conducting the General Meeting and the procedure for asking the Management Board questions regarding the company's activities.

Member of the Management Board Madis Toomsalu, Chairman of the Supervisory Board Rain Lõhmus, members of the Supervisory Board Andres Viisemann, Raivo Hein, Sten Tamkivi Tauno Tats, Tiina Mõis and Heldur Meerits, who were represented by a power of attorney, participated in the 2019 Annual General Meeting. Also, the auditor for financial years 2018 and 2019, Ago Vilu (PwC), and the auditor's candidate for the financial year 2020, Eero Kaup (KPMG), attended the Annual General Meeting. In the Special General Meeting for 2019, Member of the Management Board Madis Toomsalu, Chairman of the Supervisory Board Rain Lõhmus, members of the Supervisory Board Raivo Hein and Tauno Tats were present; Andres Viisemann, Tiina Mõis, Heldur Meerits and Sten Tamkivi were represented by a power of attorney.

None of the shareholders hold any shares, which would grant them special control rights or voting rights. LHV is not aware of any agreements in place between shareholders that would address the coordinated exercise of shareholder rights.

The only shareholders with significant influence is Rain Lõhmus and the persons related to him, holding 23.68% of the share capital.

2. Management board

2.1. Membership and duties of the Management Board

The Management Board is a governing body of LHV, representing and managing LHV. The members of the Management Board are elected and removed by the Supervisory Board. In order to elect a member of the Management Board, the candidate's written consent is required. Persons with knowledge and experience sufficient for participating in the work of the Management Board and for fulfilling the duties of a member of the Management Board and who correspond to the requirements, arising from the LHV's Articles of Association, rules of procedure of the Management Board and other internal rules of procedure and legislation, shall be appointed members of the Management Board. Before the appointment, the suitability of the person for the position is assessed pursuant to the LHV's procedure on the assessment of the members of the management body and key personnel, considering the specific nature of LHV's operations.

Pursuant to the Articles of Association of LHV, the Management Board consists of one to five members. A member of the Management Board is appointed for a term of five years, unless otherwise decided by the Supervisory Board. An extension of the term of office of a member of the Management Board may not be decided before one year before the scheduled end of the term of office and for a longer period than the maximum period prescribed in the law or the Articles of Association. If the Management Board of LHV has more than two members, the Supervisory Board must appoint the Chairman of the Management Board. The Chairman of the Management Board organises the work of the Management Board. The Supervisory Board may remove a member of the Management Board regardless of the reason. A member of the Management Board may resign from the board, regardless of the reason, informing the Supervisory Board thereof. The rights and obligations arising from a contract concluded with a member of the Management Board shall expire in accordance with the contract.

The LHV Management Board currently consists of a single member and Madis Toomsalu serves as the member of the Management Board. The Supervisory Board has entered into a management board member contract with Madis Toomsalu. The Supervisory Board establishes the remuneration principles for Management Board members and sets the severance compensation policy for premature termination of the management board member contract. The authority of the member of the Management Board shall continue until December 5, 2021.

The Management Board makes everyday management decisions at its own discretion, governed by the best interests of LHV and its shareholders, and not their personal interests. The duties of the Management Board member include day-to-day management of LHV, representation of the company, management of LHV's operations in foreign markets and investor communication, coordination of the development of LHV's strategy and its implementation by serving as an active chairman of the supervisory boards of the major subsidiaries of LHV.

The Management Board shall ensure the functioning of adequate risk management and internal control within LHV, depending on the business area pursued by LHV. LHV's internal control system covers all activities carried out by the Supervisory Board, management and staff members of LHV with the aim of ensuring efficiency of operations, adequate risk management, reliability and accuracy of internal and external reporting, correspondence to reality and unconditional compliance with all legal acts. The internal control system covers all business, support and control units.

The objective of risk management within LHV is to recognise, correctly measure and manage the risks. On a wider horizon, the objective of risk management is to enhance corporate value by minimising loss and reducing volatility of results.

Risk management is based on a strong risk culture and is built on the principle of three lines of defence, with the first line of defence, i.e. business areas, being responsible for risk-taking and day-to-day management of risks. The second line of defence, i.e. the risk management area, is responsible for developing risk management methods and reporting on risks. The third line of defence, i.e. internal audit, exercises independent supervision over the entire organisation.

2.2. Remuneration principles of the members of the Management Board

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law.

Competence for the establishment of remuneration principles and remunerations for the Management Board shall lie with the Supervisory Board. The Remuneration Committee shall review the basis for the remuneration of the Management Board on an annual basis. In assessing the activities of the Management Board, the Remuneration Committee shall, above all, consider the professional duties of the Management Board member, his activities, as well as LHV's financial position, the current status of and outlook for business operations in comparison with companies operating in the same sector of economy.

The remuneration payable to a member of the Management Board, including the options programme, must motivate the individual to operate within the best interests of LHV. The basic salary and remuneration principles of members of the Management Board shall be set forth in the employment contract or Management Board member contract concluded with the respective persons. The principles of remuneration of the Management Board or staff members engaged in internal control and risk management shall ensure their independence and objectivity in the performance of their risk management/internal control duties. The remuneration of this staff shall not depend on the results posted by the units supervised. The objectives shall be described on the level of individual staff members.

When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

The performance criteria established by LHV must not stimulate excessive risk-taking or sale of unsuitable products. The performance criteria must not merely contain performance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield) but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).

The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's professional behaviour.

A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.

Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.

Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, team-work, creativity, motivation and co-operation with other business units and the internal control function.

LHV applies the long-term incentive (LTI) plan, i.e. the options programme. An annual performance pay shall be added to the basic salaries of Management Board members, top managers and key personnel included in the options programme (including staff members equivalent to the Management Board members), the amount and disbursement of which corresponds to the achievement or non-achievement of individual targets or LHV's targets. The lower limit of the performance pay is 0 euros and the upper limit is 200% of the annual remuneration approved by the shareholders. As a rule, options will be issued in the amount of two per cent of the total number of LHV shares. The basis for establishment of performance pay in the options programme shall be objective and justifiable, with the time period for which performance pay shall be paid previously determined. The performance pay instruments consist fully of stock options.

Severance compensation payable to a member of the Management Board shall correspond to their previous work results. No severance compensation shall be paid, if this damages the interests of LHV. The size of the severance compensation shall correspond to the results achieved over time, and to the remuneration received.

Currently, the Management Board of LHV contains one member and the monthly remuneration paid to the member of the Management Board, Madis Toomsalu, under the contract of the member of the Management Board for 2019 was EUR 12 thousand, yearly remuneration totalled EUR 144 thousand. The member of the Management Board of LHV, Madis Toomsalu, can receive as performance pay for the options issued in 2017, 2018 and 2019, 72,429 shares of AS LHV Group; there are no additional bonuses and benefits applicable to the member of the LHV's Management Board. In 2019, salaries and other compensations paid to the management of LHV and its subsidiaries (including LHV Group) totalled EUR 1 453 thousand (2018: EUR 1,471 thousand), including all taxes. The remuneration/salaries and compensations of the members of the Management Board of LHV subsidiaries are included in the above total sum, whereas as at the end of 2019, the Management Board of AS LHV Pank included seven members, AS LHV Finance (subsidiary of AS LHV Pank) one member, AS LHV Varahaldus two members and OÜ Cuber Technology one member.

2.3. Conflicts of interests

The Management Board submits a declaration of economic interests and conflicts of economic interests once a year. There have been no conflicts of interest; accordingly, the respective improvement measures have not been applied.

Transactions between LHV and the Management Board, their close relatives or related persons and the terms and conditions thereof must be previously approved by the Supervisory Board. In 2019, no such transactions were concluded between the member of the Management Board, his close relatives or related persons and LHV; also, there are no such valid contracts from earlier periods.

Madis Toomsalu, the Management Board member of LHV, is not a management board member or supervisory board member in any other issuer. He has not been granted authority to issue or buy back shares.

3. Supervisory Board

3.1 Membership and duties of the Supervisory Board

The Supervisory Board is a governing body of LHV, planning the activities of LHV, organising the management of LHV and conducting supervision over the activities of the Management Board. The Supervisory Board determines and regularly reviews LHV's strategy, the general plan of action, risk management principles and the annual budget. The Supervisory Board has five to seven members. The members of the Supervisory Board are appointed for a term of three years. The members of the Supervisory Board elect amongst themselves the Chairman of the Supervisory Board, who organises the activities of the Supervisory Board. Election and extension of the mandate of the Supervisory Board members is within the competence of the General Meeting of Shareholders.

Persons with knowledge and experience sufficient for participating in the work of the Supervisory Board and fulfilling the duties of a member of the Supervisory Board and who correspond to the requirements, arising from the Articles of Association, rules of procedure of the Supervisory Board and other internal rules of procedure and legislation, shall be appointed members of the Supervisory Board. Before the appointment, the suitability of the person for the position is assessed pursuant to the LHV's procedure on the assessment of the members of the management body and key personnel, considering the specific nature of LHV's operations.

The members of the Supervisory Board of LHV are Rain Lõhmus (Chairman), Andres Viisemann, Tiina Mõis, Heldur Meerits, Raivo Hein, Tauno Tats and Sten Tamkivi. The term of office of Supervisory Board members is set to expire on 29 March 2020.

A total of eleven ordinary meetings of the Supervisory Board were held in 2019 and the decisions were adopted electronically six times. Rain Lõhmus, Tauno Tats and Raivo Hein participated in all meetings of the Supervisory Board in 2019. Andres Viisemann was absent from one, Heldur Meerits was absent from two, Sten Tamkivi was absent from three and Tiina Mõis absent from four meetings. All members of the Supervisory Board participated in more than half of the meetings of the Supervisory Board.

The Supervisory Board has formed three committees, charged with the task of advising the Supervisory Board in issues related to audit, remuneration and risk, as described in clauses 3.3 - 3.5 of this report.

In 2019, within the framework of Supervisory Board meetings, the Supervisory Board received regular overviews of the operating and financial results of LHV and its subsidiaries, along with the activities, developments and results of related areas. Risk reports and internal auditor's reports were reviewed on a quarterly basis. At the beginning of the year, the Supervisory Board approved the Annual Report for 2018, the Management Report and a proposal for the distribution of profit, made the proposal to pay dividends in the net sum of 21 cents per share, and to assign an auditor for the financial years 2020-2022. The financial and capital plan, capital targets, as well as the 5-year financial forecast and the financial calendar were approved for the year 2019. The August meeting focussed primarily on a discussion of the strategy employed by LHV and its subsidiaries. Over the course of the year, several of the procedures, policies and internal rules of LHV and its subsidiaries were reviewed, updated and approved. The pricing of options and issuing of share options for the results of 2018, and the realisation of options, were approved. Consent was given to increase the share capital of AS LHV Pank in connection with the realisation of the options programme.

The decision was made to carry out the second issuing of subordinated bonds, as planned under LHV's share programme and approved by the 20 June 2018 decision of the Supervisory Board, and to issue the shares in LHV's additional core capital. The respective results, volume and distribution of the issue were approved. In connection with the approval of the acquisition of the private loan portfolio of the Danske Bank A/S Eesti filiaal and the completion of the transaction, the financial forecast for 2019 – 2023 was updated in the second half of the year. The Supervisory Board also proposed an increase in the share capital of LHV to shareholders and that a Special General Meeting of shareholders be called, and later approved the subscription results of new shares, the volume and distribution of the issue. In December, the decision was made to terminate the activities of the Risk and Capital Committee at the LHV level, due to amendments to the Credit Institutions Act; the committee was established at AS LHV Pank level. Over the course of the year, an approval was given to increase LHV's share capital twice, and on three occasions the subordinated Tier 1 bonds and on two occasions the subordinated bonds issued by AS LHV Pank were subsribed.

3.2. Remuneration principles of the Supervisory Board and conflicts of interest

The size of remuneration and its procedure of payment to the members of the Supervisory Board is decided by the General Meeting, considering inter alia the duties of the Supervisory Board and their extent, as well as the participation at the Supervisory Board meetings and the activity of the Supervisory Board as a governing body. Additional remuneration may be determined to a member of the Supervisory Board in connection with their participation in the activity of the Audit Committee or any other body of the Supervisory Board.

The General Meeting of Shareholders has resolved to change the gross remuneration of 500 euros for Supervisory Board members per each meeting of the Supervisory Board, where the member participates, to 1500 euros. The remuneration payable to the Supervisory Board Member is paid out on the next working day following the Supervisory Board meeting, at the latest. No separate additional or performance payments or additional bonuses or benefits have been established.

In 2019 the total sum of remuneration paid to the LHV's Supervisory Board was 88,500 euros, inclusive of all taxes, out of which, 14,500 euros to the Chairman of the Supervisory Board Rain Lõhmus, 14,500 euros to the members of the Supervisory Board Raivo Hein and Tauno Tats, 13,000 euros to Andres Viisemann, 12,500 euros to Heldur Meerits, 10,000 euros to Sten Tamkivi and 9,500 euros to Tiina Mõis.

For reasons of clarity, LHV considers it important to note that in case of the Supervisory Board member Andres Viisemann, LHV applies the LTI plan, i.e. the option programme based on his activity as the head of pension funds in LHV's subsidiary AS LHV Varahaldus. The LTI instrument includes 100% share options. Andres Viisemann is entitled to a total of 34,269 shares of AS LHV Group for the options issued in 2017, 2018 and 2019.

Once a year, the members of the Supervisory Board submit a declaration of economic interests and conflicts of economic interests. No significant transactions were concluded between LHV and its Supervisory Board members, their close relatives or related parties in 2019. Also, there are no such valid contracts from earlier periods. There has been no conflict of interest; accordingly, no respective improvement measures were applied.

3.3 Audit committee

The Audit Committee is formed by Supervisory Board as an advisory body for monitoring the effectiveness of accounting and reporting (including budgeting process), audit, risk and capital management, internal control system and internal audit, also compliance with regulations. The Audit Committee is governed, in its activities, primarily by the Auditors Activities Act and the rules of procedure established by the Supervisory Board of LHV.

One of the objects of the Audit Committee is to monitor and analyse the processes, which must ensure accurate and efficient preparation of monthly reports and the annual accounts, the efficiency of an internal audit as a process in examining the LHV Group companies' annual accounts and independence of an audit firm and a sworn auditor representing an audit firm on the basis of law and the compliance of their activities with the requirements of the Auditors Activities Act.

The Audit Committee is responsible for making proposals to the Supervisory Board and providing recommendations for appointment or removal of the audit company, appointment or removal of the internal auditor, prevention or elimination of problems or inefficiencies within the organisation, and compliance with legal acts and good practice.

The Audit Committee consists of a minimum of three members. Members of the Audit Committee are appointed by the Supervisory Board for a term of three years, with the aim of ensuring diversity of competences and independence of committee members. The persons elected to the Audit Committee shall be those, who are sufficiently independent of LHV in order to fulfil their role in an efficient way and at least two of whom shall be experts in accounting, finance or law. LHV's employee, member of the Management Board, an internal auditor, a procurator or a person providing the audit auditing service shall not be a member of the Audit Committee. In order to elect a member of the Audit Committee, the candidate's written consent is required. The size of remuneration paid to the members of the Audit Committee is decided by the Supervisory Board of LHV.

The members of the Audit Committee are Kristel Aarna, Tauno Tats and Urmas Peiker (Chairman). The mandate of the Audit Committee is valid until March 31, 2020. More detailed information on the members of the Audit Committee is presented in the Annual Report, section "Corporate Governance of LHV Group". LHV's Audit Committee members are paid a monthly gross remuneration of 500 euros.

Pursuant to the rules of procedure, the Audit Committee gathers for meetings on at least a quarterly basis; however, in 2019 the Audit Committee gathered for meetings on nine occasions. At six meetings, representatives of the Risk Management Department provided the members of the Audit Committee with an overview of the various risk management topics, bank and group risk exposures, and the indicators and measures used to monitor and manage them – as well as credit risk management, anti-money laundering, management of IT risks and liquidity and market risk management.

In most of the meetings, the issues raised by the internal audit, above all in connection with various audit reports, were discussed, along with other topics. The internal auditor gave an overview of the concluded audits. The Audit Committee has reviewed all the reports prepared by the internal audit and discussed the observations made, and the Audit Committee has formulated its views on the observations. At the first meeting of the year, the internal audit work plan for 2019 was approved and at the last meeting of the year, directions for the internal auditing work plan for 2020 were discussed.

There were two meetings in February, the first of which was dedicated to the selection of a new external auditor. After which the current external auditor (PwC) was present at three meetings. In February, the external auditor gave an overview of the 2018 annual report audit process and the findings; in October, the 2019 financial audit plan and during the first meeting in December, of the findings made during the interim audit. In December, representatives of the auditor KPMG, who will audit the report on 2020, participated in the Audit Committee meeting and provided an overview of their risk assessment of LHV's audit and their auditing plan for 2020.

Over the course of the year, the Audit Committee also confirmed and approved specific additional services to be provided by the external auditor.

3.4 Remuneration Committee

The Remuneration Committee is a body formed jointly by the Supervisory Bodies of LHV and AS LHV Pank for the development, implementation and supervision of the remuneration strategy of the employees and members of the Management Board of the mentioned companies. One of the tasks of the Remuneration Committee is to evaluate the impact of any remuneration-related decision on adherence to the requirements established for the management of risks, own funds and liquidity.

The Remuneration Committee conducts supervision over the remuneration of Management Board members and staff members of LHV, evaluates implementation of the remuneration policy at least on an annual basis and, where necessary, proposes to update the remuneration principles and prepares the related draft resolutions for the Supervisory Board.

The Remuneration Committee consists of a minimum of three members, who shall be elected from among the members of the Supervisory Board. The members of the Remuneration Committee are appointed and removed by the Group's Supervisory Board. A member of the Remuneration Committee shall be appointed for a term of three years. A member of the Remuneration Committee can be re-elected and their mandate extended unlimited times. The persons elected to the Remuneration Committee shall be those, who have sufficient and relevant knowledge, proficiency and work experience in the area of remuneration policy and practices, risk management and control. The size of remuneration payable to the members of the Remuneration Committee is decided by the Supervisory Board.

Members of LHV's Remuneration Committee are Madis Toomsalu (Chairman), Rain Lõhmus and Andres Viisemann whose mandate is valid until April 11, 2021. More detailed information on the members of the Remuneration Committee is presented in the Annual Report, section "Corporate Governance of LHV Group. No remuneration is paid to the members of the Remuneration Committee.

The Remuneration Committee met once in February 2019, when the Chairman of the Committee was elected, remuneration policy and strategic principles for remuneration, market comparison, critical positions and planned positions for 2019, also results of employee satisfaction survey were reviewed. The committee discussed and made a proposal to the Supervisory Board with regard to the recipients of share options and the related amounts for the results posted in 2018, as well as with regard to the pricing of share options and the share options of resigning staff members. The remuneration system, the goals and salaries of the members of the Management Board, incl. of LHV and its subsidiaries, and the principles for remuneration of the members of the Management Board and persons who were equal to the members of the Management Board were reviewed.

3.5 Risk and capital committee

The Risk and Capital Committee is a functional body of LHV, the task of which is advising the Supervisory Board and Management Board of LHV with regard to risk management principles and risk tolerance, assessing the risks taken by LHV and monitoring implementation of the risk policy within LHV Group companies. The Risk and Capital Committee also carries out supervision of the implementation of risk management principles by the Management Board in accordance with the instructions given by the Supervisory Board, checks that the probability and timing of risk, capital, liquidity and revenue is taken into account in remuneration principles, and that the business model and risk management principles are taken into account in the fees established for customers.

The Risk and Capital Committee shall consist of a minimum of three members, who shall be elected from among the members of LHV Supervisory Board, whereas the committee members shall include the Chairman of LHV Supervisory Board. The persons elected to the Risk and Capital Committee shall be those, who have sufficient knowledge, skills and experience, in order to understand and monitor on a continuous basis the risk management principles and risk tolerance in LHV Group companies. The competence, rights, operating principles and remuneration payable to the members of the Risk and Capital Committee shall be determined by the Supervisory Board of LHV.

Rain Lõhmus (Chairman), Andres Viisemann and Tiina Mõis serve as members of the Risk and Capital Committee, whose mandate is indefinite. More detailed information on the members of the Risk and Capital Committee is presented in the Annual Report, section “Corporate Governance of LHV Group”. No remuneration is paid to members of the Risk and Capital Committee.

Four regular meetings of the Risk and Capital Committee were held in 2019, during which regular risk reports and loans with high risks (incl. introducing conclusions and changes that were entered into the corporate banking financing conditions in relation to long-term problematic clients) were reviewed. During the meetings, overviews were given regarding the field of anti-money laundering and terrorist financing, as well as the organisation of information security within LHV and the phishing wave that took place in the second half of the year, and the new pledge instrument legislation was introduced together with LHV’s action plan.

In December 2019, the Supervisory Board of LHV decided to terminate the activities of the Risk and Capital Committee at the LHV level due to amendments to the Credit Institutions Act. The Risk and Capital Committee was established at the level of AS LHV Pank, a subsidiary of LHV. Rain Lõhmus (Chairman), Andres Viisemann, Tiina Mõis and Madis Toomsalu were appointed as members of the committee with a 3-year mandate

3.6 Nominating Committee

In December 2019, the Supervisory Board of LHV decided to establish the Nominating Committee at due to amendments to the Credit Institutions Act. The purpose of the Nominating Committee, which has been formed at the level of AS LHV Pank, is to support the Supervisory Board of AS LHV Pank in questions related to the selection process and eligibility requirements. The competence of the Nominating Committee includes, among other things the presentation of the candidates, a description of the duties, and the length of the term of office of the Management Board, the assessment the composition, structure and activities of the Management Board at least once a year and, if necessary, the proposal of amendments, the continuous monitoring of the decision-making process by the Management Board, periodically the reviewal and decision-making on the content, format and frequency of the risk information received and where appropriate, assurance of the involvement of risk management, compliance testing, internal audit and other department managers in relevant matters.

The Nominating Committee shall consist of a minimum of three members, who shall be elected from among the members of LHV Supervisory Board. The committee members shall have individual and collective knowledge, experience and expertise in the selection process and the eligibility requirements, including knowledge of the requirements set out in the EBA and ESMA guidelines for assessing the suitability of members of the management board and key personnel. The competence, rights, operating principles and remuneration payable to the members of the Nominating Committee shall be determined by the Supervisory Board of LHV.

Madis Toomsalu (Chairman), Rain Lõhmus and Andres Viisemann are the members of the Nominating Committee and their mandate is valid until April 18, 2022. More detailed information on the members of the Nominating Committee is presented in the Annual Report, section “Corporate Governance of LHV Group. No remuneration is paid to the members of the Nominating Committee.

4. Cooperation of Management Board and Supervisory Board

The Management Board and Supervisory Board work in close co-operation to best protect the interests of LHV. The co-operation is, above all, based on an open exchange of views between as well as within the Management Board and the Supervisory Board.

The Management Board and the Supervisory Board joint their efforts to lay out the objectives and strategy of LHV. In the management of LHV, the Management Board is governed by the strategic instructions given by the Supervisory Board. The Management Board regularly discusses strategic management issues with the Supervisory Board within the framework of an open dialogue. The Board is invited to participate in monthly meetings of the Supervisory Board.

The Management Board regularly informs the Supervisory Board of the key circumstances regarding the activity plans and business activities of LHV, the risks involved and management of such risks.

No conflicts of interests occurred in the financial year 2019; accordingly, no respective improvement measures were applied.

5. Disclosure of information

LHV treats all shareholders equally and notifies all shareholders of relevant essential circumstances accordingly, ensuring equal and quick access to the respective information. Information is disclosed in accordance with the rules set forth for publicly traded companies.

LHV contributes actively to the development of good relations with the investor community and to raising the awareness of investors. LHV has set up an investor relations website, making all documents and information available to the shareholders in accordance with the Corporate Governance Recommendations and statutory requirements. LHV is the biggest and the only member of the Baltic market, who publishes monthly financial results, as well as the following year and the five-year financial forecast on its website. This information is disclosed also for 2019 and in 2019. The website of LHV shows also the financial calendar of the current and following year, containing the publication dates of the annual report and interim reports and the date of the Annual General Meeting of Shareholders. The disclosed information is available on the website in the Estonian, English and Russian languages. LHV also discloses its annual plans and monthly results via the stock exchange announcements.

LHV organises quarterly investor meetings and web-seminars, the summaries of which can be reviewed via the website of LHV. Additional meetings with analysts and presentations and press conferences aimed at analysts, investors or institutional investors are made in accordance with the need and wishes of interest groups. On its website, LHV explains its goals, directions and opinions in terms of possible trends, regulatory or business environment changes. LHV aims at being open to questions, transparent and report of its activities to investors. In 2019, LHV was named as the winner of the Nasdaq Baltic Awards, which recognizes the best Baltic listed companies in the areas of transparency, sound corporate governance and investor relations, in the main category Investor Relations of the Year.

LHV's dividend policy is available on LHV's website, stipulating the dividend payment principles, according to which the key precondition for payment of dividends includes external and internal regulatory capital standards, which have to be met in a sustainable manner. LHV may decide to waive dividend payment under the corresponding growth and/or investment plans. Where the preconditions are met, LHV shall pay a minimum of 25% of the shareholders' profit before taxes in dividends, income tax included.

6. Financial reporting and auditing

LHV publishes its annual report on an annual basis. The annual report is audited, and approved by the Supervisory Board and confirmed by the General Meeting.

The number of auditors is determined and the auditors appointed by the General Meeting of shareholders. The General Meeting also establishes the procedure for remuneration of auditors. The auditor's prior experience in financial services and auditing public-interest entities, team collaboration, expertise and ability to engage experts and, in case of significant differences the cost of the service, are key criteria for the auditor's appointment to the general meeting. Auditors are appointed for a single audit or for a specified term.

At the end of 2017, the Management Board, in cooperation with the Audit Committee organised a tender for selecting the auditor. Within the tender, LHV met with and requested bids from four major internationally recognised companies. When selecting the auditor, the practical work experience, skills and knowledge, trustworthiness, clear communication and offered terms and conditions of cooperation compared to market conditions and criteria, arising from the specific nature of LHV's business operations were assessed. As a result of the tender, AS PricewaterhouseCoopers was chosen and appointed the company's auditor at the Annual General Meeting of Shareholders held on April, 11, 2018. A two-year contract was entered into with AS PricewaterhouseCoopers for the audit of the financial years 2018 – 2019. The total sum paid or payable for the services provided by the auditor in 2019 is 254 thousand euros, which includes auditing and quarterly reviews in the amount of EUR 207 thousand and other services in the amount of EUR 47 thousand.

During 2019, the auditor has rendered contractual services to LHV consolidation group companies, including audits of the annual accounts of group companies and reviews of the profits disclosed in quarterly financial statements, translation services, tax advisory services, advisory services, report on the pro forma section included in the LHV Group rights issue prospectus other assurance services, which are required to be performed by auditors according to Credit Institutions Act.

Transactions with related parties are disclosed in Note 24 to the annual accounts.

In February of 2019, the Management Board, along with the Audit Committee, organised a competition for selecting an auditor to audit the annual reports for 2020 – 2022. Within the competition, an invitation was sent to the three largest auditing firms and among the two firms that submitted an offer, the decision was made to select KPMG Baltics OÜ, who was appointed to be the auditor of the Group's companies for the 2020 – 2022 period at the 13 March 2019 annual general meeting of shareholders.

Declaration of conformity

LHV adheres to the Corporate Governance Recommendations, with the exception of the following instructions and recommendations for the reasons stated below:

"*1.3.3. Issuers shall make participation in the General Meeting possible by means of communication equipment (Internet) if the technical equipment is available and where doing so is not too cost prohibitive for the Issuer.*"

Observation of the General Meeting and participation thereof has not been made possible by means of communication equipment. There has been no need, no corresponding requests and no suitable solution for such a facility. Nonetheless, LHV stands ready to ensure participation of shareholders at the General Meeting via secure electronic means (without being physically present at the general meeting), with the corresponding option added to the Articles of Association of LHV.

"*2.2.1. The Management Board shall have more than one (1) member and a Chairman elected by its members.*

The Management Board or Supervisory Board shall establish an area of responsibility for each member of the Management Board, defining as clearly as possible the duties and powers of each board member. The principles for co-operation between members of the board shall also be established.

The Chairman of the Supervisory Board shall conclude a contract of service with each member of the board for discharge of their functions.”

The Management Board of LHV has one member. LHV is a holding company without any day-to-day operational business activities. Thus, a single member of the Management Board ensures sufficient and comprehensive management of LHV. The major subsidiaries of LHV have management boards consisting of several members.

"*3.2.2. At least half of the members of the Supervisory Board of the Issuer shall be independent. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number dependent members.*"

Within the meaning of the Corporate Governance Recommendations, only Sten Tamkivi is an independent member of the Supervisory Board of LHV, for he has not been a member of the Supervisory Board for more than ten years. LHV is in the stage of active development and growth, where it has preferred people of long-term management skills and banking experience as members of the Supervisory Board. These people are also the largest shareholders of LHV. LHV believes that, as members of the Supervisory Board, the largest shareholders are best motivated to contribute to the management of LHV and its development over the long-term horizon. Based on objective and certified data, it still has been confirmed that only one of the seven members of the Supervisory Board has a qualifying holding (Rain Lõhmus and related persons holding 23.68% of the share capital) and no member of the Supervisory Board has no right in any way to determine the majority of the LHV Management or Supervisory Board members and do not exercise control over LHV in any other way, they are not bound with LHV by material business interest, they are not related to a shareholder of LHV who exercises control over LHV, they are staff members of LHV or partners or key personnel of the partner; accordingly, LHV does not consider it necessary to apply any corrective measures and assesses the Supervisory Board of LHV as collectively suitable, including in terms of independence, in the existing membership.

“Pursuant to subsection 24^2 (4) of the Accounting Act, a large undertaking whose securities granting voting rights have been admitted for trading on a regulated securities market of Estonia or another Contracting State shall describe in the corporate governance report the diversity policies carried out in the company's Management Board and senior management and the results of the implementation thereof during the accounting year. If no diversity policies have been implemented during the accounting year, the reasons for this should be explained in the corporate governance report.”

LHV has not deemed it necessary to implement a diversity policy, as LHV is governed in the recruitment of staff and management members by the best interests of LHV – the education, skills and previous experience of the person on a gender neutral on non-discriminatory basis and upon need, compliance to statutory requirements.

Tiina Mõis serves as a member of the Supervisory Board of LHV and as a member of the Risk and Capital Committee, and Kristel Aarna as a member of the Audit Committee. LHV's subsidiaries employ a total of 74 middle-level managers, of whom 21 are women; in addition there are nine Management Board Members, one of whom is a woman.

Social responsibility in LHV

LHV Group takes its social responsibility seriously. We wish to act and grow in a sustainable manner and contribute with our activity to the tackling of local as well as global challenges, as in this way we also improve the future operating environment of LHV. To do this, on a daily basis we think more broadly than just about LHV's own business.

- We promote the local economy and capital market in Estonia.
- We offer sustainable products and services.
- We keep the working environment in LHV motivational and developing.
- We assess and reduce the environmental impact of our operations.
- We contribute to society through increasing money wisdom and various support projects.
- We implement a transparent and responsible management culture.

We are aware that the impact of LHV Group in the Estonian financial sector is increasing and being a part of the important business sector for society, we have a direct as well as indirect influence on the environment surrounding us. At the same time, our most extensive direct impact arises from investment and financing operations. Through our core activity we are able to direct cash flows into sustainable and responsible activities.

On the other hand, being a transparent and public company, LHV also has the role of an opinion leader and it is in our hands to contribute to the formation of the prevailing mindset towards responsibility in entrepreneurship by leading the way. By communicating with different target groups, including clients, we can raise awareness, share knowledge, recognise responsibility.

Expectations to the financial sector

In addition to honest and transparent activity, the banking sector is facing new requirements, moral expectations and global cooperation initiatives supporting these, which assume setting a clearer focus on responsible and sustainable business. Global challenges bring the promotion of a positive environmental impact and social welfare increasingly into focus for the financial sector.

The year 2019 was a year where higher attention than ever before was paid to climate change and ecological problems throughout the world, coming more and more to the forefront in the business sector as well. For example, in the latest risk report published by the World Economic Forum (WEF), the risks dominating in the top list of risks that threaten the world, based on the likelihood and impact, are environmental problems. For the first time in history, all five most likely risks were related to environmental problems (these were extreme weather, loss of biodiversity, failure of climate measures, natural disasters, man-made environmental disasters). Clearly, there is also a prevailing trend in the financial sector to place higher priority on sustainable development and understanding of the urgency of the situation is improving.

Development of LHV's principles of responsibility

In 2019, the definition of responsibility was given a new dimension in LHV. We launched an extensive series of projects, the substantial work and public communication of which is to be carried out in 2020 and at a later time. The inclusion of LHV's employees in September was a landmark. A survey was organised among LHV's employees on corporate social responsibility, in which 162 employees (39%) attended, as well as an idea hackathon with more than 60 participants.

While the most popular choices in the employee survey were related to the economy, financial literacy and management, the following idea hackathon helped to see the wider need to also discuss the environmental issues in the future more. As LHV has already previously strongly contributed to the topics of social responsibility, financial literacy, support of economy and management quality, our target now is to also better manage the impact of our further activities in the environmental and climate areas.

In 2020, we intend to create an umbrella of LHV's sustainability principles, by phrasing the principles of corporate social responsibility more broadly and establishing the relevant goals. In doing so, we will proceed from the **UN Sustainable Development Goals** or the so-called SDG-s. The results of initial analysis revealed that LHV has the highest likelihood of influencing eight global goals.

- End poverty in all its forms everywhere
- Ensure healthy lives and promote well-being for all at all ages
- Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
- Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation

- Ensure sustainable consumption and production patterns
- Take urgent action to combat climate change and its impacts
- Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels

The goal for 2020 is to move on with our analysis by also involving external stakeholders and thereby developing more important sustainable development goals to which we can contribute.

1. Promotion of the economy and capital market

Promotion of the Estonian economy and capital market is a part of LHV's mission. The better the economy, the higher the welfare of Estonian people. We recognise the role of LHV as an influencer of the economy – we want to have an impact on Estonian entrepreneurship as well as on the financial behaviour of the people of Estonia towards smarter management. We apply our strategic strengths – investment and entrepreneurial experience – in order to enable the growth of a modern and viable financial group based on Estonian capital, that helps Estonian companies and people invest their money, and is the most internationally cooperative partner for companies developing financial technology. We are the largest domestic capital provider in Estonia.

Economic value created by LHV Group in 2018-2019

EUR thousand	2018	2019
Total taxes paid	**7 180**	**8 631**
Taxes paid (except labour taxes)	3 614	4 249
Labour taxes	3 566	4 382
Salaries paid	**12 190**	**14 883**
Jobs created	**70 jobs**	**55 jobs**
Dividends paid	**4 123**	**5 463**
Purchases from suppliers	**20 180**	**26 560**
incl. Estonian suppliers (%)	77%	69%
Investments made	**1 632**	**2 200**
incl. investments on innovation	905	697

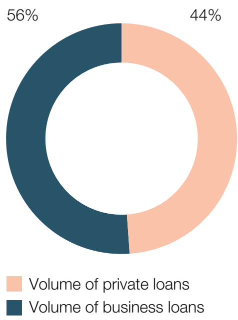
Promotion of credit market

As a local financial group we bring capital from Estonian depositors by directing it to Estonian companies. LHV has loan products that meet the needs of Estonian companies and private individuals. Our role in financing the plans of Estonian people and companies has grown strongly.

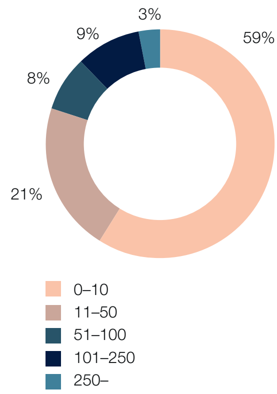
We offer our private clients loan products ranging from student loan and small-scale financing to home loans. In 2019, we took over the private loan portfolio of Danske Bank Estonian branch.

At the end of 2019, LHV's loan portfolio amounted to EUR 1.7 billion. At the same time, LHV's market share increased to nearly 10%. We are a caring financial partner for Estonian companies of all sizes. We have the competence and desire to delve into the plans of Estonian companies and provide them with support in implementing these plans. As an intermediary of domestic capital we respond fast and make decisions on the spot. Together with Kredex, we can offer credit to companies that do not have enough collateral to borrow. In cooperation with the European Investment Fund, we have improved the credit facilities of small and medium-sized enterprises. We also offer trade financing products.

Division of the loan portfolio by private and business clients



Division of business loan portfolio by number of employees in the company



Promotion of the economy through pension funds

The aim of LHV pension funds is to become Estonia's most important institutional investor. This role contributes to the development of capital market. Through pension funds, the money of pension savers helps the local economy, while growing the investment value for the saver.

Over the last three years, LHV funds have notably increased their investments in Estonia. In 2017, the investment decisions concerning Estonia (also include future commitments to invest) amounted to EUR 170 million, in 2018, EUR 153 million and in 2019, EUR 60 million.

From the investments directed to the local market we could highlight the purchase of an office building at Akadeemia tee, known as the Skype-building, as well as the bond investment of Ekspress Group. In addition, the Lumi Kodud rental home project with 127 apartments was completed in Tallinn.

Also, several local venture capital funds in which LHV has a holding, invested in domestic companies. Funds were raised by innovative companies of different sizes and different fields, such as Bolt, UpSteam Eesti, Eziil Productions Intelligence, Fractory Solutions, Vumonic Datalabs.

In order to provide the best possible overview to the people about their pension assets, in 2019 LHV launched a unique app My Pension, where people can view the size of their I, II and III pension pillar assets and the potential monthly pension payment achieved with the accumulated assets upon retirement. The app can be used by the clients of LHV pension funds as well as by people who save for a pension elsewhere. We believe that modern, smart and good tools help people make the best decisions for their future.

Export of financial services

Through the operations of the UK branch, LHV Pank has become a financial services exporting company. We commission the services created in Estonia to serve international FinTech companies. By doing this, we have contributed to the development of innovative global services and tightened relationships between the financial system of Estonia and other countries. Operating on a highly competitive international market develops the people of LHV, increasing their knowledge.

We are a contributing partner to FinTech companies. Although our clients have innovative ideas, they often lack access to the banking infrastructure. The services of LHV help to solve this problem. The clients aim to increase the speed, convenience and availability of financial services. New service providers bring the client a new level of quality of service, making it more available and affordable. Therefore, we contribute to the growth of competition and help to expand the opportunities of end-consumers.

In 2019, we continued to provide services to the clients of the financial intermediaries business line. In spring, we opened access to virtual IBAN services and real-time euro payments to them, based on which the financial intermediaries can create new services and speed up the movement of money. In May, we technically joined the pound payment system as a direct member. By doing this, LHV Connect became the first bank application programming interface (API), through which financial technology companies can access euro and pound payments. We opened pound payments for clients in January 2020.

Development of Estonian banking

Together with the expanded market share we also acknowledge the increased role of LHV in the development of Estonian banking sector. Besides competition, LHV has constructive cooperation with other actors in the financial market. As market participants we have a say in developing public policies; we aim to develop the Estonian business environment and B2B cooperation by enhancing partnership, innovation and transparency. We create and develop our services based on the principles of open banking. At the same time, we are also a partner to the state in developing innovative solutions.

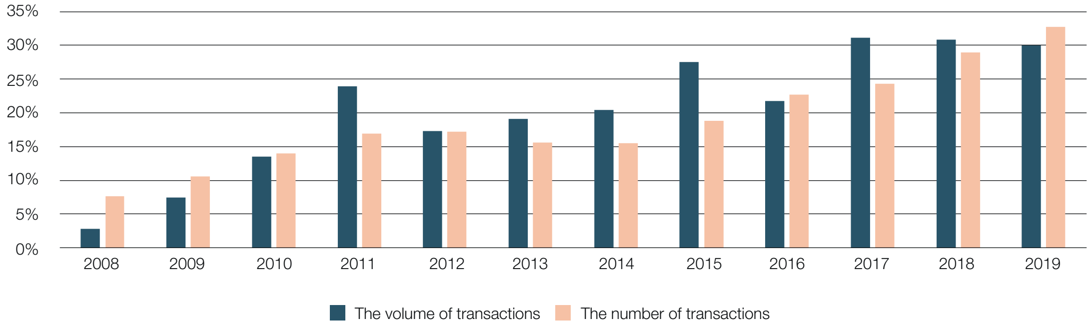
LHV Pank is an active member of the Estonian Banking Association. Additionally, we cooperate with other financial service providers through the non-profit association FinanceEstonia. We contribute to cross-sectoral issues, such as the sharing of money wisdom in Estonia, law making, the adaptation of regulations, prevention of money laundering and tackling terrorist financing, and processing payments. In 2019, Erki Kilu, Chairman of the Management Board of LHV Pank, was the Chairman of the Board of the Estonian Banking Association. LHV is represented in the work of all 28 units/workgroups of the Banking Association. Seven units are led by LHV. At the beginning of 2020, we initiated the formation of a sustainable banking workgroup at the Banking Association.

Development of capital market

As an institutional broker, LHV Bank helps Baltic companies to engage funds from investors. In 2019, we assisted AS Coop Pank in organising the initial public offering of shares. We helped the Lithuanian agricultural company AUGA in issuing green bonds. We also helped other Baltic companies to raise money from the public market and advised them on important transactions.

LHV Pank is the leading market participant on the Baltic stock exchanges. Our daily brokerage activities as well as our efforts to set an example, contribute to the functioning of Baltic capital markets. In 2019, LHV Pank received the "Best Stock Exchange Member of the Year" award of the NASDAQ Baltic stock exchanges. LHV has received this award six times altogether. We have become the market leader in the Baltics in terms of trading activity of exchange members. We prepare and publish analyses about publicly listed companies in the Baltics. We are market makers for 7 publicly traded companies.

LHV's market share on the Baltic Stock Exchange over the years 2008-2019



The best investor relations in the Baltics

As a public company we aim to lead the way in governance and communication with the public. We want to organise exemplary investor relations, act in an open and transparent manner, adhering to all requirements established with the Rules and Regulations of the Stock Exchange. We want to maximise transparency, for example by disclosing for this purpose, the salary of the issuer's management board, continuing to publish the monthly reports and financial plans. We would like as many clients and partners as possible to be shareholders and investors in LHV and to participate in the building of our shared business.

As a result of the above, Nasdaq declared LHV Group a public company with the best investor relations in the Baltics in 2019.

2. Sustainable products and services

LHV wants to conduct its daily business in a way that is sustainable in the long run and based on responsible decisions. We are not only concentrating on maximising short-term profits, but we also keep in mind the long-term, mutually beneficial relationships with the market, partners and clients.

Products and services tailored to the client's needs

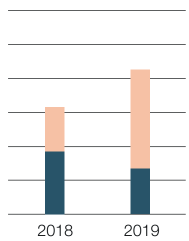
We focus on active and independent clients with an enterprising frame of mind. We position ourselves as a local bank in Estonia. We are a home bank offering a full service for clients whose income is received in LHV and who are actively using our services. In terms of asset management, our long-term ambition is to become a pension fund manager in Estonia who grows the assets of clients in the best way through a high rate of return.

For them, we are a partner who is reflective, understands the needs of clients, and offers the most advanced banking services and the best service. New initiatives can be implemented much faster and more successfully if the parties involved have the same interests and each other's long-term support. In relations with all stakeholders, we consider partnership, honesty, goodwill, engagement, transparency and trust to be important and wish to create long-term value for the stakeholders.

By virtue of the stakeholder, our products and services are simple, transparent and appropriate. Client interaction is mainly conducted using modern electronic communication channels. The saved costs will reach our clients through affordable prices of everyday services.

As we value highly innovative thinking, we contribute to ensuring that our solutions and services offered to clients are modern and internationally excellent. In 2019, the Entrepreneur Account created through the cooperation of LHV and the Tax and Customs Board was awarded the innovation award of the Banking Association, as the most innovative solution in Estonian banking; our innovation is also reflected in the development of electronic channels.

Investments in innovation



	2018	2019
Investments	1,632	2,200
incl. R&D investments in innovation	905	697

The best service in Estonia

We want to offer impeccable, caring and polite customer service. Our respect for our clients is reflected in understanding the client's needs, in our responsibility, in our availability to our clients and effective administration. We offer our clients convenient and diverse communication channels for communication. The official channels include phone, e-mail and live chat; information and feedback can be shared on social media channels and through the LHV financial portal.

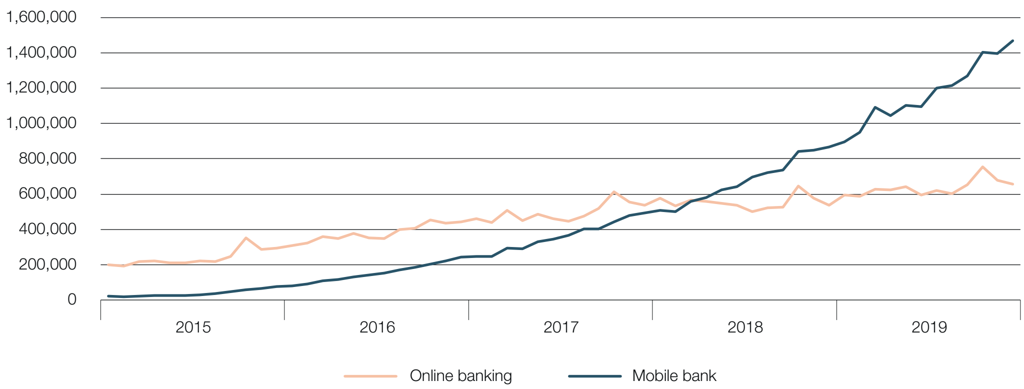
- LHV was declared the best Estonian bank for the second year in a row by Euromoney.
- The Banker named LHV bank of the year 2019 in Estonia.
- According to the survey of the survey company DIVE, LHV Pank is the bank offering the best service in Estonia. In the service study of 2020, we achieved the score of 90.1% out of the maximum (target >90%).
- We organised mystery shopping events internally as well as for our partners 132 times altogether, the consolidated result of which was 93.4% (target >90%).
- Requesting feedback, to learn what the clients like or what we could improve, continued to be important in 2019. We asked for feedback to e-mails or phone calls on 105,402 occasions. We received feedback from 36,069, i.e. 34.2% of clients and 93.5% (target >90%) of them were satisfied with the service. The number of clients who were dissatisfied, identified deficiencies or made proposals, was only 2344.
- All client complaints and proposals are registered and taken into account when organising the bank's work. In 2019, LHV Pank registered 138 client complaints (338 in 2018). Complaints were solved efficiently, transparently and quickly.
- Starting from 2019, the clients can chat on LHV's homepage with a virtual assistant Uku, to get fast real-time answers. The chatbot answered 45% of the questions automatically without the help of a human assistant.
- Additionally we implemented an in-house self-assessment environment Soket in the second half of the year, helping our employees to test and improve their knowledge about the company and services. The response rate to the 15,000 questions asked was 83%.
- In February 2019, we organised an in-house service month for LHV, where we paid attention to good service and organised evaluations more than usual. We have taken various steps for the engagement of clients.
- We organise regular internal training sessions and the necessary certification to provide the best customer service. In order to provide the best service, in addition to a customer service book, we have also developed a literary standard textbook, as LHV considers it extremely important to communicate in a simple and human way using correct Estonian language. During the year we organised 191 training sessions for the service team plus weekly language courses and statutory training across the company.

Available services, the best electronic channels

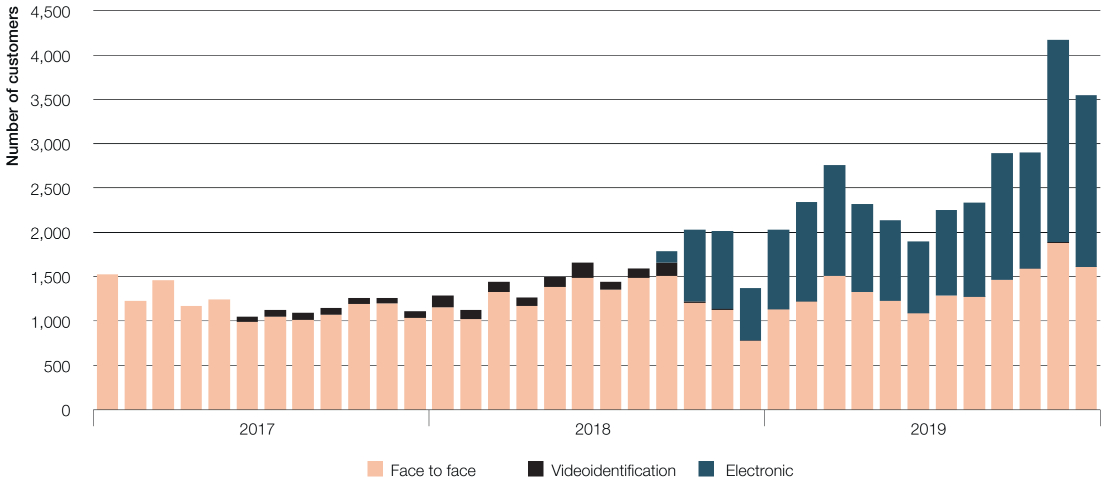
When providing the services, LHV deliberately focuses on electronic service channels. This helps clients to access the services as easily as possible, saving the environment, resources, manpower, etc. In 2019, we developed the LHV mobile app as the first priority. Over the year, the app was supplemented by the following services: account opening, ordering of a bank card, forwarding money request, securities transactions, application for loan. Internet Bank is still the number one service channel.

Electronic channels provide significant added value to target clients. The availability of the service has been greatly supported, above all by offering electronic identification. LHV clients can open accounts, use services, sign agreements, and make transactions by using the options of electronic identification and signing. For clients, this reduces the time spent, helps save on transport, etc. We have also considered the needs of visually impaired people when developing our channels.

LHV online banking and mobile bank usage activity by login



Identification upon onboarding of customers (private customers)



Secure and fair services

In terms of responsibility, it is of the utmost importance to ensure the protection and security of clients when providing the service, besides access to services, meeting the needs of the target group and modernity. This is why we pay attention to the below aspects for services.

Responsible lending

We strive to minimise any negative social impact involved in financing products. LHV's credit policy stipulates acting in a socially responsible manner. All credit decisions are governed by the principle that LHV does not finance counterparties whose activities are liable to cause disproportionate damage to the environment or do not comply with the principles of social responsibility. When crediting private individuals we make sure that we introduce the products to the consumers in a balanced way and do not encourage them to make financial decisions that may prove harmful to them.

Protection of a banking secret

LHV's operations are based on trust. Clients' assets and personal information are reliably protected at LHV. We treat all the information related to our client, including the fact that they are our bank's client, as a banking secret. LHV's employees are not permitted to disclose client-related information treated as a banking secret to persons who are not entitled to such information. We have applied measures to ensure that client data are kept confidential, including legally required security measures for the protection of personal data and prevention of the processing of personal data by unauthorised persons.

Information security and cybersecurity

LHV takes information security and the protection of clients' data seriously. LHV has formed a separate team for this purpose. We organise information security training in the company. In the Banking Association, we engage in cooperation with other banks to raise awareness on topics related to information security.

In 2019, the number of cyberattacks in LHV's area of activity increased. Although there were also attacks against LHV's systems in 2019, there were no data leakages in any of the cases. In the second half of the year, the volume of phishing letters and messages increased, also resulting in losses for unsuspecting clients. We made serious efforts to recover as large a part of the client's funds as possible. We also organised a notification campaign to warn clients. Additionally, we implemented several technical measures to reduce the possibility and impact of fraud. Thanks to the measures taken we have managed to significantly reduce the scams committed with Smart ID.

In the second half of the year, LHV experienced Ransom-Driven DDoS (RDDoS) attacks that gained momentum in Scandinavia. An extensive RDDoS attack was also directed against LHV's services, however we also managed to keep the bank services available to clients with minimum interruptions during the attacks. We plan to develop the resilience of our infrastructure in the near future.

Prevention of money laundering and terrorism

We clearly acknowledge the higher expectations of society, legislators and supervisors in respect of the AML. This is a topic on which the sustainability of the financial institutions themselves depends, as demonstrated by several events on the market.

We are exemplary in respecting all the requirements for identifying clients and the persons related to them by understanding their activities, i.e. the KYC principle. We take a risk-based approach in our operations. We also monitor our clients' activities to identify operations raising a suspicion of money laundering or terrorist financing. LHV implements international financial sanctions and does not offer services to entities subject to them. LHV Pank pays particular attention to the clients who offer financial services to their own clients. When providing services to such clients, the same due diligence measures as those used in the provision of correspondent banking services are implemented.

Also in 2019, we continued to increase our anti-money laundering and terrorist financing team, which is active in both LHV Pank as well as the bank's external initiatives. We also significantly upgraded the monitoring and screening systems. In both areas we selected and implemented the software solutions of internationally known service providers. LHV's employees are leading both AML and compliance control working groups in the Estonian Banking Association. Through the said working groups, but also other channels, we provide our input to the legislative process, help to develop good banking practices, and are active in the development of the entire anti-money laundering and terrorist financing system. We also engage in active cooperation with supervisory bodies.

Fair competition

We are accurate, honest and respectful towards the competitors, and avoid talking poorly of them in any way. We abide by the principles of fair competition, and shall only use legal and ethical means for gaining a competitive edge. Any agreements or concerted practices between market participants, which have the restriction of competition as their object or effect are prohibited.

Honest and transparent marketing and communication

LHV abides by the generally accepted marketing principles and shall neither use information that does not reflect reality nor demean competitors in advertisements. We ensure that any information provided to clients, including all marketing materials, is factually correct, easily understandable and competent, and draws sufficient attention to the potential risks and costs related to the service. LHV has compiled their advertising content guidelines. LHV has internal control measures to make sure that their advertising is in compliance with the law and its internal regulations.

Any stock exchange announcements, press releases and statements published by LHV are accurate and timely, without distorting any facts. Our statements give an open, true and fair view of the financial position, economic results and cash flows. We comment and provide information on topics related to LHV's business activities. In 2019, we informed the public with 50 stock market announcements and 39 press releases.

3. Motivating and developing working environment

People are the most important assets of LHV. The team of LHV is a community of 430 people, who carry the corporate values and act towards a common goal. We strive for an honest, open and supportive internal climate. LHV aims at being the best employer, so that every person in the company can be involved in the development of the company, feel the importance of their contribution and prosper professionally.

We want the employees to have a view of an owner in respect of LHV, which is why we have established an option programme, that is the performance pay programme for key employees, thereby integrating the interests of owners and those receiving the performance pay and encouraging focussing on long-term performance while considering the risks.

Our goal is to increase the job satisfaction of LHV's employees and motivate them, raise their competence (knowledge, skills, experience and capacity), expand personal fulfilment opportunities, guide the development of staff satisfaction and ensure the availability of young talents, and foster the feelings of solidarity and pride. The main focus of LHV as an employer is set on an inspiring organisational culture and a good feeling of employees when coming to work every day and "fulfilling" themselves.

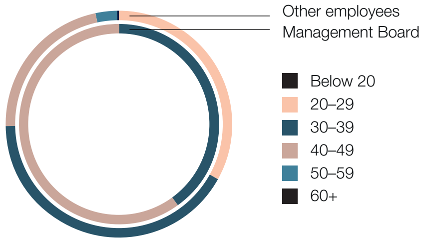
LHV is a fast-growing company, which is also reflected in recruitment. In a year, LHV created 55 new jobs. Of all people in LHV, 94% work full time. In 2019, the voluntary staff turnover in LHV Group companies was 10.9%, being higher than the 7% in 2018 (9% in 2017). Generally, staff turnover in Estonia is on the increase, as the average number of years people work with one company is dropping. Nevertheless, the LHV's indicator is good and shows satisfaction with the employer.

In the selection of LHV's employees and executives, we are guided by LHV's best interests and therefore make the choices in a gender-neutral and non-discriminatory manner based on the person's education, skills and prior experience and, if necessary, requirements arising from the respective legislation. LHV has not found it necessary to implement any diversity policies. In our remuneration policy, we are objective and unaffected by the employee's person. If required for the positions, we always check compliance with the entry criteria.

Equal treatment and non-discrimination of employees is important for LHV. In 2019, there were no such violations in LHV. There were no labour disputes, discrimination cases or violations of human rights.

Gender division of employees in 2019

Division of employees by age in 2019



We include employees

We have developed various measures to get feedback from our employees and encourage in-house communication. Every two years, we hold an employee satisfaction survey. As the survey was not conducted in 2019, we plan to do it in 2020. In 2018, the satisfaction survey was filled in by 290 employees, which is 79% of the whole staff. The overall result of the survey was 6.2 points (out of 7); the overall net promoter score was 71%, which was a record result. Our goal is to improve this score. We take employees' suggestions into account in our management decisions. Employees can give their input and contribute to the development of the company at meetings and strategy days. We collect feedback from new employees at the end of the probationary period and take it into account in the organisation of their future work.

Development of employees

We contribute to the individual development of our people. LHV's training department is guided by a person-centred approach, based on the personality needed to improve the skills, motivation, qualifications, including providing training, teaching materials etc. If necessary, we offer rotation within LHV. We have developed an internal training programme, including thorough training for new employees and language courses. In 2019, the development programme organised for the development of executives and getting their feedback has showed good results. Training designed for executives has provided the managers with practical tools to improve the management, instructions for smoother internal communication, advice for recruitment on the renewed labour market. Based on the feedback from executives, there has been an improvement in their skills in communicating with different parties, mutually sharing their experience and support. We are updating the format of performance and development discussions to make sure that people benefit more from it. In 2019, about nine out of ten employees participated in performance and development discussions.

We promote employees' health

LHV contributes to the physical and mental health of its employees. We offer the employees of LHV a possibility to use the free psychotherapy service for personal or professional consultation and also support the sports initiatives of employees (such as football, basketball, volleyball, squash, tennis, badminton, public sports events) and offer sports benefits (sports expenses, rehabilitation). The employees are provided quarterly health compensation, which was used actively in 2019: AS LHV Pank 70%; AS LHV Varahaldus 76%; AS LHV Finance 73%. In April we organised a Health Week and provided our employees courses on nutrition, exercise, mental health.

We reimburse dental care. We provide vaccinations. LHV has an outstanding occupational health package. LHV is part of a health-promoting network of employers. We consider health care recommendations: we use eye-sensitive computer screens, 100% adjustable chairs and desks, and, if necessary, provide people with assistive devices. In the office, we have healthy and natural carpeting with high wool content. The share of sick days in LHV companies in 2019 was 0.74%.

A work environment council operates at LHV, including the representatives of both the employer and the employees. We emphasise occupational safety. All worksites have undergone risk analysis. On each floor of the offices, there are first aid assistants who have received the required training, and those responsible for fire safety. There were no occupational accidents at LHV in 2019.

Winter office

For the third year in a row we enabled the employees to work partly at a winter office. In 2019, this remote work opportunity in Cyprus was used by 150 people (130 people in 2018). Employees were provided with a workplace and part of their transportation costs was covered. The winter office has received positive feedback and the project will continue next year.

We maintain balance between work and family life

We value a suitable balance between the employee's work and private life and among other goals, as a family-friendly employer, we wanted to harmonise our activities with the family-friendly employer programme of the Ministry of Social Affairs. As a result of two years of work we earned the gold level of family-friendly employer in 2019, which means that LHV supports its employees at every stage of their life. We try to consider the personal needs of people working at LHV as much as possible. For example, we can offer students part-time working hours or, if possible, flexible working hours. To ensure a good work-life balance, we value family life: upon the birth of a child, fathers are also granted 15 days' leave, employees receive monetary bonuses when their child starts school, can work reduced hours on their child's birthday, and get a day off for marriage. We offer a childbirth allowance and a death grant. We have special events for employees with families: family days, children's Christmas party.

LHV is a recognised employer

LHV as an employer has also been noticed outside of the company. In the employer survey of CV-Online, published at the beginning of 2020, LHV was considered the second most attractive employer in Estonia. We were also recognised as an attractive employer among students of economics and experienced specialists (based on Instar survey). Attractiveness as an employer enables LHV to have flexible recruitment, as the interest in LHV has improved year by year. During the year we communicated with more than 3,500 candidates and selected 4% of them to work with us. We have also placed emphasis on requesting the candidates' feedback and this process has been significantly improved by implementing the greenhouse recruitment software. We also give feedback to the candidates. We take care of our young talents by offering traineeship and job-shadowing. Every 10th employee started at LHV as a trainee. In 2019, we hosted 13 trainees, of whom 1 continued to work at LHV.

4. Managing environmental impact

Climate change occurring as a result of human activity is the biggest challenge of this century. Achievement of the goals set out in the Paris Agreement on climate requires the joint effort of all sectors and parties of society. At the same time, the financial sector, directing the cash flows, has a specifically important role in supporting transition to a climate-neutral economy. LHV understands the critical nature of environmental and climate problems and has accordingly placed the topic under sharper focus, to take effective and fast steps towards a more sustainable future.

In the second half of 2019, LHV initiated a series of projects for the better management of environmental impact in order to define more detailed goals and create action plans for moving towards climate-neutral operations. A significant input for this came from LHV's hackathon, held in October, where the participants elected the best ideas, namely those that relate to the mitigation of environmental impact. Accordingly, the hackathon helped to map an important direction for LHV and raise awareness of the employees' expectations about the better management of environmental impact. The input obtained from the event was worked on further and by the end of the year, strategic focuses of the environmental projects were laid down and external experts involved to support their implementation.

It was agreed more specifically on the managerial level that in 2020, LHV will take next steps to reduce its negative CO2 footprint:

- Within the UN Environment Programme, we will join the **UN Principles for Responsible Banking**, taking on the commitment to define the societal, economic and environmental impact of our activities, and formulate the principles of LHV's sustainability; to prepare a strategy that conforms to the UN Sustainable Development Goals and clearly considers the bank's environmental impacts; and to transparently report our progress and challenges in achieving the goals we have set;
- We begin by **evaluating the environmental impacts of our products and services;**
- We will begin measuring our carbon footprint to achieve a **carbon-neutral LHV by 2022;**
- We will bring new financial products focusing on responsibility and sustainability to our clients, to offer green alternatives to existing financial products and services;
- We will actively engage in applying for the **Green Office Certificate** for our Tallinn and Tartu offices;
- **We will increase the awareness of our employees** and involve them in being more environmentally friendly in our activities;
- We will **cooperate with clients** to also help them take their environmental impacts into account and reduce them;
- **We will support cooperation and information exchange within the sector** to accelerate the transition of the whole financial sector to a more sustainable foundation;
- We will examine the opportunities to apply for a LEED or BREEAM certificate for our Tallinn office building.

LHV is only at the beginning of this journey, but we are committed to reducing our negative environmental impacts and fulfilling the goals set out in the Paris Climate Agreement. We will involve experts and stakeholders, and promise to be more open and transparent in our activities. We will also cooperate with other market participants: for example, in the Estonian Banking Association, within the new panel of sustainable banking; through MTÜ Finance Estonia, we will support organising a conference on the topic of climate in 2020.

Environmental impacts of LHV's offices

From the beginning of LHV's operations, the effect of our office on the natural environment has been limited due to our operating procedure. We do not manage a wide network of offices, and we offer our services through electronic channels, which reduces the effect of LHV's operations on the natural environment to a certain extent. LHV Group companies are located in three places of business, in the centre of Tallinn and Tartu, and also in London. In 2019, LHV is also rented a smaller office space on Telliskivi Street in Tallinn.

In recent years, we have worked towards our offices having a smaller environmental impact:

We have reduced the use of paper (paperless document management, electronic client agreements, the so-called follow-me solution during printing). We separate the waste paper from other household waste. In 2019, LHV spent 1872 kg of paper.

To reduce water consumption, we use tap water at our offices, instead of water dispensers. In 2019, LHV offices used 2474 m3 of water.

To reduce transport volumes, we have adopted electronic means of communication for holding meetings.

We use energy efficiently. In 2019, LHV offices consumed about 409 498 kWh of electricity. For heating 1474.47 mWh of thermal energy was used.

At our offices, we adopted a system that allows for waste sorting. In 2019, LHV generated about 200,000 litres, i.e. 40 tonnes of waste. This means about 93 kg of waste per year, per one employee.

In 2019, the employees of the companies in LHV Group travelled a total of 716,247 flight kilometres with 639 flights related to work (in 2018, 1,103,797 km on 911 flights).

In relation to the aforementioned environment-related projects, we are already planning to collect significantly more data about LHV's activities in 2020, and to give an open overview of these in the reports to come.

5. Contributing to increasing financial wisdom and the development of society

Partnership, as an operating principle of LHV, is also reflected in our wider contribution to society. We are a part of the communities, into the life and activities of which we regularly contribute. Good examples here are the investor community, football community, but also many other spheres in social life.

The Estonian investor community is closely associated with LHV. On the one hand, it is reflected in our activities as a listed company; and on the other hand, in our activities which we perform to increase investor education. LHV Group has over 9000 equity or bond investors.

As a leader of the investor community, LHV takes responsibility for sharing money wisdom and advancing investor education. We contribute through the following activities:

- We organise the Investment School seminars, free of charge, which have over 6000 participants (aim: 5000; participants in 2018: 4700).
- We organise the annual stock market game Börsihai, where 4600 interested people participated (in 2018: 2600).
- We participated in projects for improving financial wisdom, organised by the Estonian Banking Association.
- We have set up and we manage a library of investment and economic literature for our clients.
- LHV manages the LHV financial portal and the forum set up for discussing investment-related subjects and sharing information.
- We offer simple products to investors for getting a start, such as the Growth Account.
- In 2019, we published the free-of-charge web magazine “Investeeri”, addressing various topics related to entrepreneurship and investing.
- We supported the news portal Rahageenius, which provides economy-related content to regular consumers.
- We organised activities on the topic of financial wisdom within LHV Youth Bank.

Sponsorship

Within its means, LHV supports activities and initiatives which contribute to the development of Estonian society. In our sponsorship projects, we prefer long-term and substantial cooperation.

Estonian culture and society

- Estonian Music Days – for four years already, we have supported the Estonian New Music Award, which was awarded to Helena Tulve in 2019.
- Enn Soosaar Foundation – we support issuing the Ethical Essayists Award. In 2019, the award went to Hasso Krull.
- Intsikurmu Festival in Põlva – we supported the organisation of the festival for the fourth time to help deepen common cultural values in society through art, music and nature.

Sport and a healthy lifestyle

- The Estonian Football Association – LHV Pank has been the main sponsor of the Association and the Estonian National Team since 2010. In addition, we have created the support system of LHV's Football Card that earned 77,694 euros for Estonian football clubs in 2019. The Football Card system enables us to unite and maintain the football community.
- Estonian Optimist Class Association – we have helped to ensure the sustainability of Estonian sailing for more than ten years. With the support of LHV, the activities of the association were revived in 2007 when active work started again, sparking interest in sailing among children.
- Running competitions – in 2019, we supported the Peetri Run and the Rapla Selver Grand Run.
- We organise a corporate football event, the LHV Cup. In 2019, it was held for the third time.

Economy and Entrepreneurship of Estonia

- Estonian Entrepreneur of the Year competition – we have been one of the main sponsors of the Estonian Entrepreneur of the Year competition since 2012. In 2019, the title of Entrepreneur of the Year was awarded to Tõnis Kaasik.
- The Gazelle movement – LHV is the sponsor of the Gazelle movement. The movement supports and acknowledges rapidly growing Estonian companies.
- We supported organising the tech conference Latitude59 for the third year in a row.
- We supported organising TEDx Lasnamäe.
- We support many smaller local initiatives with our knowledge, LHV's thematic gifts, advice and performances by our people. We participate in fairs, cooperate with universities, also within the framework of internship programmes. We belong to the Estonian Association of Information Technology and Telecommunications, the Estonian Chamber of Commerce and Industry and the Estonian Employers' Confederation. We also consider it essential to help Estonian producers and companies through our procurement and cooperation relations. LHV consciously uses the products and services of Estonian entrepreneurs.

6. Transparent and responsible management culture

Responsibility is one of our operating principles and one of the prerequisites that LHV's mission, vision and values are based on. We believe that an ethical and appropriate course of action will ensure success in the long term. Therefore, all LHV's managers and employees must behave ethically and responsibly. Following the Code of Ethics is mandatory for all of LHV's employees.

LHV's Code of Ethics is the foundation of LHV's various policies, including the Company Governance Policy, internal rules and procedures governing the specifics of adherence to the Code of Ethics. Primarily we rely on lawfulness, good practices and the principle of common sense, doing our job responsibly, transparently and openly. The work of the Supervisory Board of the Group is supported by different committees: the Remuneration Committee, the Nominating Committee, the Audit Committee, the Risk and Capital Committees. LHV's basic principles of governance are described in more detail in the "Best Practice of Corporate Governance".

The LHV management structure is organised in an easy-to-understand manner and includes understandable lines of responsibility. One important part of responsible governance is a high level of risk management and analysing our own activities. LHV takes the mapping and mitigation of credit risks, liquidity risks, market risks, crime risks, and operational risks very seriously. The supervisory board, the management board and subdivisions pay attention to this. We have three lines of defence for risk monitoring and risk control. The internal control framework covers both well-functioning independent risk management, compliance checks and staff performing audit functions. Management has established the necessary committees to advise on risk management. The company gives a comprehensive overview of the risks in the annual "Risk and Capital Report of AS LHV Group".

In January 2020, the credit rating agency Moody's again assigned LHV Pank an investment grade credit rating, confirming a sustainable strong financial profile and its ability to serve the commitments taken.

The important role of responsible management is coordinated with legislation and sector-specific rules. LHV is precise and cooperative in dealing with regulators and monitoring agencies. We comply with all obligations and accountability arising from the law. In 2019, no nonconformities to regulations or requirements were identified regarding LHV.

We have acknowledged the complexity of the legal environment, which is why the management board and the supervisory board are given regular reviews of the changes. In our business development, we are trying to find a balance between requirements and opportunities – a high level of awareness and a risk-based approach enable better decisions to be made. We are working on possible changes as early as possible to avoid the later realisation of risks.

As the regulation of banking increases, so do the costs related to fulfilling requirements. The changes also involve sanctions for breaching the regulations. It must be taken into account that Estonia is transposing the financial sector punishments set out in European Union Law. There are no grounds for thinking that the supervision is not ready to implement these. Considering the changes in the environment, the Financial Supervision Authority has also changed its management structure. The area of responsibility of the new field is management of risks related to regulations, and enforcement. We also take these changes into account and continuously implement measures to effectively manage conformity risk.

In addition to everyday activities of identifying changes to regulations and assessing their effects, among other things, in 2019, we have separated compliance control and risk management for improving the efficiency of compliance control and emphasising its independence, and have brought compliance control in LHV Pank under the direct subordination of the Chairman of the Management Board.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of profit or loss and other comprehensive income

(in thousands of euros)	Note	2019	2018
Continuing operations			
Interest income		61 414	45 622
incl interest income based on EIR		57 805	43 047
Interest expense		-14 026	-7 471
Net interest income	5, 7	**47 388**	**38 151**
Fee and commission income		37 026	32 844
Fee and commission expense		-11 349	-7 799
Net fee and commission income	5, 8	**25 677**	**25 045**
Net gains from financial assets measured at fair value	5, 11, 12	591	379
Foreign exchange rate gains/losses		79	64
Net gains from financial assets	5	**670**	**443**
Other income		93	905
Other expense		-9	-43
Staff costs	9	-19 265	-15 756
Administrative and other operating expenses	9	-20 003	-16 387
Profit before credit losses		**34 551**	**32 358**
Impairment losses on loans and advances	5, 13	-3 210	-4 879
Profit before income tax		**31 341**	**27 479**
Income tax expense	5, 6, 27	-4 249	-3 614
Profit from continuing operations	5	**27 092**	**23 865**
Profit from discontinued operations	26	**0**	**3 324**
Profit for the year		**27 092**	**27 189**
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Changes in the fair value of debt instruments measured at FVOCI		0	-36
Items that will not be reclassified to profit or loss:			
Net gains on investments in equity instruments designated at FVOCI	11	134	78
Total profit and other comprehensive income for the year		**27 226**	**27 231**
Total profit attributable to:			
Owners of the parent		24 797	25 237
Non-controlling interest		2 295	1 952
Total profit for the year	5	**27 092**	**27 189**
Total profit and other comprehensive income attributable to:			
Owners of the parent		24 931	25 279
Non-controlling interest		2 295	1 952
Total profit and other comprehensive income for the year		**27 226**	**27 231**
Basic earnings per share (in euros)	25	0.91	0.97
Diluted earnings per share (in euros)	25	0.89	0.96
Basic earnings per share (in euros) from continuing operations	25	0.91	0.85
Diluted earnings per share (in euros) from continuing operations	25	0.89	0.83

Notes on pages 54 to 144 are an integral part of the consolidated financial statements.

Initialled for identification purposes only
Initials I.S. Date 21.02.2020

Consolidated statement of financial position

Assets

(in thousands of euros)	Note	31.12.2019	31.12.2018
Assets			
Due from central bank	10	1 232 733	639 862
Due from credit institutions	10	32 947	25 791
Due from investment companies	10	5 473	17 005
Equity instruments at fair value through other comprehensive income	11	432	298
Financial assets at fair value through profit or loss	12	40 530	46 856
Loans and advances to customers	13	1 687 034	918 761
Receivables from customers	14	3 551	3 721
Other financial assets	15	2 246	2 936
Other assets	15	1 961	1 651
Tangible assets	16	1 909	1 135
Right-of-use assets	16	4 777	0
Intangible assets	16	14 705	15 470
Goodwill	6	3 614	3 614
Total assets	5	**3 031 912**	**1 677 100**
Liabilities			
Deposits from customers and loans received	17	2 726 562	1 443 782
Financial liabilities at fair value through profit or loss	12	8	11
Accounts payable and other liabilities	18	24 314	24 644
Subordinated debt	20	75 000	50 900
Total liabilities	5	**2 825 884**	**1 519 337**
Equity			
Share capital	21	28 454	26 016
Share premium	21	70 136	46 653
Statutory reserve capital	21	4 713	3 451
Other reserves	11,21	3 280	2 090
Retained earnings		94 228	75 430
Total equity attributable to owners of the parent		**200 811**	**153 640**
Non-controlling interest	6	5 217	4 123
Total equity		**206 028**	**157 763**
Total liabilities and equity		**3 031 912**	**1 677 100**

Notes on pages 54 to 144 are an integral part of the consolidated financial statements.

Consolidated statement of cash flows

(in thousands of euros)	Note	2019	2018
Cash flows from operating activities			
Interest received		59 768	45 007
Interest paid		-11 005	-6 781
Fees and commissions received		37 026	32 844
Fees and commissions paid		-11 349	-7 799
Other income received		82	891
Staff costs paid		-17 877	-14 647
Administrative and other operating expenses paid		-13 873	-13 415
Income Tax		-4 208	-3 070
Cash flows from operating activities before change in operating assets and liabilities		**38 564**	**33 030**
Net increase/(decrease) in operating assets:			
Net increase/(decrease) in financial assets at fair value through profit or loss		49	-115
Loans and advances to customers		-770 388	-199 259
Mandatory reserve at central bank		-12 146	1 094
Security deposits		690	-647
Other assets		27	-597
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers		885 356	-105 607
Term deposits of customers		390 754	-9 316
Loans received		10 000	16 250
Repayments of loans received		-5 886	-722
Financial liabilities held for trading at fair value through profit or loss		-3	8
Other liabilities		-6 295	-38 271
Discontinued operations		0	-121
Net cash from/(used in) operating activities		**530 722**	**-304 415**
Cash flows from investing activities			
Purchase of tangible and intangible assets	16	-3 772	-3 450
Disposal of tangible assets	16	5	0
Disposal of subsidiaries, net of cash disposed	6	0	5 046
Proceeds from disposal and redemption of investment securities at fair value through other comprehensive income	11	0	520
Net changes of investment securities at fair value through profit or loss	12	6 869	9 473
Net cash from/(used in) investing activities		**3 102**	**11 589**
Cash flows from financing activities			
Paid in share capital (incl. share premium)	21	26 013	598
Paid dividends	21	-6 664	-5 295
Subordinated loans received	20	40 000	20 000
Subordinated loans redeemed	20	-15 900	0
Repayment of principal of lease liabilities	19	-1 003	0
Net cash from financing activities		**42 446**	**15 303**
Effect of exchange rate changes on cash and cash equivalents		**79**	**64**
Net increase/(decrease) in cash and cash equivalents		**576 349**	**-277 459**
Cash and cash equivalents at the beginning of the year	10	668 378	945 837
Cash and cash equivalents at the end of the year	10	**1 244 727**	**668 378**

Notes on pages 54 to 144 are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(in thousands of euros)	Share capital	Share premium	Statutory reserve capital	Other reserves	Retained earnings	Total	Non-controlling interest	Total equity
Balance as at 01.01.2018	**25 767**	**46 304**	**2 471**	**1 449**	**54 688**	**130 679**	**7 893**	**138 572**
Paid in share capital	249	349	0	0	0	**598**	0	**598**
Disposal of subsidiary	0	0	0	0	0	**0**	-4 550	**-4 550**
Transfer to statutory reserve capital	0	0	980	0	-980	**0**	0	**0**
Dividends paid	0	0	0	0	-4 123	**-4 123**	-1 172	**-5 295**
Share options	0	0	0	599	608	**1 207**	0	**1 207**
Profit for the year	0	0	0	0	25 237	**25 237**	1 952	**27 189**
including changes on initial application of IFRS 9					-731	**-731**	-18	**-749**
Other comprehensive income	0	0	0	42	0	**42**	0	**42**
Total profit and other comprehensive income for 2018	0	0	0	42	25 237	**25 279**	1 952	**27 231**
Balance as at 31.12.2018	**26 016**	**46 653**	**3 451**	**2 090**	**75 430**	**153 640**	**4 123**	**157 763**
Balance as at 01.01.2019	**26 016**	**46 653**	**3 451**	**2 090**	**75 430**	**153 640**	**4 123**	**157 763**
Paid in share capital	2 438	23 483	0	0	0	**25 921**	0	**25 921**
Transfer to statutory reserve capital	0	0	1 262	0	-1 262	**0**	0	**0**
Dividends paid	0	0	0	0	-5 463	**-5 463**	-1 201	**-6 664**
Share options	0	0	0	1 056	726	**1 782**	0	**1 782**
Profit for the year	0	0	0	0	24 797	**24 797**	2 295	**27 092**
Other comprehensive income	0	0	0	134	0	**134**	0	**134**
Total profit and other comprehensive income for 2019	0	0	0	134	24 797	**24 931**	2 295	**27 226**
Balance as at 31.12.2019	**28 454**	**70 136**	**4 713**	**3 280**	**94 228**	**200 811**	**5 217**	**206 028**

Additional information on equity is provided in Note 21.

Notes on pages 54 to 144 are an integral part of the consolidated financial statements.

pwc Initialled for identification purposes only
Initials I.S. Date 21.02.2020

Notes to the consolidated financial statements

NOTE 1 General information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2019 for AS LHV Group and its subsidiaries AS LHV Pank (hereinafter referred to as "the Bank"), AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus and OÜ Cuber Technology (hereinafter referred together as "the Group" or "LHV"). AS LHV Group holds 65% interest in LHV Finance through AS LHV Pank. AS LHV Group held 50% + 1 share interest in UAB Mokilizingas till end of April 2018 (the financial results of the first 4 months are shown as discontinued operations in the comparative data).

AS LHV Group is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. AS LHV Group is a holding company, whose subsidiary AS LHV Pank provides banking, financial advisory and securities brokerage services to customers in Estonia and in UK. There are offices for client servicing in Tallinn and Tartu and also London branch was opened in 2018. AS LHV Finance offers hire-purchase services to merchants and consumer finance. AS LHV Varahaldus offers fund management services for pension funds and other funds to clients in Estonia. As at 31.12.2019 the Group employed 449 full-time employees, incl. 25 non-active (31.12.2018: 395 employees, incl. 23 non-active).

The consolidated annual report (incl. financial statements) was approved by the management board on 20th of February 2020. Rain Lõhmus, who owns 23.7% of the voting rights and Andres Viisemann, who owns 9.8% of the voting rights (see also Note 21), have significant influence over AS LHV Group.

The consolidated annual report approved by the management board shall be authorised for approval by the supervisory board and shareholders. The shareholders have the right not to approve the consolidated annual report while the supervisory board does not have that right.

NOTE 2 Summary of significant accounting policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2019 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as: "financial assets and liabilities at fair value through profit or loss", including derivatives and financial assets at fair value through OCI.

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

The financial year started at 1 January 2019 and ended at 31 December 2019. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new IFRS amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements, which became mandatory for the Group's reporting periods beginning on or after 1 January 2019. The overview of these standards and the potential impact of applying the new standards and interpretations are stated below.

(a) Adoption of new or revised standards and interpretations

The following new or revised standards and interpretations became effective for the Group from 1 January 2019.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees are required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Starting from 1 January 2019, the Group recognised EUR 4 042 thousand on the Group's statement of financial position as right-of-use assets and lease liabilities, thus increasing the total of the statement of financial position of the Group. More information on the right-of-use assets is provided in the Note 16, for lease liabilities in the Note 18. The full accounting policy in disclosed in Note 2.19

(b) New accounting pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2020, and which the Group has not early adopted.

Amendments to the Conceptual Framework for Financial Reporting (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting. The Group is currently assessing the impact of the new amendment.

Definition of a business – Amendments to IFRS 3 (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if are no outputs. The definition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a 'concentration test'. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets). The Group is currently assessing the impact of the new amendment.

Definition of materiality – Amendments to IAS 1 and IAS 8 (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The Group is currently assessing the impact of the new amendment.

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

IFRS 17, Insurance Contracts (effective for annual periods beginning on or after 1 January 2021; not yet adopted by the EU).

IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare the financial performance of similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Group is currently assessing the impact of the standard to it's financial statements.

2.2 Consolidation

The 2019 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank, AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus and OÜ Cuber Technology. AS LHV Group holds 65% interest in LHV Finance through AS LHV Pank. Till end of April 2018 AS LHV Group held 50% + 1 share interest in UAB Mokilizingas.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The acquisition method of accounting is used to account for the acquisition of subsidiaries (except for acquisitions among enterprises under common control) and business operations. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed. According to the acquisition method, the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary are recognised at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

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

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

Intercompany transactions balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless transaction provides evidence of an impairment of the asset transferred.

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

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

In the parent separate primary financial statements, disclosed in these consolidated financial statements (see Note 28), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognised.

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, which is attributable to interests, which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity. Non-controlling interest in the consolidated statement of financial position is disclosed separately from the equity attributable to the shareholders of the parent company. In consolidated statement of profit or loss and other comprehensive income, non-controlling interest share of profit is disclosed separately from owners of the parent.

2.3 Associates

An associate is an entity over which the Group has significant influence but which it does not control. Generally, significant influence is assumed to exist when the Group holds between 20% and 50% of the voting rights. The Group does not have any associate as at 31.12.2019 and 31.12.2018

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognised at cost which is thereafter adjusted for post-acquisition changes in the investor's share of the investee's equity (changes both in the profit/loss of the associate as well as other equity items) and with elimination or depreciation/amortisation of the differences between fair values and carrying amounts of the investee's assets, liabilities and contingent liabilities as determined in the purchase analysis. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets.

When the Group's share of losses in the associate accounted under the equity method exceeds the carrying amount of the associate, the carrying amount of the investment is reduced to zero and such long-term loans granted to the associate that in substance form a part of the investment are written down. Further losses are carried off-balance sheet. When the Group has guaranteed or incurred obligations on behalf of the associate, the respective liability as well as the loss under the equity method are recorded in the statement of financial position. Other receivables from the associate are recorded at amortised cost less a provision for impairment.

An investment in the assets and liabilities of the acquired associate and goodwill that arose on acquisition is presented as a net amount in the statement of financial position line "Investments in associates".

At the end of each reporting period, it is assessed whether there is any indication that the recoverable amount of the investment has fallen below its carrying amount. If any such indications exist, an impairment test is performed. To determine the recoverable amount of the investment, the principles described in section 2.9 are used.

2.4 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of entities in the Group is euro except the branch in UK which has pound as functional currency As the branch had limited activities and transactions in 2019, the effect to Group financial statements is immaterial.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the end of the reporting period. Non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the fair value measurement date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of profit or loss under the line "Foreign exchange rate gains/losses". Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the statement of profit or loss under the line "Net gains from financial assets measured at fair value".

2.5 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, demand deposits with central bank and other banks and investment companies, term deposits with original maturities of three months or less, that are available for use without any restrictions and which are subject to an insignificant risk of changes in value.

2.6 Financial assets

Initial recognition and derecognition

Financial assets are recognised on the statement of financial position when the Group becomes a party to the contractual provisions of the instrument and are measured at fair value on initial recognition. Transaction costs are included in the fair value on initial recognition except for financial assets at fair value through profit or loss where transaction costs are expensed in profit or loss. Financial assets at fair value are recognised on the statement of financial position on trade date. Financial assets measured at amortised cost are recognised on trade date.

Financial assets are derecognised when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Subsequent measurement

The Group classifies and subsequently measures its financial assets in the following categories: financial instruments at fair value through profit or loss; fair value through other comprehensive income and amortised cost. The classification will depend on if the financial asset is a debt instrument, an equity instrument or a derivative.

Debt instruments (Loans and debt securities)

The classification is based on a combination of assessing the business model for managing the financial assets and whether the contractual cash flows consist of solely payments of principal and interest ('SPPI'). The business model assessment is performed for homogenous portfolios/products identified based on how the business is managed in the divisions of the Group. The assessment is based on reasonable scenarios taking into consideration how the portfolio is evaluated and reported to management; the risks affecting the performance of the portfolio and how these risks are managed; how managers are compensated; and the frequency, value and timing of sales including the reasons for the sales. In determining if the cash flows consist solely of principal and interest, the principal is defined as the fair value of the debt instrument at initial recognition, which can change over the life if there are repayments or capitalisation of interest. Interest cash flows are consistent with components per a basic lending arrangement including consideration for time value of money, credit risk, liquidity risk as well as administrative costs and profit margin. If there are contractual features introducing an exposure to other risks or volatility, it is not considered to consist of solely payments of principal and interest. SPPI tests are performed as a part of new product approval tests. In implementation of IFRS 9 in 2018 SPPI was applied to 22 larger products carried at amortised cost.

Debt instruments are presented in the statement of financial position line items: Due from central banks, credit institutions and investment companies; Loans and advances to customers; Financial assets at fair value through other comprehensive income; Financial assets at fair value through profit or loss; Receivables from customers and Other financial assets, and include instruments in the following measurement categories.

Fair value through profit or loss: Debt instruments are classified in this category if not meeting the criteria for amortised cost or fair value through other comprehensive income. This is the case if the business model is held for trading; where financial assets are considered held for trading if they are held with the intention to be sold in the short-term and for the purpose of generating profits. Debt instruments are mandatorily measured at fair value through profit or loss if the assets are managed and evaluated on a fair value basis or the assets are held with an intention to sell, or alternatively, if the cash flows do not consist of solely payments of principal and interest.

Fair value through other comprehensive income: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to both hold assets to collect contractual cash flows and to sell the assets (b) the contractual cash flows consist of solely payments of principal and interest. The assets are measured at fair value and gains and losses arising from changes in fair value are reported in other comprehensive income and accumulated in equity. The cumulative gain or loss is reclassified from equity to profit or loss upon derecognition of the debt instrument. Interest is calculated by applying the effective interest method on interest-bearing financial assets and expected credit losses are recognised in profit or loss.

Amortised cost: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to hold assets to collect contractual cash flows and (b) the contractual cash flow characteristics consist of solely payments of principal and interest. The gross carrying amount of these assets is measured using the effective interest method and adjusted for expected credit losses.

Equity instruments

Equity instruments are per default classified as financial assets at fair value through profit or loss. An irrevocable election can be made on initial recognition to classify equity instruments (not held for trading) at fair value through other comprehensive income.

Derivatives

Derivatives are classified as fair value through profit or loss (held for trading).

Modification

The Group may renegotiate loans and modify contractual terms. If the new terms are substantially different from the original terms, the Group derecognises the original financial asset and recognises a new asset. The Group also assesses whether the new financial asset is credit-impaired at initial recognition. If the terms are not substantially different, the modification does not result in derecognition and the Group recalculates the gross carrying amount based on the new cash flows using the original effective interest rate of the financial asset and recognises a modification gain or loss.

Reclassification

In rare circumstances debt instruments (financial assets) excluding those designated at fair value through profit or loss on initial recognition, can be reclassified if there has been a change in the business model for managing the financial asset.

Write-off

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a dercognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognised as income.

At least one of the conditions has to be filled to declare claim irredeemable based on the product class.

IFRS 9 category		Class (applied by the Group)		31.12.2019	31.12.2018
Financial assets	Amortised cost	Due from banks and investment companies		1 271 153	682 658
		Loans and advances to customers	Loans to legal entities	950 541	705 186
			Loans to individuals	736 493	213 575
		Receivables from customers		3 551	3 721
		Other financial assets		2 246	2 936
	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	Shares and fund units	500	510
			Listed bonds	32 331	38 697
			Derivatives	4	59
			Pension fund units	7 695	7 590
	Equity instruments at fair value through other comprehensive income	Investment securities	Unlisted shares	432	298

2.7 Impairment of financial assets carried at amortised cost

Measurement

The impairment requirements are based on an expected credit loss (ECL) model. The guiding principle of the ECL model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments.

All debt financial assets measured at amortised cost and fair value through other comprehensive income, as well as lease receivables, financial guarantees contracts, contract assets and certain loan commitments are in scope for expected credit loss.

ECLs on financial assets measured at amortised cost and lease receivables are presented as allowances, i.e., as an integral part of the measurement of those assets in the statement of financial position. The allowance reduces the gross carrying amount. ECLs on loan commitments and financial guarantee contracts are presented as provisions, i.e., as a liability, in the statement of financial position. Adjustment to the loss allowance and provision due to changes in ECLs is recognised in the statement of profit or loss as net expected credit losses.

The assessment of credit risk, and the estimation of ECL, shall be unbiased and probability-weighted, and shall incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. LHV uses both models and expert based individual assesments for calculating ECLs.

The ECL model has a three-stage approach based on changes in the credit risk. A 12-month ECL (Stage 1) applies to all items, unless there is a significant increase in credit risk since initial recognition. For items where there is a significant increase in credit risk (Stage 2) or in default (Stage 3), lifetime ECL applies.

Significant increase in credit risk

At the end of each reporting period the Group performs an assessment of whether credit risk has increased significantly since initial recognition. The assessment of whether there has been a significant change in credit risk is based on quantitative and qualitative indicators. Indicators include payments that are past due >30 days and <90 days and financial assets that have been classified as watch-list or with forbearance measures (loans whose contractual terms have been revised due to the customer's financial difficulties). A quantitative indicator is calculated based on the change in lifetime probability of default (PD) by comparing the scenario-weighted lifetime PD at the reporting date with the scenario-weighted lifetime PD at initial recognition. In case there has been a significant increase in credit risk since initial recognition, an allowance for lifetime ECL shall be recognised and the financial instrument is transferred to Stage 2. The approach is symmetrical, meaning that in subsequent reporting periods, if the credit quality of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the financial asset moves back to Stage 1.

Definition of default

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments has been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %
- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. Financial instruments in default are in Stage 3. All financial assets in Stage 3 are considered credit-impaired.

Modelling

The ECL is calculated as a function of the probability of default (PD), the exposure at default (EAD) and the loss given default (LGD), as well as the timing of the loss. The Group's IFRS 9 methodology for ECL measurement is based on existing internal scoring and rating models.

PD represents the likelihood that a loan will not be repaid and will go into default in either a 12-month or lifetime horizon. The expected PD for each individual instrument incorporates a consideration of past events, current market conditions and reasonable and supportable information about future economic conditions. LHV uses existing scoring and rating models that are adjusted according to specific IFRS 9 requirements. The models are calibrated based on a combination of asset class and product type.

EAD represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default. LGD takes into consideration the amount and quality of any collateral held. LHV uses existing LGD models adjusted to meet IFRS 9 requirements. When measuring ECL, LHV uses the maximum contractual period during which LHV is exposed to risk.

Forward-looking information

The Group uses internally developed macroeconomic forecasts as the basis for the forward-looking information incorporated in the ECL measurement. In order to ensure an unbiased estimation of credit losses under IFRS 9, at least three scenarios shall be used. One of the scenarios shall be the base case scenario, representing the most likely outcome, which is also applied in the regular financial planning and budgeting process, while other case scenarios shall represent more optimistic or pessimistic outcomes.

Forecasts are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business and finance. As available without undue cost, external experts and externally developed ‘benchmark forecasts’ should be consulted. The referred benchmark forecasts include but are not limited to World Economic Outlook by the IMF, European Economic Forecasts by the European Commission and Economic Forecasts by Bank of Estonia. The scenarios shall be approved by the Risk and Capital Committee.

Scenarios are be developed for a time horizon over which reliable projections can be made, typically for a time horizon of 3 years. At minimum, selected macro indicators have to be forecasted for a period of two years following the current year. In general, scenarios are reviewed on a quarterly basis. In case of significant changes in the macroeconomic environment and outlook, the scenarios shall be updated.

Individual assesments and Management´s judgement

The Group uses both models and expert based judgement in order to determine ECLs. The degree of judgement that is required to estimate ECL depends on the model outcome, materiality and the availability of detailed information. The model provides guidance and transparency as to how economic events could affect the impairment of financial assets. Expert based judgement may be applied to the modelled outcome to incorporate an estimated impact of factors not captured by the model. Such individual ECL assesments may be applied to significant exposures at a counterparty level. These assesments are decided by the Credit Committee. In addition there may be a need for adjustments at a portfolio level, which is decided by the Risk and Capital Committee.

2.8 Tangible fixed assets

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

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

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. The Group performs an impairment test when there are circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell or its value in use), it is written down immediately to its recoverable amount recognising an impairment loss in the statement of profit or loss for the reporting period.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in operating expenses or other income in the statement of profit or loss for the reporting period.

2.9 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis, except client agreements (see below). The annual amortisation rate for purchased licenses is 33%.

Sales costs for the acquisition of new clients are capitalised. The amortisation method for client agreements is the diminishing balance method. The annual amortisation rate for purchased client agreements is 12% of the residual value of those assets. At the end of each reporting period, the appropriateness of amortisation rates, methods and residual values is assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset’s fair value less costs to sell and value in use.

2.10 Impairment of assets

Assets that have indefinite useful lives (including goodwill) are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts.

Assets with an unlimited useful life and depreciable assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount of the asset is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit).

Impairment losses are recognised in statement of profit or loss.

At the end of each following reporting period, assets that have been written down are assessed to determine whether their recoverable amount has increased (except for impairment losses of goodwill that are not reversed). If the impairment test indicates that the recoverable amount of an asset or asset group (cash-generating unit) has increased above its carrying amount, the previous impairment loss is reversed up to the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. Reversals of impairment losses are recognised in the statement of profit or loss as a reduction of the impairment loss.

2.11 Loan commitments, Financial guarantees and performance guarantees

The Group issues commitments to provide loans. These commitments are irrevocable or revocable only in response to a material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Group cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

The Group issues financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the financial guarantee. At the end of each reporting period, the financial guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. Performance guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the contract. At the end of each reporting period, the performance guarantee contracts are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the contract at the end of each reporting period, discounted to present value. Where the Group has the contractual right to revert to its customer for recovering amounts paid to settle the performance guarantee contracts, such amounts will be recognised as loans and receivables upon transfer of the loss compensation to the guarantee's beneficiary.

2.12 Financial liabilities

The Group classifies financial liabilities either:

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

b) financial liabilities measured at amortised cost

c) financial guarantee contracts and loan commitments

Recognition of a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.6.. All other financial liabilities are subsequently measured at amortised cost using the effective interest method. Transaction costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the statement of profit or loss during the term of the instrument, using the effective interest rate. Interest costs are included in the statement of profit or loss line "Interest expenses".

Deposits from customers are initially recorded on their settlement date at their fair value less transaction costs and are subsequently measured at amortised cost using effective interest method in the statement of financial position line "Deposits from customers and loans received", accrued interest liabilities are included in the same line. Interest expense is recognised in the statement of profit or loss line "Interest expense" on the accrual basis.

Loans received, debt securities issued and similar subordinated debts are initially recognised at fair value, less transaction costs (cash received less transaction costs). The subordinated debts are those liabilities, which in case of a liquidation of a credit institution or declaration of bankruptcy, are settled after the satisfaction of the justifiable claims of other creditors. Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognised at fair value less transaction costs and are subsequently carried at amortised cost.

Financial liabilities are derecognised when they are extinguished (ie. when the obligation specified in the contract is discharged, cancelled or expired).

2.13 Payables to employees

Payables to employees include unpaid salary accruals and a vacation pay accrual calculated in accordance with employment contracts and the laws in force in employee residential country as at the end of the reporting period. The liability related to the payment of a vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the statement of financial position and as staff costs in the statement of profit or loss.

Social security tax includes payments to the state pension fund. Group has neither existing legal nor constructive obligations to make pension or similar payments supplementary to social security tax.

2.14 Share-based payments

AS LHV Group operates a share-based compensation plan, under which the company receives services from group employees as consideration for equity instruments (options) of LHV Group. The fair value of the employee services received in exchange for the grant of the options is recognised during the shared-based compensation program as group's staff expense and as an increase in the equity (other reserves). The total amount to be expensed is determined by the fair value at the time of issuing the options. The fair value of the options granted:

- including any market performance conditions influencing the share price (e.g. LHV Group share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period).

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the vesting conditions (other than market conditions). It recognises the impact of the revision to original estimates, if any, in the statement of profit or loss, with a corresponding adjustment to equity.

When the options are exercised, LHV Group issues new shares.

The grant by LHV Group of options over its equity instruments to the employees of subsidiary undertakings in the group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity accounts. According to the contractual conditions of the share options there are no social security tax charges when exercising the options after the 3-year period.

2.15 Provisions and contingent liabilities

Liabilities arising from an obligating event before the end of the reporting period that have either a legal basis or that have arisen from the Group's current operating practice (legal or constructive obligation) that require probable outflow of resources, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the statement of financial position. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the statement of financial position in the amount which according to the management is necessary as at the end of the reporting period for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and an expense from the change in the carrying amount of provisions are included within expenses in the reporting period. Provisions are not set up to cover future operating losses.

When it is probable that a provision will be realised later than 12 months after the end of the reporting period it is recorded at discounted value (present value of expected outflows), unless the discounting effect is immaterial.

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

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

Assets from which resources are expected to flow to the Group within 12 months are recognised as current assets. The portion of assets with expected inflows later than 12 months after the end of the reporting period is recognised as non-current assets (see Note 3.4).

Liabilities are classified as current when they are due within twelve months after the end of the reporting period or if the Group does not have an unconditional right to defer the payment for later than 12 months after the end of the reporting period. Loans received with due date within 12 months after the end of the reporting period which are refinanced as non-current after the end of the reporting period but before the financial statements are authorised for issue, are recognised as current. Loans received that the lender has the right to recall at the end of the reporting period due to breaches of contractual terms are also classified as current.

For all long-term assets and liabilities, the long-term portion is separately disclosed in respective disclosure to these financial statements (see Note 3.4).

2.17 Revenues and expenses

The effective interest method is applied to recognise interest income and interest expenses in profit or loss for financial assets and financial liabilities measured at amortised cost or debt investments at fair value through other comprehensive income.

The effective interest method is a method of calculating the gross carrying amount of a financial asset or the amortised cost of a financial liability and of allocating interest income and interest expenses. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial instrument. When calculating future payments, all payments included in the terms and conditions of the contracts, such as advance payments, are taken into consideration. The calculation of the effective interest rate includes fees that are an integral part of the effective interest rate. However, expected credit losses are not taken into account.

If a financial asset subsequently has become credit impaired the interest income is recognised applying the effective interest rate to the amortised cost, i.e. gross carrying amount adjusted for the loss allowance. In case a financial asset is credit-impaired at initial recognition, the expected credit losses are included in the estimated cash flows to calculate a credit adjusted effective interest rate which then is applied to recognise the interest income.

Fee and commission income

The recognition of revenue from contracts with customers is reported as fee and commission income. This does not apply for revenue from leasing contracts or financial instruments and other contractual obligations within the scope of IFRS 9 Financial Instruments.

Fees that are included in the calculation of the effective interest rate of a financial instrument measured at amortised cost, such as loan origination fees, are allocated over the expected tenor of the instrument applying the effective interest method and presented in Net interest income.

Fee and commission income is recognised to depict the transfer of promised services to the customers in an amount that reflects the consideration to which LHV expects to be entitled in exchange for the service.

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Group's performance. Variable fees are recognised only to the extent that management determines that it is highly probable that a significant reversal will not occur.

Other fee and commission income is recognised at a point in time when the Group satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations.

The major types of fees are described below.

Fee and commission income for asset custody and asset management to customers is recognised as revenue over the period in which the services are provided. Performance based fees are recognised when it is highly probable that a significant reversal of recognised revenue will not occur, which is most often when the performance criteria are fulfilled.

Brokerage fees, commission and fees from negotiating a transaction for a third party, such as arrangement of acquisitions or purchase or sale of a business, are recognised on completion of the transaction.

Expenses that are directly related to the generation of fee and commission income are recognised as fee and commission expense.

Net financial income

Gains and losses arising from changes in fair value of financial assets and liabilities measured at fair value through profit or loss are reported under the item Net gains from financial assets. For financial liabilities designated at fair value through profit or loss the change in fair value relating to change in own credit risk is accounted for in other comprehensive income.

Dividend income

Dividends are recognised when the entity's legal right to receive payment is established.

2.18 Asset management services

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

2.19 Leases - Group as the lessee

Since 1 January 2019 the IFRS 16 Leases are recognised in the Group's financial reporting.

Lessees are required to recognise:

(a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and

(b) depreciation of lease assets separately from interest on lease liabilities in the income statement.

The group has adopted IFRS 16 Leases retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period as permitted under the specific transition provisions in the standard.

On adoption of IFRS 16, the group recognised tangible assets and lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17 Leases.

The Group leases various properties. Rental contracts are typically made for fixed periods of up to 5 years but as a rule, include extension and termination options. Lease terms are negotiated on an individual basis and may contain a wide range of different terms and conditions.

The Group recognises leases as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use.

Lease liabilities were recognised as present value of lease payments. The right-of use assets were measured at the amount equal to the lease liability, as no adjustments to right of use assets were necessary. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life or the lease term on a straight-line basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments, less any lease incentives receivable.
- variable lease payment that are based on some kind an index (for example inflation, Euribor).

• amounts expected to be payable by the lessee under residual value guarantees.

• the exercise price of a purchase option if the lessee is reasonably certain to exercise that option.

The lease payments are discounted using the interest rate implicit in the lease, if it is readily determinable, or the Group's incremental borrowing rate. The alternative interest rate is the rate of interest that a lessee would have to pay to borrow, over a similar term and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Short-term leases are leases with a lease term of 12 months or less. Low value assets comprise IT-equipment and small items of office furniture. In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option or not to exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The management reviews the assessment if a significant event or a significant change in circumstances occurs which affects the probability of using options and that is within the control of the management. Alternatively, the extension period of the contract has changed (for example, Group has exercised an option, which initially was considered reasonably uncertain or has not exercised an option, which was initially considered reasonably certain).

According to the contracts, Group has not granted any residual value guaratees in the end of the contract.

On applying the standard as at 01.01.2019, the lease payments were discounted at the Group's incremental borrowing rate of 3.75% on average.

The Group has used the following practical expedients permitted by the standard:

- the accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases.
- lease agreements for low value assets are excluded.
- the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application.

As the result of application, the Group's total assets in the statement of financial position as at 01.01.2019 increased 4 042 thousand euros and liabilities increased 4 042 thousand euros. During the year 2019 EUR 1 634 thousand was additionally recorded as lease liability which was related to the new lease properties, see also Note 16, 18 and 19 for more details.

2.20 Taxation and deferred income tax

Corporate income tax in Estonia

Estonian companies generally do not pay corporate income tax on profits on a current basis. Tax is paid on distributions of profit, either formal (dividends, other payments from equity) or deemed (non-business expenses, transfer pricing adjustments, certain payments to tax havens, etc.). Dividends and other profit distributions are subject to corporate income tax at the rate of 20/80 on the net amount. Starting from 2019, regular dividend payments will be subject to corporate income tax at the reduced rate of 14/86 to the extent of the average dividend distribution of three preceding years. The first year to be taken into account is 2018. Corporate income tax arising from dividend distributions is recorded as a liability and income tax expense when the dividends are declared. The tax becomes due to the tax authorities on the 10th day of the month following the dividend payment.

Starting from second quarter of 2018 credit institutions are obliged to pay advance income tax of 14% on quarterly profits under IFRS (Note 27). The tax becomes due to the tax authorities on the 10th day of the third month following the quarter. Advance income tax paid is non-refundable and thus recorded as expense, but can be used to reduce income tax payable on future dividend distributions.

Corporate income tax in other countries

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

Corporate income tax rates	2019	2018
Lithuania	15%	15%
United Kingdom	19%	19%

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

A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the statement of financial position. The maximum amount of income tax payable, which would arise from paying out the retained earnings as dividends, is disclosed in the Note 21 to the financial statements.

2.21 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. More detailed information in Note 3.10.

2.22 Statutory reserve capital

Statutory reserve capital is formed from annual net profit allocations to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be transferred to the statutory reserve, until the reserve reaches one-tenth of share capital. Statutory reserve may be used to cover a loss, or to increase share capital. Payments to shareholders from statutory reserve are not allowed.

2.23 Discontinued operations

A discontinued operation is a component of the Group that is classified as held for sale, and represents a separate major line of business or geographical area of operations and is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations. Non-current asset or disposal group is classified as held for sale when their carrying amount is to be covered principally through a sale transaction rather than through continuing use, and the sale is considered highly probable. The disposal group is recognised at carrying amount or fair value less costs related to the transaction of sale, depending on which is lower. Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented. Intergroup transactions between discontinued and countuing operations are eliminated depending on whether the transactions will continue after the transaction of sale.

NOTE 3 Risk management

Risk is defined as a potential negative deviation from expected financial results. LHV encounters several risks in its day-to-day operations. The objective of risk management at LHV is to recognise these risks, to measure them appropriately, to manage and to report them. More broadly, the aim of risk management is to increase the value of LHV by minimising losses and reducing the volatility of results. Risk management at LHV is based on a strong risk culture and is built on the principle of three lines of defence where the first line of defence, the business units, are responsible for taking risk and for day-to-day management. The second line of defence, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of defence, the internal audit, conducts independent supervision over the entire group. Risk management principles, requirements and areas of responsibility are described in risk management policy. The principles and objectives of capital management are described in internal documents (capital management policy and capital objectives). More detailed risk management processes are described in the policies of the respective field.

Under the leadership of the Risk Management Unit, LHV has developed a group-wide risk appetite framework, approved by the Supervisory Board. The framework includes quantitative risk tolerance levels by main risks.

Risk framework

Risk management principles, roles and responsibilities

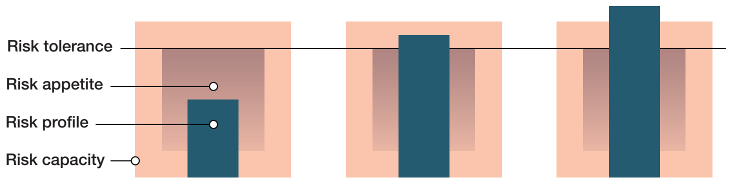
- Risk management and control principles
- Ethics principles
- Remuneration principles
- Organizational structure
- Roles and responsibilities

Goals, measures and controls

- Risk tolerance levels
- Measurement of risks
- Rights and limits

Internal and external reporting, disclosure

The risk appetite reflects LHV's willingness to take risks in order to achieve its business goals. LHV has defined the limit of the risk appetite as risk tolerance – the maximum level of risk that LHV is willing to take in order to achieve its goals. Risk capacity is defined as the greatest risk that LHV can withstand. The figure on the next page illustrates the three different risk profile levels to levels of risk tolerance and briefly describes the activities in these situations.



The actual risk profile is inside the risk appetite, but below the risk tolerance level. Risk profile is under control and no specific action needed.

The actual risk profile exceeds the risk tolerance level, but is below the risk capacity. An action plan has been launched to reduce the risk profile.

The actual risk exceeds the LHV risk capacity. Financial recovery plan has been launched.

Risk capacity – the maximum damage that LHV can withstand. Financial recovery plan has been launched to overcome the risk.

Risk tolerance – the maximum risk that LHV is prepared to take to achieve its goals. When exceeding the risk tolerance level the activities at enterprice level will be launched to reduce the risk profile.

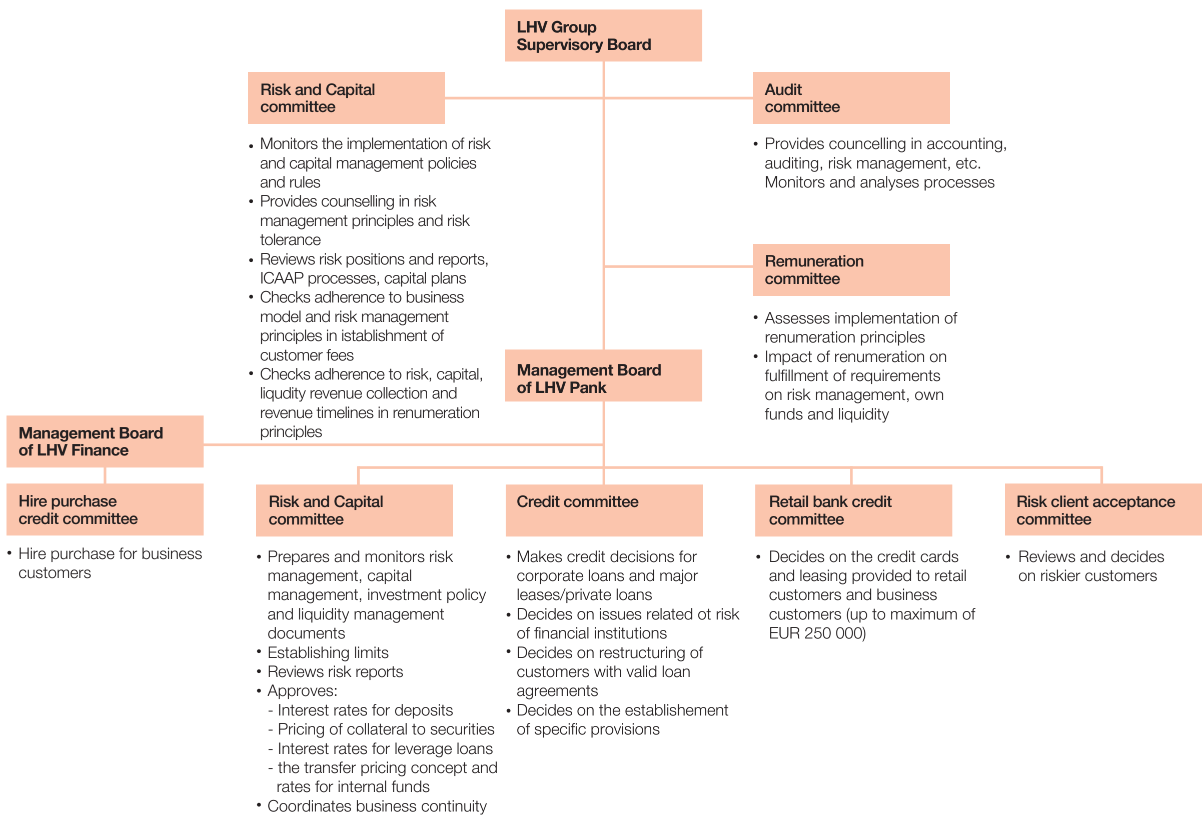
Risk appetite is the recommended level of risk that LHV plans to take to implement its plans and goals. Risk appetite reflects the desired risk profile. The maximum risk appetite is defined as a risk tolerance.

Risk profile – combination of the real risks of LHV resulting from the nature, scale and complexity of our activities and the operation environment.

As seen from the figure, if the actual risk profile remains within the limits of the risk appetite, it is a foreseeable situation and no further action is needed. If the actual risk profile exceeds the risk tolerance level, an action plan is put in place to reduce the risk profile. It is also necessary to inform the Supervisory Board in that case. The management of LHV risk profile and ensuring it stays within the limits of the risk appetite is the responsibility of the first line of defence, while independent monitoring and reporting is the responsibility of the risk management unit. Within the framework of the financial recovery plan, LHV has developed early warning indicators with thresholds and corresponding measures.

In accordance with risk management policy, the risk tolerance levels must be specified at minimum for capital risk, credit risk, market risk, operation risk, liquidity risk and anti-money laundering risk. The levels of risk tolerance are described in each of the respective risk policies, which are approved at Supervisory Board level. Detailed instructions and guidelines are described in the policies.

LHV has a system of committees and decision-making competencies. The functions of the main committees are shown in the figure below.



As part of the risk policy framework, LHV has developed a risk reporting process. The table below gives an overview of the main reports prepared by the risk management department, which are presented to the governing bodies and their reporting frequency.

Governing body	Members	Title of the report	Report frequency	Coverage of risks
Supervisory board of the Group	All the members of the supervisory board of the Group	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Compliance overview	Monthly	Compliance risk
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks
Supervisory board of the Pank	All the members of the supervisory board of the Pank	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Risk management overview	Once a year	All the risks
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks
Risk and Capital Committee of the Group	Rain Lõhmus, Andres Viisemann, Tiina Mõis	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Problematic loan clients	Quarterly	Credit risk
Audit committee	Kristel Aarna, Urmas Peiker, Tauno Tats	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
CEO of the Group, Chairman of the Supervisory Board of the Pank	Madis Toomsalu	Risk report	Monthly	Credit risk, market risk, interest risk, The liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
Risk Capital Committee of the Pank	Management board members of the Pank, Kadri Haldre, Romet Enok	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
		Business continuity test and planning	After every test	Operation risks
		Risk self-assessment	After assessment	Operation risks
Management Board of the Pank	Management board members of the Pank	Compliance overview	Once in a year	Compliance risks
		Anti-money laundering overview	Once in a year	Anti-money laundering risks
		Monitoring of legislation	Monthly	Compliance risks
		Compliance audit	After every audit	Compliance risks
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks

LHV has established a risk management policy, which sets the risk management framework. Separate policies are set for major risk categories. The risks are analysed and monitored and reported to different levels on a monthly and quarterly basis. The risk report, which is compiled on a monthly basis, presents information by type of risk. The risk report also includes information on capital adequacy. It allows getting a regular overview of all the important risks at the company level and to monitor their development, identify bottlenecks, and react promptly.

3.1 Capital management

The goal of the Group's capital management is to:

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

The Group considers net own funds valid according to capital adequacy regulation as capital. The amount of capital that the Group managed as at 31.12.2019 was EUR 241 801 thousand (31.12.2018: EUR 167 457 thousand). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

- The Group must be adequately capitalised at all times, having necessary capital to ensure economic preservation and enabling financing of new profitable growth opportunities;
- The main focus of the capital management is on tier 1 own funds, because only tier 1 own funds can absorb losses. All other capital layers in use are dependent of tier 1 own funds volume;
- Capital of the Group can be divided into: 1) regulated minimum capital and 2) capital buffer held by the Group. In order to reach its long-term economic goals the Group must on one hand strive towards proportional lowering of the regulated minimum capital (through minimising risks and high transparency). On the other hand, the Group must strive towards sufficient and conservative capital reserve, which will ensure economic preservation even in the event of severe negative risk scenario;
- The risk appetite set by the Group is an important input to capital management planning and capital goal setting. Higher risk appetite requires maintaining higher capital buffer.

Own funds

(in thousands of euros)	31.12.2019	31.12.2018
Paid-in share capital	28 454	26 016
Share premium	70 136	46 653
Statutory reserves transferred from net profit	4 713	3 451
Other reserves	212	78
Accumulated profit/(deficit)	69 452	50 193
Intangible assets (subtracted)	-18 319	-19 084
Net profit for accounting period (COREP)	12 186	13 605
Deductions	-33	-194
Tier 1 own funds	**166 801**	**120 718**
Additional Tier 1 capital	20 000	0
Total Tier 1 capital	**186 801**	**120 718**
Subordinated debt	55 000	50 900
Total Tier 2 own funds	**55 000**	**50 900**
Total net own funds	**241 801**	**171 618**

The net capital of a credit institution at any time shall be equal to or exceed the minimum amount of share capital prescribed in the Credit Institutions Act (EUR 5 million). Started from 2014, the capital of banks and investment firms in the European Union became subject to a legal framework (CRD IV/CRR), largely based on the Basel III framework that was agreed in the Basel Committee on Banking Supervision. The objective of the framework is to strengthen the resilience of the financial sector to adverse economic shocks and thereby ensure an adequate and sustainable financing of the economy. Significant changes implemented by the new requirements include the requirement for credit institutions to maintain a higher level and quality of capital than before and a unified framework for designing liquidity buffers. The capital requirements directive also define measures for macro-financial supervision that member states can use to control the behaviour of credit institutions in amplifying the cycles and to alleviate risks arising from market structure. Every year additional smaller changes have been implemented in the regulations and completely updated regulation will be valid started from 2022.

The regulation, which is directly applicable in the member states, obligates all credit institutions operating in the European Union (including their consolidating holding companies) and investment firms to maintain 4.5% of Common Equity Tier 1 (CET 1) and 6.0% of Tier 1 Capital against risk assets. The overall Capital Adequacy Requirement (CAD), including both Tier 1 and Tier 2 capital, remains at the existing 8.0% level.

In addition to the main requirements based on uniform rules, the directive defines the principles for forming capital buffers. In Estonia, in addition to the baseline capital requirements, credit institutions have been subjected to capital maintenance and systemic risk buffers, which are 2.5% (imposed by the Financial Supervisory Authority), 1.0% (imposed by Bank of Estonia) and systematically importance buffer (imposed by Financial Supervisory Authority), respectively. In 2018 the grouping of capital requirements changed and SREP buffers were moved to higher capital buffers, meaning that first bank will breach other buffers before SREP buffers. Breaching each buffer triggers different actions from regulators side and first one in list is set by Estonian Central Bank triggering limitation of ECB transactions.

The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions. An overview of capital requirements as of 31.12.2019 is provided in the table below:

Requirements	CET1	Tier 1	CAD
Base capital requirement	4.50%	6.00%	8.00%
Pillar 2 capital charge	0.39%	0.52%	1.53%
Non-resident financial intermediates deposits*	0.28%	0.28%	0.28%
Total SREP capital requirement	5.17%	6.80%	9.81%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemically importance buffer	1.00%	1.00%	1.00%
Systemic risk buffer	1.00%	1.00%	1.00%
Contra cyclical buffer	0.00%	0.00%	0.00%
Capital requirements total	**9.67%**	**11.30%**	**14.31%**

* Capital charge is volatile and calculated as 0.2% from non-resident financial intermediates deposits. Here volumes in financial plan is used for ratio calculation

	CET1	Tier 1	CAD
Capital requirements valid from August 2017*	7.92%	9.42%	11.42%
Capital requirements valid from October 2016*	8.00%	9.50%	11.50%

* In addition to base requirement Pillar II requirement and systematically importance requirement were separately added. Starting from mid 2018 all these components are inside capital requirements.

Capitalisation levels have been increased not due to riskiness of the bank, but because of the increasing market share of the bank. In 2018 LHV was considered as one of four systematically important bank in Estonia. This decision has increased capital buffers by 0.5% from 1st of July 2018 and by another 0.5% from 1st of January 2019. LHV has been keeping conservative approach in capital management and keeps additional internal buffers compared to regulatory ones.

Internal capital adequacy targets for 2019 were as follows:

- Core Tier 1 capital adequacy 10.40% (10.49% in 2018)
- Tier 1 capital adequacy 12.10% (12.21% in 2018)
- Total capital adequacy 15.50% (15.06% in 2018)
- Leverage ratio 3.50% (not changed)
- MREL ratio 6.08% (not changed)

LHV has received the new SREP report only in January 2020, according to which capitalisation requirements in 2020 will remain almost the same. The new internal targets will be set by supervisory board in next regular meeting in February.

Each year, the Group's supervisory board confirms the goals of capitalisation and the target level of capital adequacy to cover potential risks arising from fast growth. Each year, an internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential internal capital needs in addition to regulatory capital requirements.

Estonian FSA informed LHV in January 2020 that MREL requirement will change from end of Q2 2021 to the level of 10.15%, as LHV is treated as systematic bank and will and bank has to keep sizable amount of suitable liabilities which could be converted to own funds in case of resolution process.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. Reports about the compliance with prudential and capital requirements for covering the risks are submitted regularly to supervision authorities. The Group uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement.

The own funds of LHV Varahaldus as the fund manager need at any given time exceed the minimum amount of share capital laid down in the Investment Funds Act (EUR

3 million). Starting from January 10th 2017, the net own funds of a fund manager have to be 0.5% of the market value of managed pension funds with the market value less than EUR 1 billion and 0.02% of the market value of managed pension funds with the market value more than EUR 1 billion. The Group and its subsidiaries have complied with all capital requirements during the financial year and in previous years.

3.2 Credit risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises from cash and cash equivalents, derivatives and deposits with banks and other financial institutions, debt securities, but mainly from credit exposures to customers, including outstanding loans, given guarantees, other receivables and commitments.

Credit risk is one of the largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. In order to evaluate credit risk, Group analyses the operations and financial position of its customers and business partners. After approving the credit, the solvency of the customer and the value of the collateral are regularly monitored. The credit risk management and control are centralised in a credit risk management unit which reports regularly to the Management Board and Supervisory Board.

3.2.1 Distribution of credit risks

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

a) due from central bank and credit institutions (referred to as "banks" in the tables) and investment companies

b) debt securities and derivatives

c) leveraged loans (loans secured by debt or equity securities)

d) corporate credit portfolio, including
- loans and overdrafts
- financial guarantees
- warehouse financing
- factoring
- leasing
- unused loan commitments

e) retail credit portfolio, including
- mortgage loans (home and private loans)
- consumer loans without collateral
- hire-purchase
- credit cards and overdrafts to individuals
- leasing
- retail loans and overdrafts to SMEs
- financial guarantees to SMEs
- unused loan commitments

Maximum exposure to credit risk

(in thousands of euros)	Note	31.12.2019	31.12.2018
Due from banks and investment companies	10	1 271 153	682 658
Financial assets at fair value (debt securities)	12	32 335	38 756
Loans and advances to customers	13	1 687 034	918 761
Receivables from customers	14	3 551	3 721
Other financial assets	15	2 246	2 936
Total financial assets		**2 996 319**	**1 646 832**
Exposures related to off-balance sheet items, excluding performance guarantees	23	373 379	198 210
Total maximum exposure to credit risk		**3 369 698**	**1 845 042**

3.2.2 Credit risk measurement

For all loan products, except leverage loans, LHV uses either rating or scoring systems to assess customer credit risk, as outlined in the table below. In retail, for credit decisions, application PD models are used, while portfolio scoring PD models are developed for existing contracts. There are also separate models to cover the dimensions of Loss Given Default (LGD) and Credit Conversion Factor (CCF).

Portfolio	Segment	Definition	PD	LGD	CCF/EAD
Corporate	Corporate exposures	Loans to companies with total exposure to LHV >= EUR 500 000 (2018: EUR 250 000)	Rating models	Model	Model
Retail	SME, incl. micro enterprises	Loans to companies with total exposure to LHV < EUR 500 000 (2018: EUR 250 000)	Scoring models		
	Private mortgage	All mortgage loans to private individuals	Scoring models		
	Private consumer	All consumer financing products and car leasing to private individuals	Scoring models		

(a) Due from banks and investment companies

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. Loans and advances to central bank, credit institutions and investments companies are not overdue, and are also unsecured. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating). In case there are ratings available from more than one rating agency, the average, or the most conservative rating is used. The positions are held as follows:

Rating

(in thousands of euros)	Credit institutions	Investment companies	Total 31.12.2019	Credit institutions	Investment companies	Total 31.12.2018
Central bank (The Bank of Estonia, The Bank of England)	1 232 733	0	1 232 733	639 862	0	639 862
AA- to AA+	312	0	312	209	0	209
A- to A+	7 993	0	7 993	11 352	0	11 352
BBB to BBB+	4 091	4 917	9 008	5 661	16 505	22 166
B to B+	0	556	556	0	500	500
Non-rated	20 551	0	20 551	8 569	0	8 569
Total (Note 10)	**1 265 680**	**5 473**	**1 271 153**	**665 653**	**17 005**	**682 658**

Non-rated credit institutions are banks or financial institutions without external credit rating, however management considers their credit quality to be good based on available market information. If credit institutions do not have the external rating and they are subsidiaries of large EU banks, then the rating of the parent company is used. Management has assessed that the ECL from credit institutions and investment companies exposures is immaterial due to the strong ratings of corresponding parties, their financial position and also due to the positive economic outlook in short-term perspective, as the Group holds only very liquid positions with the counterparties. See also note 3.2.4.2 for additional information.

(b) Debt securities and derivatives

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

No principal and accrued interest receivables arising from debt securities are overdue. The bonds have no collateral.

The Group´s derivatives, debt securities at fair value through profit or loss (FVTPL) according to ratings given by Standard & Poor's or equivalent:

Ratings distribution
(in thousands of euros)

	Mandatory FVTPL				
	Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	Total 31.12.2019
AAA	11 627	0	0	0	11 627
A- to A+	2 890	17 814	0	0	20 704
Non-rated	0	0	0	4	4
Total (Note 11,12)	**14 517**	**17 814**	**0**	**4**	**32 335**

Ratings distribution
(in thousands of euros)

	Mandatory FVTPL				
	Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	Total 31.12.2018
AAA	0	18 439	0	0	18 439
A- to A+	18 006	0	0	0	18 006
AA- to AA+	0	1 229	0	0	1 229
Non-rated	0	0	1 023	59	1 082
Total (Note 11,12)	**18 006**	**19 668**	**1 023**	**59**	**38 756**

Debt securities classified as FVTPL is based on the management assessment of the instrument's business model and how management monitor these investments. Therefore, fair value through profit or loss measurement basis was applied at the application of IFRS 9 as at 1 January 2018.

(c) Other receivables

Credit quality of other receivables
(in thousands of euros)

	31.12.2019	31.12.2018
Receivables (not overdue)	3 440	3 498
Receivables (overdue)	111	223
incl. receivables from individuals	101	196
incl. receivables from legal entities	10	27
Total (Note 14)	**3 551**	**3 721**

As at 11 February 2019, other receivables of EUR 205 thousand euros are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 15) in amount EUR 2 246 thousand (31.12.2018: EUR 2 936 thousand) are guarantee deposits on the Baltic stock exchanges held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions. The Group considers the counterparties credit risk as very low.

(d) Leveraged loans

The Bank issues margin loans secured by debt or equity securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account, and on the general limit set by the Bank, which is currently EUR 100 thousand (or an equivalent in a foreign currency) per customer. Granting loans above the threshold but not higher than 500 thousand assumes an analysis of the overall financial situation of the client and the portfolio offered as collateral by the customer and the decision is within the competence of the Chief Financial Officer and Head of Brokerage. Loans higher than EUR 500 thousand require a further analysis of the overall financial situation of the client and the portfolio offered as collateral by the customer and the decision is within the competence of the Credit Committee. The Group has set sufficiently conservative limits to the ratio of the loan and the collateral assets value. The list of acceptable marketable financial instruments and the levels of the required collateral are published on the Bank's website www.lhv.ee.

(e) Corporate credit portfolio

Corporate credit portfolio customers are evaluated on individual basis. Each customer is assigned a credit rating between 1 and 13, where 1 means the lowest probability of default and 13 indicates insolvency. Credit rating is assigned to a customer considering combination of financial status and business risk.

The specific financial ratios and business risk aspects considered depend on the rating model used: corporate, commercial real estate, residential development, and commodity. Credit rating is assigned by credit analyst and confirmed by Head of Credit Analysis Department, but final decision of risk taking is the unanimous decision by the Credit Committee.

After issuing the loan, follow-up monitoring is performed at least quarterly for each customer's financial position. At least annually all client ratings are reviewed. Clients with significant increase in credit risks are listed in watchlist. The financial position, liquidity and collateral value of watchlist clients is thoroughly monitored more frequently. See Note 3.2.4. for more detailed information on the credit quality of loans.

(f) Retail loans to SME´s

In 2016, the Group started offering micro loans. The loan is aimed to micro enterprises in the growth stage and the maximum loan amount is up to EUR 25 000.

In addition to micro loans, the retail banking segment also includes other corporate credit commitments in the amount of up to EUR 500 thousand (until May 2019 up to 250 EUR thousand). Credits below EUR 500 thousand are analysed with a more cost-efficient scoring process. The scoring process is carried out at the time of loan application and it is one of the criteria for issuing the loan.

Financial data and information on payment behaviour of the company is used when calculating the probability of default (PD). The structure of assets and liabilities are taken into account, also the profitability and cash flow ratios.

Retail loans of legal entities are included in the retail loans financial statement line item.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(g) Consumer loans without collateral and hire-purchase

Group offers consumer loans and hire-purchase through its subsidiary LHV Finance in Estonia. The maximum loan amount is up to EUR 20 thousand and hire purchase for private individuals up to EUR 10 thousand and for enterprises up to EUR 20 thousand. Hire purchase service is offered through merchant partners. Scoring model are used to assess the customer's credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a credit.

The Group has entered into agreements where most overdue consumer loans and hire purchase agreements are sold – usually when loans reaching overdue at least of 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(h) Credit cards

The Bank issues credit cards and Partner credit cards in cooperation with Tallinna Kaubamaja. Similarly to consumer loans and hire purchase most overdue loans are sold when overdues breach 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(i) Student loans

In 2018, the Group started offering student loans. The loan is aimed to students to cover costs during their studies. The maximum amount of state secured student loan is EUR 2 000 per academic year.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(j) Mortgage loans

In 2013, Group started to offer on a limited basis mortgage loans (private loans) to customers in the Tallinn and Tartu region only. In autumn 2016, Group started offering the mortgage loan (home loans) to a large scale of retail clients without regional limits within Estonia. In November 2019 Danske Bank Estonian Branche's private individual mortgage loan portfolio was acquired by LHV. The maximum loan amount is in line with the regulations set by Central Bank of Estonia.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(k) Leasing

The Bank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using a rating model for clients with exposure of more than EUR 500 thousand and scoring models for clients with exposure of less than EUR 500 thousand. Rating model is the same which used for assessment of creditworthiness of corporate credit portfolio customers.

See Note 3.2.4. for more detailed information on the credit quality of loans.

Risk concentration

Several tolerance limits that are regularly monitored and reported have been introduced in Group's Credit Policy to control and hedge concentration risk. These limits are set for overall credit portfolio and separately for the largest – corporate credit portfolio. The most significant metrics and limits measured at the last day of each quarter are as follows:

a) The share of small financing in the Group's total credit portfolio

b) The share of financing non-domicile customers in the Group's total credit portfolio

c) The share of shadow banking financing compared to net owned funds

d) The share of ten largest credit customers compared to net owned funds

e) The share of financing the higher risk rating classes compared to the total corporate credit portfolio

f) The share of financing the catering and construction sector compared to the total corporate credit portfolio

g) The share of financing outside of Estonia (incl. financing in EU countries and UK).

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

As at 31.12.2019, the loans issued to 10 customers (2018: total 8) had a large risk exposure, i.e. more than 10% of the net own funds (NOF) of Group either individually or via group risk, totalling 160% of NOF (2018: 111%).

As of 31.12.2019 the Group has not invested in the debt securities with a large risk exposure (2018: 2 debt securities; 21% of NOF). Of customer deposits, the deposits of 3 (2018: 3) customers have a high risk concentration, which amounts to 192% (2018: 89%) of NOF. There are 3 clients holding more than 1% of all deposits (2018: 6). Their total deposits amount was EUR 463 million (2018: 189). Share of Top 20 depositors was 25.5% as of 31.12.2019 compared to more than 20% as end of 2018.

31.12.2019

(in thousands of euros)

	Note	Estonia	Latvia	Lithuania	Finland	Germany	Other EU	USA	UK	Other	Total
Due from banks and investment companies	10	1 229 169	0	0	0	0	10 972	4 929	23 041	3 042	**1 271 153**
Financial assets at fair value	11, 12	8 484	760	19 951	0	9 840	1 907	4	0	16	**40 962**
Loans and advances to customers	13	1 656 373	445	287	5 574	840	19 951	379	0	3 185	**1 687 034**
Receivables from customers	14	3 551	0	0	0	0	0	0	0	0	**3 551**
Other financial assets	15	110	0	0	0	0	0	2 136	0	0	**2 246**
Total financial assets		**2 897 687**	**1 205**	**20 238**	**5 574**	**10 680**	**32 830**	**7 448**	**23 041**	**6 243**	**3 004 946**
Deposits from customers and loans received	17	1 870 475	12 725	1 503	19 564	372 390	394 310	1 241	0	54 354	**2 726 562**
Subordinated debt	20	75 000	0	0	0	0	0	0	0	0	**75 000**
Accounts payable and other financial liabilities	18	20 739	0	4	27	0	13	3	3	0	**20 789**
Financial liabilities at fair value	12	8	0	0	0	0	0	0	0	0	**8**
Total financial liabilities		**1 966 222**	**12 725**	**1 507**	**19 591**	**372 390**	**394 323**	**1 244**	**3**	**54 354**	**2 822 359**

31.12.2018

(in thousands of euros)

	Note	Estonia	Latvia	Lithuania	Finland	Germany	Other EU	USA	Other	Total
Due from banks and investment companies	10	650 321	0	0	0	0	13 599	16 541	2 197	**682 658**
Financial assets at fair value	11, 12	8 392	772	17 242	0	1	20 704	43	0	**47 154**
Loans and advances to customers	13	886 881	52	10 561	1 524	6	18 433	175	1 129	**918 761**
Receivables from customers	14	3 706	1	5	0	0	0	0	9	**3 721**
Other financial assets	15	111	0	0	0	0	0	2 825	0	**2 936**
Total financial assets		**1 549 411**	**825**	**27 808**	**1 524**	**7**	**52 736**	**19 584**	**3 335**	**1 655 230**
Deposits from customers and loans received	17	1 154 012	10 041	951	3 414	13 274	220 749	3 085	38 256	**1 443 782**
Subordinated debt	20	50 900	0	0	0	0	0	0	0	**50 900**
Accounts payable and other financial liabilities	18	21 381	0	4	27	0	13	3	0	**21 428**
Financial liabilities at fair value	12	11	0	0	0	0	0	0	0	**11**
Total financial liabilities		**1 226 304**	**10 041**	**955**	**3 441**	**13 274**	**220 762**	**3 088**	**38 256**	**1 516 121**

Distribution of loans granted by industry (gross):

(in thousands of euros)	31.12.2019	%	31.12.2018	%
Individuals	738 152	43.6%	214 702	23.1%
Real estate	353 405	20.9%	246 930	26.6%
Manufacturing	114 104	6.7%	98 073	10.6%
Art and entertainment	42 638	2.5%	34 582	3.7%
Financial services	71 690	4.2%	95 697	10.3%
Wholesale and retail	80 767	4.8%	24 378	2.6%
Administrative activities	67 064	4.0%	39 808	4.3%
Transport and logistics	15 337	0.9%	11 076	1.2%
Agriculture	59 657	3.5%	20 231	2.2%
Other servicing activities	7 290	0.4%	25 669	2.8%
Construction	38 951	2.3%	35 808	3.9%
Information and communication	7 017	0.4%	4 115	0.4%
Professional, scientific and technical activities	47 368	2.8%	18 779	2.0%
Education	1 976	0.1%	2 391	0.3%
Other areas at activities	47 722	2.8%	56 798	6.1%
Total (Note 13)	**1 693 138**	**100%**	**929 037**	**100%**

Loans and advances (incl. loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 3.3.2 for more details.

Credit risk grading

The Group uses internal credit risk grading that reflect the assessment of the probability of default of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between rating grade 4 and 5 is lower than the difference in the PD between a 7 and 8.

The following are additional considerations for each type of portfolio held by the Group:

Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on a periodic basis to develop a behavioural score. Any other known information about the borrower which impacts their creditworthiness – such as unemployment and previous delinquency history – is also incorporated into the behavioural score. This score is mapped to a PD.

Corporate

For corporate business, the rating is determined at the borrower level. A credit analyst will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the analyst will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and PD.

Treasury

For debt securities in the Treasury portfolio, the credit standing of the security is determined on the basis of the ratings of external rating agencies. These ratings are continuously monitored and updated. The PD's associated with each rating are mapped to LHV's rating scale.

Liquidity Risk

As LHV keeps its liquid assets mainly in cash in ECB then concentration risk in liquidity risk concerns mostly funding risks. 98% of LHV funding is in the form of deposits and therefore the most important metrics to measure concentration risk concerning liquidity is deposit concentration (Note 3.2.2. Risk concentration).

Credit Risk

The Group's rating method used for evaluating the PD of corporate loans consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk (default). Ratings 1 and 2 are attributed only based on average ratings of rating agencies Fitch, Moody's and Standard & Poor's, and are subject to the Group's financial analysis as necessary.

Thus, ratings 1 and 2 are attributed only to international enterprises, organisations, local governments and countries whose solvency has been confirmed by the rating agencies with their investment grade rating. Also rating classes 3 -13 are partly based on the evaluation of rating agencies, although this category includes mainly Estonian enterprises that do not have an international rating.

The group's internal rating scale for corporate loans and mapping of external ratings:

LHV rating	LHV description	PD%	S&P	Moody's
1		0.03	AAA	Aaa
2		0.05	AA+	Aa1
3		0.10	AA, AA-	Aa2, Aa3
4		0.20	A+,A,A-	A1,A2,A3
5	Investment grade	0.30	BBB+	Baa1
6		0.40	BBB	Baa2
7		0.50	BBB-	Baa3
8		1.00	BB+,BB	Ba1,Ba2
9		2.50	BB-	Ba3
10	Non-investment grade	5.00	B+	B1
11	(including special monitoring)	10.00	B,B-	B2,B3
12		30.00	CCC/C	Caa
13	Default	100.00	D	C

The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

All retail loans have a behavioural score. This score is mapped to a PD. Retail loans are divided into three groups: investment grade, special monitoring and default. Investment grade is allocated when the loan is not overdue as at balance sheet date. Special monitoring status is allocated when the loan has overdue status more than 31 days and default status is based on the definition of default principle.

3.2.3 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.2.3.1 for a description of how the Group determines when a significant increase in credit risk has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.2.3.2 for a description of how the Group defines credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.2.3.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 3.2.3.4 includes an explanation of how the Group has incorporated this in its ECL models.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	Stage 2	Stage 3
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below.

3.2.3.1 Significant increase in credit risk

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

Quantitative criteria

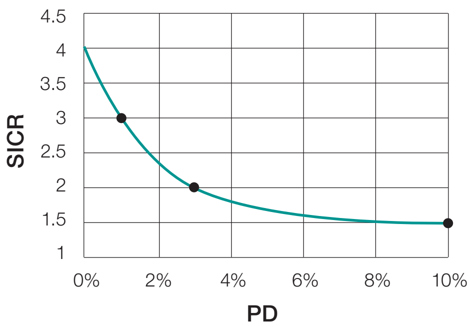
Quantitative criteria is applied to all credit contracts initiated in 2018 in the current portfolio and Wholesale legacy portfolio, for which a rating based Lifetime PD is used.

The remaining Lifetime PD at the reporting date has increased, compared to the residual Lifetime PD expected at the reporting date when the exposure was first recognised, so that it exceeds the relevant threshold per the table below:

Current portfolio – contracts initiated from 1st January 2018

Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
X%	≥100 bps
And	Current PD_life/Initial PD_life > 1.4885+exp(0,9549-54,173*Initial PD_life)

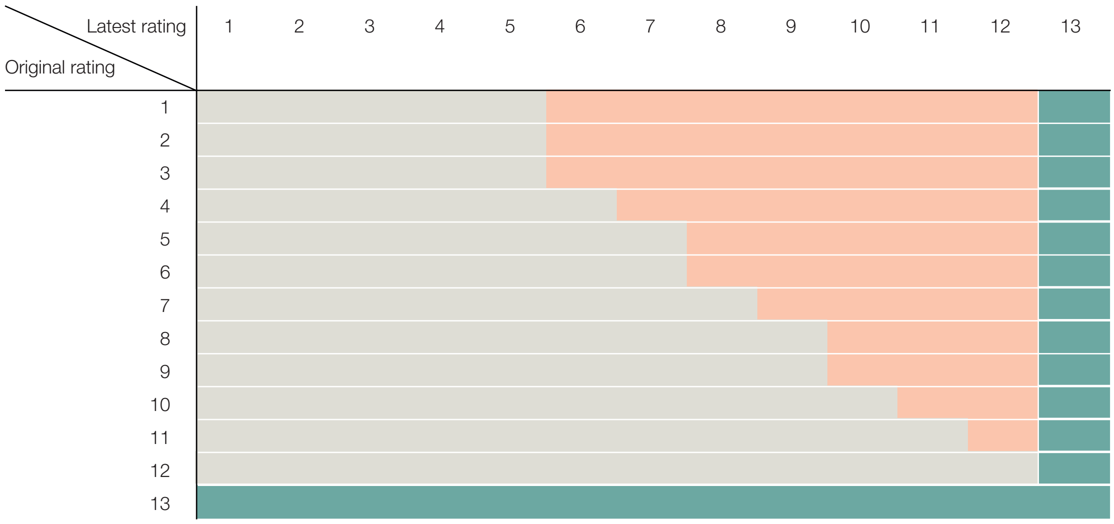
To illustrate the formula, see SICR curve graphic below. In addition to the curve, the PD increase has to be at least 100 bps.



SICR curve: Relation between the Origination PD and the significance threshold (PD increase in number of times) for identifying significant increase in default risk

To illustrate the application of these thresholds, take for example a 3-year retail business loan agreement initiated on 13th February 2018 which at initial recognition had a Lifetime PD of 3.36 % and was expected to have a residual Lifetime PD of 2.76% ten months later at the current reporting date. If at the current reporting date the loan has a current lifetime PD of 8.86% then this exceeds the expected PD of 2.76% by more than the threshold shown above. Therefore a significant increase in credit risk has occurred.

Legacy portfolio – corporate contracts initiated before 1st January 2018



These thresholds have been determined by assessing how the Lifetime PD moves prior to an instrument becoming delinquent. The Lifetime PD movements on instruments which do not subsequently become delinquent have also been assessed, to identify the „natural" movement in Lifetime PD, which is not considered indicative of a significant increase in credit risk. The average maturity of the corporate portfolio is short, namely 2.5 years.

Qualitative criteria

Qualitative criteria is applied in SICR calculation to legacy retail portfolio that was initiated before 2018. For the current portfolio, the qualitative criteria is included in the PD calculation and therefore included in the SICR calculation through Lifetime PD.

Due to the average short maturity of the legacy portfolio (1.75 years) it was not practical to go back to history to predict initial PDs for the contracts initiated before the of 1st December, 2017 and therefore the application PD or rating PD were used as initial PDs for legacy portfolio.

Retail legacy portfolio – private person contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or
- The customer has had more than one payment alert or tax debt over the last 12 months
- In case of home or private loan the contract LTV >100% is also considered.

Retail legacy portfolio – business contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or
- The customer has had more than one payment alert or has had at least four incidents of tax debt in the amount of over 640 euros over the last 12 months.

The assessment of SICR incorporates forward-looking information (see note 3.2.3.4. for further information) and is performed on a quarterly basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent member of Credit Risk team.

Backstop

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

The Group has used the low credit risk exemption for cash and nostro accounts fulfilling the liquidity portfolio criteria in the year ended 31 December 2019 and 31 December 2018.

The following tables show the impact on the 31 December 2019 and 31 December 2018 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognised.

Product 2019
(in thousands of euros)

	+10% Change in SICR	-10% Change in SICR
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	-1	0
Consumer loans	-4	5
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	-8	7
Private loans	-2	1
Leasing	-5	1

Product 2018
(in thousands of euros)

	+10% Change in SICR	-10% Change in SICR
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	-3	3
Hire-purchase	0	0
Credit cards	0	1
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

Product 2019
(in thousands of euros)

	SICR with 0.5% treshold	SICR with 1.5% treshold
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

Product 2018
(in thousands of euros)

	SICR with 0.5% treshold	SICR with 1.5% treshold
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

As evidenced by above tables, changing SICR by +/- 10% or changing the 100bps threshold to 50bps or 150bps have limited impact to the overall ECL of the Group.

3.2.3.2 Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments has been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %
- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

For applying the default status a customer based approach is used for wholesale and contract based approach is used for the retail portfolio.

An instrument is considered to no longer be in default when it no longer meets any of the default criteria for the probation period of corresponding to the reason of default. The shortest probation period of three months is applied to the contracts that defaulted due to filling the quantitative criteria from the date the criteria is no longer met.

Loans under distressed restructuring are considered to require particular attention in the reclassification to non-defaulted status because the assessment of days past due is based on the modified payment arrangement and the exposure cannot stop being restructured by the time it is fully repaid. Therefore the probation period for these loans is defined as at least 1 year from the latter of:

- the moment of extending the restructuring measures;
- the moment when the exposure has been classified as defaulted; or
- the end of grace period included in the restructuring arrangements.

3.2.3.3 Measuring ECL - Explanation of inputs, assumptions and estimation techniques

The aim of the ECL model is to calculate the 12-month and lifetime expected credit losses that:

- are unbiased, i.e. do not include any conservatism or optimism;
- are probability-weighted amounts that are determined by evaluating three provisioning scenarios (base scenario, upside scenario and downside scenario);
- reflect the time value of money;
- use reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.

The Group's ECL model follows widely accepted sum of marginal losses approach, whereby ECLs are calculated as the sum of the marginal losses occurring in each time period (month) from the reporting date. The marginal losses are derived from individual risk parameters (PD, LGD, EAD) that estimate exposures and losses in the case of default and the marginal probability of default for each period (the probability of a default between time periods t and t+1).

ECL calculations are based on four components:

Probability of Default (PD) is an estimate of the likelihood of default over a given time horizon.

Exposure at Default (EAD) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

Loss Given Default (LGD) is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that LHV would expect to receive, including from any collateral. LGD is expressed as a percentage of the EAD.

Discount factor is used to discount an expected loss to a present value at the reporting date.

Mathematically, the ECL amount for prediction horizon T (12 months or lifetime, depending on whether 12-month or lifetime ECL estimates are concerned) is expressed as follows:

$$ECL_T = \sum_{t=1}^{T} PD_t * LGD_t * EAD_t * d_t$$

Where:

t = 0,…,T	*– a one month period within the prediction horizon T; for a 12-month ECL estimate, T = 12 months; for a lifetime ECL estimate, T = expected life of the lending exposure;*
PDt	*– marginal PD for month t;*
LGDt	*– LGD as estimated for month t;*
EADt	*– exposure amount, incl. expected drawdowns of undrawn commitments, at month t;*
dt	*– discount factor for month t.*

The discount rate represents the effective interest rate ("EIR") for the financial instrument or an approximation thereof.

A simplified example of the calculation logic is illustrated in table below. Note that in this example for secured loans, LGD is directly derived from the collateral value and as a simplification, fair value is assumed to be constant. However, ECL model takes into account the possible decrease of collateral fair value over time through different scenarios.

	31/01/2019	28/02/2019	31/03/2019	30/04/2019	31/05/2019	30/06/2019	31/07/2019	31/08/2019	30/09/2019
(1) Exposure (EAD)	4000	3500	3000	2500	2000	1500	1000	500	0
(2) Marginal PD	0.40%	0.38%	0.36%	0.34%	0.32%	0.30%	0.28%	0.26%	0.24%
(3) Collateral value	2000	2000	2000	2000	2000	2000	2000	2000	2000
(4) Potential loss amount [Max (0;1-3)}	2000	1500	1000	500	0	0	0	0	0
(5) Expected marginal loss [2*4]	8	5.7	3.6	1.7	0	0	0	0	0
(6) Expected marginal loss, discounted	7.97	5.65	3.56	1.67	0	0	0	0	0
Lifetime ECL at 31.12.2018 [Sum(6)]	18.85								

Note. Discounting is done, assuming current reporting date 31.12.2018 and a 5% discount rate.

For the defaulted exposures, ECL is computed as:

$$ECL_T \sum_{t=1}^{T} LGD_t * Exposure_t * d_t$$

Each of the risk dimensions (PD, LGD, EAD) is covered with the internally developed rating- and scoring models. These models have been developed for the business- and credit management.

As can be concluded, the key issue in ECL modelling is to transform the available risk parameter values into forward looking PiT estimates and 'feed' them into the expected credit loss calculation formula.

IFRS 9 parameters

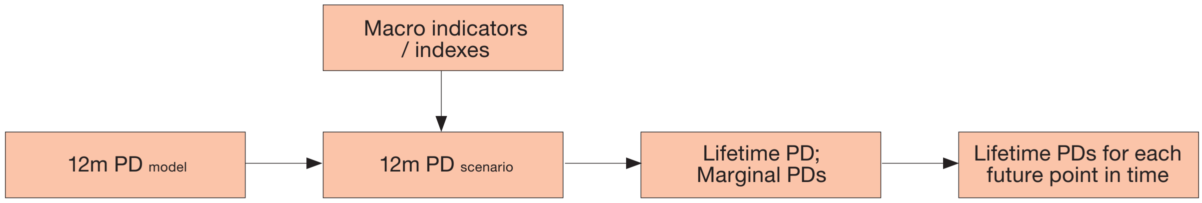
Definition of Default	• 90 days past due • Unlikely to pay without the bank turning to recourses such as selling collateral
PD	• 12-month PD; lifetime PD broken down further into marginal probabilities for sub-periods • Forward looking PiT estimate, reflecting assessment of current and future economic conditions, and a range of possible future outcomes • No regulatory floors or margins of conservatism applied
LGD	• Neutral PiT projections • Consider current and future economic conditions, and a range of possible future outcomes • Recoveries discounted, using EIR as discount rate • No regulatory floors or margins of conservatism applied
CCF/EAD	• Reflects expected changes in the balance outstanding over the lifetime of the lending exposure, incl. scheduled loan payments and prepayments
ECL	• PV of cash shortfalls. For Stage 1 exposures, 12-month PD is used. For stage 2 exposures, lifetime PD is used. For Stage 3 exposures, PD = 100%

The following paragraphs outline how the existing underlying models are leveraged off for the ECL measurement. Each risk dimension in detail is discussed in the following chapters.

3.2.3.3.1 'Feeding' PDs from underlying rating and scoring models into ECL model

Instead of the historically based or long run average 12-month PDs (model PDs), forward looking 12-month and lifetime PiT estimates and marginal PDs are required for the IFRS 9 expected credit loss calculation.

The transformation of the model PD (PDmodel) is performed in the following flow:



Firstly, model PD is re-calibrated to the forward looking 12-month PiT estimate, given the defined macro scenario (12m PDscenario). Selected macro indicators, transformed into macro indexes, serve as inputs for this purpose.

Next, forward looking 12-month PiT estimate is converted to lifetime PD and marginal PDs. This is done using the segment-specific standard default curve which gives the timing of the expected defaults for the remaining life of an exposure.

Lastly, lifetime PDs for each of the future points in time till the end of the expected life of the exposure are calculated.

3.2.3.3.2 'Feeding' LGDs from underlying models into ECL model

In LGD dimension, the use of the underlying LGD models differs for secured and unsecured lending exposures.

As IFRS 9 parameter should take into account the expected drop in the exposure amount over time, LGD for the secured part of the secured loans is directly calculated from the estimated fire-sale price of the collateral; no input from the underlying LGD models is used.

LGDs from the underlying LGD models 'feed' into the ECL calculation for the unsecured exposures and unsecured parts of the secured exposures.

Further, macroeconomic scenarios are incorporated into both secured and unsecured LGDs as applicable for the defined provisioning scenarios.

3.2.3.3.3 'Feeding' CCF estimates from underlying models into ECL model

Internal CCF estimates feed directly to the ECL model and are used in the EAD. No further adjustments are needed for the CCF as the internal estimates do not include margins of conservatism, or through the cycle (TtC) or downturn adjustments.

3.2.3.4 Forward-looking information incorporated in the ECL model

In order to incorporate forward looking information into the ECL measurements and capture a range of possible outcomes for the future conditions, probability-weighted ECL amounts based on the three provisioning scenarios (base, upside and downside) are calculated. Among others, this approach enables to reflect non-linear relationships between alternative scenarios and the ECL.

Mathematically:

$$ECL = p_{base} * ECL_{base} + p_{up} * ECL_{up} + p_{down} * ECL_{down}$$

Where:

pbase, pup, pdown	– probabilities of the base, upside and downside scenarios respectively;
ECLbase, ECLup, ECLdown	– expected credit loss amounts calculated for each of the defined scenarios.

ECLs for each of the defined scenarios are derived based on the general formula, using scenario specific risk parameter values. Probability-weighted lifetime PD estimates for the purpose of assessing significant increase in credit risk are calculated in the same way:

$$PD = p_{base} * PD_{base} + p_{up} * PD_{up} + p_{down} * PD_{down}$$

Where:

PDbase, PDup, PDdown	– lifetime PD estimates corresponding to each of the defined scenarios.

3.2.3.4.1 Selected indicators for private person credit portfolios

Selected macro indicators for private person credit portfolios and relative importance of each of the indicators are shown in table below:

	Mortgage	Consumer financing, fixed rate	Consumer financing, floating (incl. leasing)
Wage growth, %	17%	22%	18%
Unemployment rate, %	33%	44%	36%
Houseprice index growth, %	8%	0%	0%
Inflation rate, %	8%	11%	9%
Euribor, 6m	17%	0%	18%
Bank lending margins	17%	22%	18%
TOTAL	**100%**	**100%**	**100%**

Note. Relative importance of each of the indicators is calculated based on the indicator 'weights'.

3.2.3.4.2 Selected indicators for companies

A wide range of macroeconomic and industry sector-specific indicators was considered for companies. The analysis was conducted based on the two industry breakdowns:

1) broad industry sector level based on letter codes / alphabetical branch of the NACE Rev.2 classification, and
2) sub-sectors based on lower level numerical codes of the NACE Rev.2 classification.

The following conclusions were drawn from the analysis:

All sectors have been affected by the same credit cycle and have experienced major sector-wide financial difficulties at the same time. Despite of that, there are certain idiosyncratic differences between the industry sub-sectors e.g. in manufacturing.

There are only a few variables that 'work'; the variables that have explanatory power, tend to 'work' similarly for most of the industry sectors:

- GDP growth which explains the general state of economy,
- Change in turnover,
- Change in number of persons employed.

Change in an industry sector's profit/loss was also tested, but tends to be too volatile for drawing conclusions on substantial change in default risk.

A few macro indicators are significant to certain industry sectors, sub-sectors and/or groupings of sub-sectors even if correlations are difficult to show due to low numbers of observations and/or because of relatively short observation period. E.g.:

- Export conditions for export-oriented industries such as: metal products, chemical products and electrical equipment;
- Population growth and income growth for residential real estate;
- Household consumption growth for industries that are oriented to internal consumption such as retail trade.
- In conclusion, gross value added by industry sectors was selected as the indicator for companies, this given several considerations:
- Observed correlation with the considered proxies for default rates;
- GDP, which is close indicator to the gross value added, is the preferred approach for the industry;

It is easier to project for a macro economist than alternative indicators.

Economic variable assumptions

Macoreconomic scenarios (forecasts) and its indicators (incl. corporate portfolio PD and LGD estimates) are developed at least once a year and which are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business, finance and external experts.

Macro developments are monitored on a quarterly basis as new macroeconomic data becomes available. Forecasts are updated as necessary in order to ensure timely inclusion of new forward-looking information into the ECL estimates.

Developed provisioning scenarios and significant updates to the scenarios are approved in the Risk and Capital Committee.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 31.12.2019

General macro-financial indicators	Base scenario 2020E	Base scenario 2021E	Downside scenario 2020E	Downside scenario 2021E	Upside scenario 2020E	Upside scenario 2021E
Real GDP growth, %	**2,2%**	**2,6%**	**0,2%**	**0,6%**	**2,7%**	**3,1%**
Household consumption, %	3,6%	2,8%	1,6%	0,8%	4,1%	3,3%
Government consumption, %	0,1%	-0,2%	-2,0%	-2,2%	0,6%	0,3%
Gross fixed capital formation, %	0,6%	2,7%	-1,5%	0,7%	1,1%	3,2%
Exports of goods and services, %	1,6%	3,1%	-0,4%	1,1%	2,1%	3,6%
Imports of goods and services, %	2,1%	3,1%	0,1%	1,1%	2,6%	3,6%
Nominal GDP, EURm	29 472	31 010	27 791	28 111	30 048	31 924
GDP deflator, % change	3,0%	2,6%	1,0%	0,6%	3,5%	3,1%
Consumer price growth, %	2,1%	2,0%	2,0%	2,0%	2,6%	2,5%
Unemployment rate, %	5,6%	5,9%	7,6%	7,9%	5,1%	5,4%
Change in employment, %	0,2%	-0,1%	-0,3%	-0,8%	0,7%	0,5%
Net monthly wage growth, %	5,5%	5,1%	3,4%	3,1%	5,9%	5,6
House price index growth, %	4,0%	4,1%	-4,8%	-4,4%	5,5%	5,1%
Euribor 6m	-0,6%	-0,5%	-0,6%	-0,6%	-0,5%	-0,3%
Bank lending margins on new loans	2,3%	2,5%	2,5%	2,7%	2,0%	2,0%

Nominal growth

Gross value added by sectors, y-o-y growth rates	Base scenario 2020E	Base scenario 2021E	Downside scenario 2020E	Downside scenario 2021E	Upside scenario 2020E	Upside scenario 2021E
Total - all NACE activities	**5,3%**	**5,2%**	**1,2%**	**1,2%**	**6,2%**	**6,2%**
Agriculture, forestry and fishing	5,0%	5,0%	0,6%	0,5%	9,3%	6,0%
Industry (except construction)	4,9%	5,0%	-0,2%	0,3%	6,2%	5,7%
Industry, except construction and manufacturing (mostly energy related)	5,0%	5,0%	-0,5%	-0,6%	6,0%	6,0%
Manufacturing	5,0%	5,0%	-0,1%	0,5%	6,3%	5,7%
Construction	3,6%	5,0%	-8,5%	0,5%	6,0%	7,4%
Wholesale and retail trade, transport, accomodation and food service activities	4,5%	4,5%	0,1%	0,1%	5,5%	6,9%
Information and communication	8,5%	8,4%	8,5%	8,4%	9,5%	9,4%
Financial and insurance activities	7,2%	5,0%	2,7%	-2,6%	7,1%	6,0%
Real estate activities	4,0%	4,1%	-4,8%	-4,4%	5,5%	5,1%
Professional, scientific and technical activities; administrative and support service activities	5,0%	5,0%	0,6%	0,5%	6,0%	6,0%
Public administration, defence, education, human health and social work activities	5,0%	5,0%	6,1%	5,5%	6,0%	6,0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organisations and bodies	0,8%	0,6%	-1,5%	-3,7%	1,7%	1,6%

The weightings assigned to each economic scenario at 31 December 2019 were as follows:

Valid at 31.12.2019

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

The weightings assigned to each economic scenario at 31 December 2018 were as follows:

Valid at 31.12.2018

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

The most significant period-end assumptions used for the ECL estimate as at 31 december 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 31.12.2018

	Base scenario		Downside scenario		Upside scenario	
General macro-financial indicators	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Real GDP growth, %	3,0%	2,9%	1,0%	0,9%	4,0%	3,9%
Household consumption, %	3,9%	3,0%	2,0%	1,0%	4,5%	3,5%
Government consumption, %	0,8%	0,7%	0,7%	0,6%	1,2%	1,0%
Gross fixed capital formation, %	4,4%	4,2%	2,0%	1,9%	8,0%	8,0%
Exports of goods and services, %	3,8%	3,8%	0,5%	0,3%	4,3%	4,3%
Imports of goods and services, %	4,0%	3,9%	1,0%	0,7%	4,8%	4,8%
Nominal GDP, EURm	27 051	28 614	26 161	26 919	27 722	29 875
GDP deflator, % change	3,2%	2,8%	2,5%	2,0%	3,9%	3,7%
Consumer price growth, %	3,0%	2,6%	2,1%	1,7%	3,5%	3,5%
Unemployment rate, %	4,6%	4,5%	5,5%	5,9%	4,5%	4,5%
Change in employment, %	0,8%	-0,1%	0,0%	-0,3%	1,1%	0,3%
Net monthly wage growth, % (nominal)	6,0%	5,2%	3,0%	2,5%	7,5%	6,0%
House price index growth, %	3,4%	3,2%	-4,0%	-4,1%	4,4%	4,2%
Euribor 6m	-0,2%	0,2%	-0,2%	0,2%	-0,1%	0,3%
Bank lending margins on new loans	2,0%	2,0%	2,3%	2,5%	2,0%	2,0%

Nominal growth

	Base scenario		Downside scenario		Upside scenario	
Gross value added by sectors, y-o-y growth rates	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Total - all NACE activities	6,3%	5,7%	3,5%	3,1%	8,0%	7,8%
Agriculture, forestry and fishing	10,0%	10,0%	5,0%	5,0%	14,0%	14,0%
Industry (except construction)	5,0%	4,3%	2,8%	2,2%	6,2%	5,5%
Industry, except construction and manufacturing (mostly energy related)	5,0%	3,0%	4,8%	2,8%	6,0%	4,0%
Manufacturing	5,0%	4,7%	2,1%	2,0%	6,3%	6,0%
Construction	9,0%	5,0%	-6,0%	-4,0%	12,0%	11,0%
Wholesale and retail trade, transport, accomodation and food service activities	5,0%	4,8%	1,5%	0,5%	6,5%	6,5%
Information and communication	14,1%	14,0%	14,1%	14,0%	15,8%	15,8%
Financial and insurance activities	6,0%	6,0%	3,5%	3,5%	9,0%	9,0%
Real estate activities	3,3%	3,3%	-1,0%	-5,0%	3,8%	3,8%
Professional, scientific and technical activities; administrative and support service activities	7,0%	6,0%	5,0%	4,0%	9,0%	8,0%
Public administration, defence, education, human health and social work activities	6,0%	6,0%	9,0%	9,0%	8,0%	8,0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organisations and bodies	7,0%	6,5%	4,5%	4,0%	9,0%	8,5%

Sensitivity analysis
The most significant assumptions affecting the ECL allowance are as follows:

Retail portfolio

- Unemployment rate
- Wage growth
- Euribor
- Bank lending margins
- GDP

Corporate portfolio

- Estimated portfolio PiT PD values for each scenario
- Estimated LGD impact on downside scenario

The table below illustrates the impact of changing scenario weights of positive and negative scenarios to the portfolio as it was at 31 December 2018 and 31 December 2019.

31.12.2019	65-5-30	65-15-20
(in thousands of euros)	(base/up/down)	(base/up/down)
Change in scenario weights	293	-284

31.12.2018	65-5-30	65-15-20
(in thousands of euros)	(base/up/down)	(base/up/down)
Change in scenario weights	265	-265

Set out below are the changes to the ECL as at 31 December 2019 and 31 December 2018 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions (for example, the impact on ECL of increasing the estimated unemployment rate by X% in each of the base, upside, downside scenarios):

31.12.2019

(in thousands of euros)	Impact of increase	Impact of decrease
Unemployment rate +/-1%	114	-93
Wage growth +/- 5%	-113	92
Euribor +/-0.5%	17	-11
Bank lending margins +/-0.5%	159	-167
Consumer price growth +/-1%	-37	30
House price index +/- 2%	-4	4
Gross value added by sectors, yoy growth rates +/- 5%	-37	34

31.12.2018

(in thousands of euros)	Impact of increase	Impact of decrease
Unemployment rate +/-1%	37	-24
Wage growth +/- 5%	-35	27
Euribor +/-0.5%	1	-1
Bank lending margins +/-0.5%	62	-50
Consumer price growth +/-1%	-13	8
House price index +/- 2%	0	0
Gross value added by sectors, yoy growth rates +/- 5%	-24	27

The Group has performed stress test scenarios when PD and LGD estimations will both increase by 0.5. The impact of the described stress test to impairments is aggregated in the table below. The table includes loans, which have collective impairment and which have material balances and potential impact

2019

(in thousands of euros)	Impact on loss allowances
LGD negative 0.9	136
LGD negative 1.0	29
Average PiT PD -0.5%	-898
Average PiT PD +0.5%	875

2018

(in thousands of euros)	Impact on loss allowances
LGD negative 0.88	260
LGD negative 1.0	-246
Average PiT PD -0.5%	-843
Average PiT PD +0.5%	814

3.2.4 Credit risk exposure

3.2.4.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 3.2.3. „Expected credit loss measurement". The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Corporate Credit portfolio

As at 31.12.2019, the impairment reserve makes up 0.44% of corporate loans and overdraft and the related interest receivables (31.12.2018: 1.4%).

Distribution of corporate loans, overdraft and trade financing by internal ratings

(in thousands of euros)	31.12.2019	31.12.2018	Grading
4 low credit risk	40	1 162	Investment grade
5 low credit risk	14 984	31 936	
6 low credit risk	133 538	103 019	
7 medium credit risk	215 853	155 855	
8 medium credit risk	263 626	180 376	
9 heightened credit risk	151 446	116 164	
10 high credit risk	49 375	38 407	Non-investment grade (incl. special monitoring)
11 high credit risk	4 559	3 121	
12 non-satisfactory rating	4 268	5 807	
13 insolvent	1 036	12 425	Default
Total	**838 725**	**648 271**	

Corporate loans

2019 ECL staging *(in thousands of euros)*	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
Credit grade					
Investment grade	744 985	11 795	0	0	**756 780**
Non-investment grade (incl. special monitoring)	21 521	26 627	0	0	**48 148**
Default	0	0	1 036	0	**1 036**
Gross carrying amount	**766 506**	**38 422**	**1 036**	**0**	**805 964**
Loss allowances	2 410	1 128	0	0	**3 538**
Carrying amount	**764 096**	**37 294**	**1 036**	**0**	**802 426**

Corporate loans

2018 ECL staging *(in thousands of euros)*	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
Credit grade					
Investment grade	471 744	603	0	0	**472 348**
Non-investment grade (incl. special monitoring)	135 723	27 775	0	0	**163 498**
Default	0	0	12 045	380	**12 425**
Gross carrying amount	**607 468**	**28 378**	**12 045**	**380**	**648 271**
Loss allowances	1 973	1 107	5 486	186	**8 751**
Carrying amount	**605 495**	**27 272**	**6 560**	**194**	**639 520**

As at 31.12.2019 stage 3 includes 3 loans which are well collateralised taking into consideration all three scenarios and, therefore, the related ECL is considered to be 0 EUR. For off-balance sheet exposures related with corporate credit portfolio, a provision of EUR 178 thousand was recorded as of 31.12.2019 (31.12.2018: EUR 128 thousand).

Trade financing

As at 31.12.2019, the group-based impairment reserve makes up 0.38% of trade financing portfolio and the related interest receivables.

Trade financing
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	22 707	0	0	0	**22 707**
Non-investment grade (special monitooring)	10 055	0	0	0	**10 055**
Default	0	0	0	0	**0**
Gross carrying amount	**32 761**	**0**	**0**	**0**	32 761
Loss allowances	123	0	0	0	**123**
Carrying amount	**32 638**	**0**	**0**	**0**	32 638

The size of the trade finance portfolio was negligible as at 31.12.2018 and it was recorded as part of the corporate loan portfolio.

Retail loans

As at 31.12.2019, the group-based impairment reserve makes up 0.1% of retail loans to SME and related claims (31.12.2018: 0.4%). Credit decision is done by the majority decision of the Retail Banking Credit Committee.

Retail loans to SMEs
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	36 275	0	0	0	**36 275**
Special monitoring	0	4 528	0	0	**4 528**
Default	0	0	164	0	**164**
Gross carrying amount	**36 275**	**4 528**	**164**	**0**	40 967
Loss allowances	36	45	72	0	**153**
Carrying amount	**36 239**	**4 483**	**92**	**0**	40 813

Retail loans to SMEs
2018 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	14 966	0	0	0	**14 966**
Special monitoring	0	1 043	0	0	**1 043**
Default	0	0	191	0	**191**
Gross carrying amount	**14 966**	**1 043**	**191**	**0**	16 200
Loss allowances	31	54	98	0	**184**
Carrying amount	**14 935**	**988**	**93**	**0**	16 016

For off-balance sheet exposures related with retail credit portfolio, a provision of EUR 1 thousand was recorded as of 31.12.2019 (2018: EUR 19 thousand).

Private loans
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	39 860	0	0	0	**39 860**
Special monitoring	0	4 806	0	0	**4 806**
Default	0	0	50	93	**143**
Gross carrying amount	**39 860**	**4 806**	**50**	**93**	**44 810**
Loss allowances	24	49	1	14	**89**
Carrying amount	**39 836**	**4 757**	**49**	**79**	**44 721**

Private loans
2018 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	35 248	0	0	0	**35 248**
Special monitoring	0	2 516	0	0	**2 516**
Default	0	0	146	16	**163**
Gross carrying amount	**35 248**	**2 516**	**146**	**16**	**37 927**
Loss allowances	8	0	1	0	**10**
Carrying amount	**35 239**	**2 516**	**145**	**16**	**37 917**

Consumer loans

PD and LGD values are updated at least once a year with new historical data in order to maintain adequate provision levels on portfolio. If necessary, additional impairments will be made in the statement of financial position. If non-performing or doubtful loan recovery is neither economical nor practical to continue, the loan is written off as irrecoverable. The gross amount of consumer loans written off and recorded as off-balance sheet EUR 68 thousand as at 31 December 2019 (2018: 26).

As at 31.12.2019, the group-based impairment reserve makes up 1.26% of consumer loans and the related interest receivables (31.12.2018: 1.7%).

Consumer loans
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	44 235	0	0	0	**44 235**
Special monitoring	0	5 076	0	0	**5 076**
Default	0	0	98	3	**101**
Gross carrying amount	**44 235**	**5 076**	**98**	**3**	**49 412**
Loss allowances	290	276	55	3	**624**
Carrying amount	**43 945**	**4 800**	**43**	**0**	**48 788**

Consumer loans
2018 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	29 427	0	0	0	**29 427**
Special monitoring	0	4 372	0	0	**4 372**
Default	0	0	190	0	**190**
Gross carrying amount	**29 427**	**4 372**	**190**	**0**	**33 989**
Loss allowances	213	267	88	0	**568**
Carrying amount	**29 214**	**4 105**	**102**	**0**	**33 421**

For off-balance sheet exposures related with consumer credit portfolio, a provision of EUR 0 thousand was recorded as of 31.12.2019 and 31.12.2018.

Mortgage loans

The provisions are made based on the same framework as for consumer loans. As of 31 December 2019, the group-based impairment amounted to 0.13% of mortgage portfolio (31.12.2018: 0.03%).

Mortgage loans
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	548 054	0	0	0	**548 054**
Special monitoring	0	37 916	0	0	**37 916**
Default	0	0	78	1 808	**1 886**
Gross carrying amount	**548 054**	**37 916**	**78**	**1 808**	**587 855**
Loss allowances	193	496	2	54	**745**
Carrying amount	**547 861**	**37 419**	**75**	**1 754**	**587 110**

Mortgage loans
2018 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	93 158	0	0	0	**93 158**
Special monitoring	0	7 851	0	0	**7 851**
Default	0	0	0	0	**0**
Gross carrying amount	**93 158**	**7 851**	**0**	**0**	**101 009**
Loss allowances	19	7	0	0	**26**
Carrying amount	**93 139**	**7 844**	**0**	**0**	**100 983**

Leasing

The leasing provisioning is done based on Leasing scoring models. The provisions are made based on the same framework as for consumer loans. As of 31 December 2019, the group-based impairment reserve amounted to 0.71% of leasing portfolio (31.12.2018: 0.8%).

Leasing
2019 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	77 742	8 957	0	0	**86 700**
Special monitoring	0	2 708	0	0	**2 708**
Default	0	0	81	0	**81**
Gross carrying amount	**77 742**	**11 665**	**81**	**0**	**89 488**
Loss allowances	147	477	15	0	**639**
Carrying amount	**77 596**	**11 188**	**66**	**0**	**88 850**

Leasing
2018 ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	53 810	3 874	0	0	**57 684**
Special monitoring	0	2 198	0	0	**2 198**
Default	0	0	284	0	**284**
Gross carrying amount	**53 810**	**6 071**	**284**	**0**	**60 165**
Loss allowances	92	312	63	0	**467**
Carrying amount	**53 717**	**5 760**	**221**	**0**	**59 698**

Corporate factoring

As at 31.12.2019, the group-based impairment reserve makes up 0.1% of corporate factoring portfolio and the related interest receivables. As at 31.12.2019 the balance of corporate factoring portfolio was EUR 5 389 (31.12.2018: 0) thousand and the related loss allowance was EUR 5 (31.12.2018: 0) thousand. Majority of the loans were recorded in stage 1.

Hire purchase

Similarly, to other homogenous portfolios, provisions are made based on the same framework as consumer loans. As of 31 December 2019, the group-based impairment reserve amounted to 0.68% of hire-purchase portfolio (31.12.2018: 0.8%). As at 31.12.2019 the balance of hire purchase portfolio was EUR 16 410 (31.12.2018: 17 750) thousand and the related loss allowance was EUR 112 (31.12.2018: 140) thousand. Majority of the loans were recorded in stage 1.

Leveraged loans

The Bank had no impaired leveraged loans as at 31.12.2019 and 31.12.2018.

The impairment reserve amounted to 0.11% of the leveraged loans portfolio.

As at 31.12.2019 the balance of leverage loan portfolio was EUR 5 988 (31.12.2018: 3 730) thousand and the related loss allowance was EUR 6 (31.12.2018: 3) thousand.

Credit cards

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework is based on PD, LGD and EAD indicators. As of 31 December 2019, the group-based impairment reserve amounted to 0.7% of credit card loans and related receivables (31.12.2018: 0.4%).

For off-balance sheet exposures related with credit cards portfolio, a provision of EUR 2.5 thousand was recorded as of 31.12.2019 (31.12 2018: EUR 1 thousand).

As at 31.12.2019 the balance of credit cards loan portfolio was EUR 7 665 (31.12.2018: 6 853) thousand and the related loss allowance was EUR 53 (31.12.2018: 27) thousand. Majority of the loans were recorded in stage 1.

3.2.4.2 Maximum exposure to credit risk – Financial instruments not subject to impairment

Financial assets kept in fair value are by definition not subject to impairment, their changes in credit risk is automatically accounted through market value changes.

In addition some accounts carrying smaller credit risk are not part of impairment calculation:

- **Cash and balances with central bank**
- **Nostro accounts**

Both of these account types carry very limited amount of credit risk and maturity tenor in general is just 1 day. Cash and central bank balances are limited per currencies – only currencies bank is active are allowed. Nostro accounts are subject to credit risk limits, all counterparts have to minimally have investment grade rating. In case counterparts rating is lowered below investment grade, the nostro account will not qualify for having balances by the end of banking day.

3.2.4.3 Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The valuations of the market value of collaterals are based on the principle of conservatism, which takes into account the type of collateral, the location, the likelihood of realisation and liquidity.

Expert evaluations are used to evaluate immovables. In order to ensure that market values are up to date, the individual assessments of commercial real estate are updated at least once a year. In the case of residential and other homogeneous types of real estate, statistical indexation models are also used for regular re-evaluation.

The principal collateral types for loans and advances are:

- Mortgage
- Commercial pledge
- Commodity pledge
- Deposit
- Credit insurance
- Marketable securities
- Unlisted securities
- Pledge of claim
- Rights of claims
- Guarantee of KredEx Fund or Rural Development Foundation
- Letter of credit
- Surety of private person or legal entity
- Machinery and equipment

The preferred collateral is where there is no strong correlation between the client's default risk and value of the collateral. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance.

Unsecured loan can be issued to private customers up to a specified amount. For corporate customers this is only allowed when cash flow forecast shows stable and significantly strong cash flows and/or customer's credit risk is valued to be low.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

Mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in low loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is EUR 587 855 thousand as at 31 December 2019.

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

31.12.2019

(in thousands of euros)	Gross exposure	Impairment allowance	Carrying amount	Fair value of collateral held
Credit-impaired assets				
Loans to corporate entities:				
- Large corporate customers	1 036	0	1 036	2 800
Loans to private individuals:				
- Mortgage loans	1 808	54	1 754	2 243
Total credit-impaired assets	**2 844**	**54**	**2 790**	**5 043**

31.12.2018

(in thousands of euros)	Gross exposure	Impairment allowance	Carrying amount	Fair value of collateral held
Credit-impaired assets				
Loans to corporate entities:				
- Large corporate customers	380	(186)	194	194
Total credit-impaired assets	**380**	**(186)**	**194**	**194**

In the table below, collateral information of loans and advances are disclosed based on the collateral type and carrying value or fair value of collateral held if it is lower.

The under-collateralised amount is presented as "Unsecured loans".

Loans against collateral as at 31.12.2019 *(in thousands of euros)*	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purchase	Mortgage loans	Total
Listed securities	0	5 988	0	0	0	0	**5 988**
Unlisted equity securities	35 396	0	1 066	0	0	0	**36 462**
Mortgages, real estate	581 750	0	41 663	0	0	584 685	**1 208 098**
Guarantee of KredEx and Rural Development Foundation	30 377	0	7	0	0	2 612	**32 996**
Pledges of rights of claim	84 365	0	0	0	0	0	**84 365**
Deposits	3 141	0	2 000	0	0	0	**5 142**
Leased assets	0	0	0	76 407	0	0	**76 407**
Others	51 174	0	674	0	0	0	**51 848**
Unsecured loans	98 878	0	57 226	13 081	16 410	6 237	**191 832**
Total	**885 081**	**5 988**	**102 637**	**89 488**	**16 410**	**593 534**	**1 693 138**

Loans against collateral as at 31.12.2018 *(in thousands of euros)*	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purc-hase	Mortgage loans	Total
Listed securities	0	3 730	0	0	0	0	**3 730**
Unlisted equity securities	21 257	0	673	0	0	0	**21 930**
Mortgages, real estate	333 498	0	28 224	0	0	100 281	**462 003**
Guarantee of KredEx and Rural Development Foundation	4 395	0	0	0	0	0	**4 395**
Pledges of rights of claim	35 250	0	0	0	0	0	**35 250**
Deposits	3 168	0	1 654	0	0	0	**4 822**
Leased assets	53 309	0	0	41 033	0	0	**94 342**
Others	25 136	0	7 390	0	0	0	**32 526**
Unsecured loans	191 525	0	40 904	19 132	17 750	728	**270 039**
Total	**667 538**	**3 730**	**78 845**	**60 165**	**17 750**	**101 009**	**929 037**

Collaterals for leveraged loans are monitored on a daily basis and, if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31 December 2019 and as of 31 December 2018, all leveraged loans are over-collateralised. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing and mortgage loans are all over-collateralised. The Group monitors customers in arrears of leasing, hire purchase, mortgage loans and overdraft to private individuals on regular basis.

In relation to under-collateralised corporate loans, it should be taken into consideration, that the Group has assessed the market value of certain collaterals conservatively (personal sureties, commercial pledges). Under-collateralised loans are mainly considered to bear higher risk, for which the Group carries out monthly monitoring in credit committee, in order to mitigate potential credit losses. Under-collateralised loans include contracts with more than 90 days overdue totalling EUR 322 thousand (2018: EUR 13 592 thousand) euros with a collateral value of 131 thousand (2018: EUR 7 172 thousand) euros.

	Over-collateralised loans		**Under-collateralised loans**	
(in thousands of euros)	Carrying value	Fair value of collateral	Carrying value	Fair value of collateral
As at 31.12.2019	**826 643**	**1 523 286**	**866 495**	**674 663**
Corporate and retail loans (including overdraft)	211 756	294 565	673 325	574 448
Leveraged loans	5 988	137 767	0	0
Credit cards, consumer loans, overdraft to private individuals	37 119	57 802	65 518	8 291
Leasing	76 407	76 407	13 081	0
Hire-purchase	0	0	16 410	0
Mortgage loans	495 373	956 745	98 161	91 924
As at 31.12.2018	**364 598**	**616 532**	**564 439**	**294 379**
Corporate and retail loans (including overdraft)	236 687	397 060	430 851	239 326
Leveraged loans	3 730	6 293	0	0
Credit cards, consumer loans, overdraft to private individuals	37 846	100 820	40 999	74
Leasing	0	0	60 165	41 033
Hire-purchase	0	0	17 750	0
Mortgage loans	86 335	112 359	14 674	13 946

3.2.5 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent „step up" (or „step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular update of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period (see note 3.2.6.).

The following tables explain the changes in the loss allowances between the beginning and the end of the annual period due to these factors.

Corporate loans and overdraft
(in thousands of euros)

		Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019		2 272	1 122	5 299	186	**8 879**
Movements with P&L impact		-123	123	0	0	**0**
Transfers:	From Stage 1 to Stage 2	-145	145	NA	0	**0**
	From Stage 1 to Stage 3	0	NA	0	0	**0**
	From Stage 2 to Stage 1	22	-22	NA	0	**0**
New financial assets originated or purchased		667	721	0	0	**1 388**
Changes in PDs/LGDs/EADs		-75	-35	0	0	**-110**
Changes to model assumptions and methodologies		-2	-1	0	0	**-3**
Modifications of contractual cash flows of financial assets		0	0	0	0	**0**
Unwind of discount		-329	-802	-5 299	-186	**-6 616**
FX and other movements		0	0	0	0	**0**
Total net P&L charge during the period		**138**	**6**	**-5 299**	**-186**	**-5 341**
Other movements with no P&L impact						
Transfers:	From Stage 2 to Stage 3	NA	0	0	0	**0**
	From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period		0	0	0	0	**0**
Write-offs		0	0	5 299	186	**5 485**
Loss allowance as at 31 December 2019		**2 410**	**1 128**	**0**	**0**	**3 538**

Initialled for identification purposes only
pwc Initials I.S. Date 21.02.2020

LHV

Corporate loans and overdraft
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	1 112	1 241	2 199	0	**4 552**
Movements with P&L impact	-226	226	0	0	**0**
Transfers: From Stage 1 to Stage 2	-227	227	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	1	-1	NA	0	**0**
New financial assets originated or purchased	1 165	86	0	186	**1 437**
Changes in PDs/LGDs/EADs	192	-455	3 091	0	**2 828**
Changes to model assumptions and methodologies	28	24	0	0	**52**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	0	0	10	0	**10**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**1 159**	**-119**	**3 101**	**186**	**4 327**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	115	0	**115**
Loss allowance as at 31 December 2018	**2 271**	**1 122**	**5 299**	**186**	**8 879**

Trade financing
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	5	0	0	0	**5**
Movements with P&L impact	0	0	0	0	**0**
Transfers: From Stage 1 to Stage 2	0	0	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	123	0	0	0	**123**
Changes in PDs/LGDs/EADs	0	0	0	0	**0**
Changes to model assumptions and methodologies	-3	0	0	0	**-3**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	-2	0	0	0	**-2**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**118**	**0**	**0**	**0**	**118**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2019	**123**	**0**	**0**	**0**	**123**

Retail loans to SMEs
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	31	54	99	0	**184**
Movements with P&L impact	-24	11	13	0	**0**
Transfers: From Stage 1 to Stage 2	-12	12	NA	0	**0**
From Stage 1 to Stage 3	-13	NA	13	0	**0**
From Stage 2 to Stage 1	1	-1	NA	0	**0**
New financial assets originated or purchased	19	11	0	0	**30**
Changes in PDs/LGDs/EADs	-1	-1	-2	0	**-4**
Changes to model assumptions and methodologies	0	0	0	0	**0**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	11	-30	-38	0	**-57**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**5**	**-9**	**-27**	**0**	**-31**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	-35	35	0	**0**
From Stage 3 to Stage 2	NA	2	-2	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	13	0	**13**
Loss allowance as at 31 December 2019	**36**	**45**	**72**	**0**	**153**

Retail loans to SMEs
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	131	0	0	0	**131**
Movements with P&L impact	-148	49	99	0	**0**
Transfers: From Stage 1 to Stage 2	-49	49	NA	0	**0**
From Stage 1 to Stage 3	-99	NA	99	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	20	1	0	0	**21**
Changes in PDs/LGDs/EADs	46	3	-1	0	**48**
Changes to model assumptions and methodologies	1	1	0	0	**2**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	-19	0	1	0	**-18**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-100**	**54**	**99**	**0**	**53**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	25	0	**25**
Loss allowance as at 31 December 2018	**31**	**54**	**99**	**0**	**184**

Consumer loans
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	212	267	89	0	**568**
Movements with P&L impact	0	0	0	0	**0**
Transfers: From Stage 1 to Stage 2	0	0	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	234	169	10	3	**416**
Changes in PDs/LGDs/EADs	-25	-24	-5	0	**-54**
Changes to model assumptions and methodologies	7	7	1	0	**15**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	-138	-143	-40	0	**-321**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**78**	**9**	**-34**	**3**	**56**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	19	0	**0**
Loss allowance as at 31 December 2019	**290**	**276**	**55**	**3**	**624**

Consumer loans
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	442	0	0	0	**442**
Movements with P&L impact	-219	133	86	0	**0**
Transfers: From Stage 1 to Stage 2	-133	133	NA	0	**0**
From Stage 1 to Stage 3	-86	NA	86	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	212	32	1	0	**245**
Changes in PDs/LGDs/EADs	-223	102	2	0	**119**
Changes to model assumptions and methodologies	0	0	0	0	**0**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	0	0	0	0	**0**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-230**	**267**	**89**	**0**	**126**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**212**	**267**	**89**	**0**	**568**

Private loans
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	9	0	1	0	**10**
Movements with P&L impact	-23	22	1	0	**0**
Transfers: From Stage 1 to Stage 2	-22	22	NA	0	**0**
From Stage 1 to Stage 3	-1	NA	1	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	12	18	0	14	**44**
Changes in PDs/LGDs/EADs	1	2	1	0	**4**
Changes to model assumptions and methodologies	16	33	10	0	**59**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	10	-26	-12	0	**-28**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**16**	**49**	**0**	**14**	**78**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	3	-3	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2019	**25**	**49**	**1**	**14**	**89**

The size of the private loan portfolio allowance was negligible as at 31.12.2018.

Mortgage loans
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	17	9	0	0	**26**
Movements with P&L impact	-21	21	0	0	**0**
Transfers: From Stage 1 to Stage 2	-22	22	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	1	-1	NA	0	**0**
New financial assets originated or purchased	174	474	0	54	**702**
Changes in PDs/LGDs/EADs	-4	-11	-1	0	**-16**
Changes to model assumptions and methodologies	139	358	41	0	**538**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	-112	-355	-38	0	**-505**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**176**	**487**	**2**	**54**	**719**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	3	-3	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2019	**193**	**496**	**2**	**54**	**745**

Mortgage loans
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	32	0	0	0	**32**
Movements with P&L impact	0	0	0	0	**0**
Transfers: From Stage 1 to Stage 2	0	0	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	42	3	0	0	**45**
Changes in PDs/LGDs/EADs	-58	5	0	0	**-53**
Changes to model assumptions and methodologies	0	0	0	0	**0**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	0	0	0	0	**0**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-16**	**9**	**0**	**0**	**-7**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**17**	**9**	**0**	**0**	**26**

Leasing
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	92	312	63	0	**467**
Movements with P&L impact	-140	140	0	0	**0**
Transfers: From Stage 1 to Stage 2	-148	148	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	8	-8	NA	0	**0**
New financial assets originated or purchased	64	156	0	0	**220**
Changes in PDs/LGDs/EADs	-5	-17	-1	0	**-23**
Changes to model assumptions and methodologies	-2	-8	0	0	**-10**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	138	-106	-47	0	**-15**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**55**	**165**	**-48**	**0**	**172**
Other movements with no P&L impact					
Transfers: From Stage 2 to Stage 3	NA	0	0	0	**0**
From Stage 3 to Stage 2	NA	3	-3	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	8	0	**0**
Loss allowance as at 31 December 2019	**147**	**477**	**15**	**0**	**639**

Leasing
(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	233	0	0	0	**233**
Movements with P&L impact	-268	238	30	0	**0**
Transfers: From Stage 1 to Stage 2	-238	238	NA	0	**0**
From Stage 1 to Stage 3	-30	NA	30	0	**0**
From Stage 2 to Stage 1	0	0	NA	0	**0**
New financial assets originated or purchased	43	7	0	0	**50**
Changes in PDs/LGDs/EADs	85	67	33	0	**185**
Changes to model assumptions and methodologies	0	0	0	0	**0**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	0	0	0	0	**0**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-140**	**312**	**63**	**0**	**235**
Other movements with no P&L impact					
Transfers: From Stage 1 to Stage 3	NA	0	0	0	**0**
From Stage 2 to Stage 1	NA	0	0	0	**0**
Financial assets derecognised during the period	0	0	0	0	**0**
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**92**	**312**	**63**	**0**	**467**

Other loan portfolios and changes in the impairments between the beginning and the end of the annual period are disclosed in the Note 13. ECL allowance related information is disclosed in the Note 3.2.4.1.

Significant changes in the gross carrying amount of financial assets that contributed to changes in the loss allowance were as follows:

- Changes in loss allowances of corporate loan portfolio explained in detail in table below

The following table further explains changes in the gross carrying amount of the portfolio to help explain their significance to the changes in the loss allowance for the same portfolio as discussed above:

Corporate loans
(in thousands of euros)

		Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019		607 468	28 378	12 045	380	**648 271**
Movements with P&L impact						
Transfers:	From Stage 1 to Stage 2	-16 784	16 784	NA	NA	**0**
	From Stage 1 to Stage 3	0	NA	0	NA	**0**
	From Stage 2 to Stage 3	NA	-46	46	NA	**0**
	From Stage 3 to Stage 2	NA	0	0	0	**0**
	From Stage 2 to Stage 1	3 318	-3 318	NA	NA	**0**
Financial assets derecognised during the period		-110 503	-14 242	-24 048	-379	**-149 172**
New financial assets originated or purchased		283 300	10 788	0	0	**294 088**
Modifications of contractual cash flows of financial assets		0	0	0	0	**0**
Changes in interest accrual		-293	78	-35	-1	**-251**
Write-offs		0	0	13 028	0	**13 028**
FX and other movements		0	0	0	0	**0**
Gross carrying amount as at 31 December 2019		**766 506**	**38 422**	**1 036**	**0**	**805 964**

Corporate loans and overdraft
(in thousands of euros)

		Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Gross carrying amount as at 1 January 2018		456 747	25 150	14 043	0	**495 940**
Movements with P&L impact						
Transfers:	From Stage 1 to Stage 2	-11 244	11 244	NA	0	**0**
	From Stage 1 to Stage 3	0	NA	0	0	**0**
	From Stage 2 to Stage 3	NA	-3 415	3 415	0	**0**
	From Stage 3 to Stage 2	NA	0	0	0	**0**
	From Stage 2 to Stage 1	2 208	-2 208	NA	0	**0**
Financial assets derecognised during the period		-45 325	-4 479	-5 528	0	**-55 332**
New financial assets originated or purchased		204 715	2 066	0	380	**207 161**
Modifications of contractual cash flows of financial assets		0	0	0	0	**0**
Changes in interest accrual		367	20	0	0	**387**
Write-offs		0	0	115	0	**115**
FX and other movements		0	0	0	0	**0**
Gross carrying amount as at 31 December 2018		**607 468**	**28 378**	**12 045**	**380**	**648 271**

The Group considers the loan as non-performing and assesses impairment when the loan payments have not been collected by the due date and/or the expected cash flows from the realisation of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments.

The Group evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the carrying value of the receivable and expected cash flows discounted at the effective interest rate. In 2019, the Group provisioned corporate loans in the total amount of EUR 3 431 thousand (2018: EUR 4 303 thousand).

Loan customers with ratings of 10-13 are subject to more frequent monitoring during which the solvency of the borrower is evaluated. In case of a deterioration of payment behaviour, the requirement for individual provisioning is evaluated, considering, among other factors, the collateral of the loan, therefore some loans are not individually impaired, because they are sufficiently secured. The ratings-based rate of the collective provisioning is applied to those loans.

In addition to loans issued, loan agreements have been concluded and signed for the unused loan commitment amount of 359 230 thousand euros at 31.12.2019 (31.12.2018: 188 841 thousand euros).

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2019 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans to individuals in total amount of EUR 69 898 thousand (31.12.2018: EUR 41 430 thousand). All uncommissioned loans available to individuals have at least investment grade scoring as at the end of each reporting period.

Credit quality of off-balance sheet liabilities

commitments for corporate loans and financial guarantees)

(in thousands of euros)	31.12.2019	31.12.2018
3 very low risk	100 000	0
5 low credit risk	615	5 302
6 low credit risk	42 265	17 202
7 medium credit risk	29 462	25 997
8 medium credit risk	86 923	71 244
9 heightened credit risk	41 016	25 142
10 high credit risk	15 743	10 534
11 high credit risk	16	17
12 payments are delayed	77	604
Non-rated (retail clients)	2 730	737
Total	**318 847**	**156 780**

The total amount of undiscounted expected credit losses at initial recognition for purchased or originated credit-impaired financial assets recognised during the period was EUR 71 thousand.

3.2.6. Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognised as income.

At least one of the conditions has to be filled to declare claim irredeemable based on the product class.

Credit cards and hire purchase

There has been no significant contribution in 12 months since the client's insolvency (default) and the court proceedings relating to arrears have terminated to the Group's detriment or the client fails to comply with the court decision.

A bankruptcy has been announced to the client or the client has been declared insolvent.

The court confirms the debt restructuring plan (the claim recognised in the plan is less and the actual claim).

Criminal proceedings have been initiated in relation to issued credit or fraud has been used to obtain credit.

The customer is dead and after the inventory of the estate bankruptcy is declared.

The client forwarded to the bailiff has a foreign address or none at all.

Leasing, private and business loans

The client does not voluntarily reimburse the Group's claim risen from the difference of original claim and the realisation of the collateral.

3.2.7. Modifications of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset (refer to note 2.6). The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. The gross carrying amount of such assets held as at 31 December 2019 was EUR 0 (2018: 0).

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

There were no such financial assets with lifetime ECL whose cash flows were modified during the period.

3.3 Market risk

Market risk arises from the Group's positions which are exposed to changes in interest rates, foreign exchange rates and securities prices. Such positions arise from the Group's trading, market making and investment activities as well as from the Bank's lending and funding activities (banking book). The Bank has set very conservative limits for the trading, liquidity and investment portfolios and open foreign currency exposures.

LHV Varahaldus invests most of its available resources into its own managed pension funds. The management of LHV Varahaldus is responsible for monitoring the market risk.

3.3.1 Foreign currency risk

Foreign currency risk arises from the potential mis-match of the Bank's foreign currency assets and liabilities. Treasury is responsible for daily monitoring of net open foreign currency positions. The Group's management of foreign currency risk is governed by risk policies, risk metrics, limits and internal procedures. The internal limits for net open foreign currency positions are proposed by the Risk Control unit and Treasury and the limits are set internally by the Risk and Capital Committee. The limits set by the Committee are maximum nominal limits in euro equivalent for each currency. The nominal limits are calibrated to ensure that the total potential loss from foreign currency risk would remain within a specified percentage with respect to the Group's net own funds. If the open currency position exceeds the limits set by the Committee, measures are immediately implemented to close or reduce such positions (hedging the risk with relevant instruments, such as foreign currency spot, forwards or futures).

A sensitivity analysis has been performed for the effect of possible changes attributable to net open currency positions on statement of profit or loss, with the assumption of other conditions remaining constant.

Impact on statement of profit or loss
(in thousands of euros)

	2019	2018
USD exchange rate +/- 10%	+/-3	+/-13
SEK exchange rate +/- 10%	+/-3	+/-0
GBP exchange rate +/- 10%	+/-1	+/-10
CHF exchange rate +/- 10%	+/-2	+/-2

Open currency exposures

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in euro equivalent in respective columns, according to the exchange rate prevailing at the end of the reporting period. Derivatives reported at fair value in the statement of financial position have been included at contractual amounts under off-balance sheet assets and liabilities. Open currency exposure and the volume of financial assets and liabilities of the Group at the end of the reporting period do not significantly differ from the average exposure during the year. The balances of total assets and total liabilities bearing currency risk do not include currency futures at their fair value, but they are shown here at their full contractual cash flow amounts as off-balance sheet assets and liabilities; also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

31.12.2019
(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	10	1 231 788	514	27 690	1 053	1 362	8 745	**1 271 153**
Investments in debt and equity securities	11, 12	24 714	0	0	1	16 241	5	**40 962**
Loans and advances to customers	13	1 685 519	4	62	584	788	77	**1 687 034**
Receivables from customers	14	2 548	10	601	56	0	335	**3 551**
Other financial assets	15	110	0	0	0	2 136	0	**2 246**
Total assets bearing currency risk		**2 944 679**	**528**	**28 353**	**1 695**	**20 528**	**9 163**	**3 004 946**
Liabilities bearing currency risk								
Deposits from customers and loans received	17	2 655 331	4 538	27 138	8 139	20 356	11 061	**2 726 562**
Financial liabilities at fair value	12	5	0	0	1	1	1	**8**
Accounts payable and other financial liabilities	18	17 110	62	1 201	345	245	1 826	**20 789**
Subordinated debt	20	75 000	0	0	0	0	0	**75 000**
Total liabilities bearing currency risk		**2 747 446**	**4 600**	**28 339**	**8 485**	**20 602**	**12 888**	**2 822 359**
Open gross position derivative assets at contractual value		615	4 054	0	6 816	713	3 359	**15 557**
Open gross position derivative liabilities at contractual value		14 942	0	0	0	615	0	**15 557**
Open foreign currency position		**182 906**	**-18**	**14**	**26**	**25**	**-366**	**182 587**

31.12.2018
(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	10	651 175	2 224	18 319	2 536	1 430	6 973	**682 658**
Investments in debt and equity securities	11, 12	22 750	0	1 174	1	23 230	0	**47 154**
Loans and advances to customers	13	902 843	0	14 707	220	957	34	**918 761**
Receivables from customers	14	2 802	0	374	42	0	503	**3 721**
Other financial assets	15	840	0	0	0	2 096	0	**2 936**
Total assets bearing currency risk		**1 580 410**	**2 224**	**34 574**	**2 799**	**27 713**	**7 511**	**1 655 230**
Liabilities bearing currency risk								
Deposits from customers and loans received	17	1 356 671	2 194	41 600	6 363	29 297	7 657	**1 443 782**
Financial liabilities at fair value	12	0	0	0	0	3	8	**11**
Accounts payable and other financial liabilities	18	15 299	50	2 238	410	120	3 311	**21 428**
Subordinated debt	20	50 900	0	0	0	0	0	**50 900**
Total liabilities bearing currency risk		**1 422 870**	**2 244**	**43 838**	**6 773**	**29 420**	**10 976**	**1 516 121**
Open gross position derivative assets at contractual value		610	0	9 166	3 973	2 186	3 234	**19 169**
Open gross position derivative liabilities at contractual value		18 559	0	0	0	610	0	**19 169**
Open foreign currency position		**139 591**	**-20**	**-98**	**-2**	**-130**	**-232**	**139 108**

3.3.2 Price risk

Financial instruments bearing price risk at Group are securities held in the liquidity portfolio, trading portfolio and investment portfolio (Note 11, 12). Limits have been set for the size of the trading and investment portfolios. There are criteria in place for acceptable credit ratings as well as other parameters of the debt securities that can be held by the Group. The Risk Control unit monitors the compliance with limits.

Pursuant to the Investment Funds Act, the minimum shares of LHV Varahaldus as the management company is 0.5% (according to the Investment Funds Act in force until 9 January 2017, it was 1%) of the number of units in each of the mandatory pension fund managed by it. Based on historical performance and volatility of the pension fund unit NAV changes, the price changes should remain +/- 10% in the next 12-month period with the most likely change +/-5% and the impact to statement of profit or loss is presented in the next table.

LHV Varahaldus invests the remaining available assets in euros, to ensure liquidity and to not bear investment risk.

The Bank does not hold significant amounts of equity securities in its position (see Note 12), accordingly the sensitivity to change in the market price of these positions is marginal.

Bank's debt securities portfolio recognised at the market price is short-term and of high quality, therefore, the effect of the changes in market risk premiums on the market value of the debt security portfolio should remain at around 1.0% (2018: 1.0%).

The following table presents the results of a sensitivity analysis (the impact from the risk exposures to the net result of the Group's largest entity AS LHV Pank from a reasonably possible change in thousands euros):

Impact on statement of profit or loss (profit after tax)

(in thousands of euros)	2019	2018
Equity securities and fund units +/-10%	+/-50	+/-51
Mandatory pension fund units +/-5%	+/-385	+/-380
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-323	+/-387

Impact on other comprehensive income

(in thousands of euros)	2019	2018
Equity securities (FVOCI/AFS) +/-10%	+/- 43	+/- 30

3.3.3 Interest rate risk

Interest rate risk arises from the mismatch of interest rate types, refixing periods or base rates of assets and liabilities (both balance sheet and off-balance sheet items). The Group's interest rate risk management is based on risk policies, limits and internal procedures which identify all significant sources of interest rate risk and provide for balanced risk taking.

Interest rate risk is measured by conducting gap and duration analysis under different scenarios. The goal of the analysis is to determine the maximum potential loss in case of an adverse change in interest rates.

Duration analysis (change in the economic value of equity) aims to assess the change in the economic value of the assets, liabilities and equity in different interest rate scenarios. Gap analysis assesses the impact of interest rate changes on net interest income in the next 12-month period.

Both duration analysis and gap analysis are regularly conducted for two scenarios including an increase as well as decrease of interest rates. The key scenario is parallel upward or downward shift in interest rates of 200 bps. The statement of financial position and margins on assets and deposits are assumed to be constant over time.

Internal limits for interest rate risk management are set by AS LHV Pank's Risk and Capital Committee. Limits on interest rate risk are set in relation to net own funds. Treasury is responsible for managing interest rate risk on an ongoing basis.

The deposits interest rates did not change in 2019 remaining at the level of up to 1.0% (up to 1.0% in 2018).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2019, the interest rate on loans received for specific purposes was around 1.0% (2018: 1.0%). The effective interest rate of subordinated debts entered into in 2015 was 6.5%, the effective interest rate of subordinated debts entered into in 2018 was 6.0% and the effective interest rate of subordinated debts entered into in 2019 was 8%. The information about subordinated debt contractual interest rates is provided in Note 20.

As at 31.12.2019, stress tests were performed to the biggest interest sensitive subsidiary of the group: AS LHV Pank. An increase of 1 percentage point in interest rates would affect the Bank's annual net interest income and profit by EUR +9 362 thousand (2018: EUR +10 263 thousand). In the same time, a decrease of 1 percentage point in interest rates would affect the Bank's annual net interest income (profit) by EUR 127 thousand (2018: EUR -1 657 thousand). A 1 percentage point increase in market interest rates would raise the Bank's economic value, i.e. equity, by EUR +16 946 thousand (2018: EUR+11 437 thousand). A 1 percentage point decrease in market interest rates would affect the Bank's economic value (equity) by EUR +74 229 thousand (2018: EUR +25 265 thousand). Effect on the Group's economic value is positive since the Group has invested in short-term assets, the loans granted to customers are largely based on the 6-month Euribor, the level of which does not fall below 0% according to loan agreements, and due to the longer-term nature of the demand obligations, the average duration of interest-bearing assets is shorter than the average duration of interest-bearing liabilities.

When calculating the effects of the change in the net interest income on profit and the simulation of the change in the economic capital, the terms of loan contracts are taken into account (including interest rate floors which are relevant in the case of downward scenario). Lower limits are also used for certain other assets. On the liabilities side, it is assumed that deposit interest rates will not become negative. Demand deposits are assumed to have a behavioural duration of 2 years for interest rate changes. Part of the deposits are assumed to be converted into term deposits in the case of interest rate increase.

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

31.12.2019 *(in thousands of euros)*	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impairments	Total
Financial assets									
Due from banks and investment companies	10	1 271 153	0	0	0	**1 271 153**	0	0	**1 271 153**
Financial assets at fair value (debt securities)	11, 12	10 682	12 950	7 925	0	**31 557**	774	0	**32 331**
Loans and advances to customers	13	729 768	851 657	84 798	22 988	**1 689 211**	3 927	-6 104	**1 687 034**
Total		**2 011 603**	**864 607**	**92 723**	**22 988**	**2 991 921**	**4 701**	**-6 104**	**2 990 518**
Financial liabilities									
Deposits from customers and loans received	17	363 823	491 080	1 868 767	1	**2 723 671**	2 891	0	**2 726 562**
Subordinated debt *	20	0	0	0	75 000	**75 000**	444	0	**75 444**
Total		**363 823**	**491 080**	**1 868 767**	**75 001**	**2 798 671**	**3 335**	**0**	**2 802 006**
Net interest sensitivity gap		**1 647 780**	**373 527**	**-1 776 044**	**-52 013**	**193 250**			

31.12.2018 *(in thousands of euros)*	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impairments	Total
Financial assets									
Due from banks and investment companies	10	682 658	0	0	0	**682 658**	0	0	**682 658**
Financial assets at fair value (debt securities)	11, 12	20 546	0	15 031	2 000	**37 577**	1 120	0	**38 697**
Loans and advances to customers	13	391 815	486 576	45 087	16 770	**940 248**	2 667	-11 501	**931 414**
Total		**1 095 019**	**486 576**	**60 118**	**18 770**	**1 660 483**	**3 787**	**-11 501**	**1 652 769**
Financial liabilities									
Deposits from customers and loans received	17	110 719	111 503	1 221 205	18	**1 443 445**	337	0	**1 443 782**
Subordinated debt *	20	0	0	0	50 900	**50 900**	314	0	**51 214**
Total		**110 719**	**111 503**	**1 221 205**	**50 918**	**1 494 345**	**651**	**0**	**1 494 996**
Net interest sensitivity gap		**984 300**	**375 073**	**-1 161 087**	**-32 148**	**166 138**			

* The contractual term of subordinated debts received in 2018 is 10 years and the interest rate is fixed at 6.0%. The contractual term of subordinated debts received in 2015 is 10 years and the interest rate is fixed at 6.5%. The contractual term of subordinated debts received in 2019 is 10 years and the interest rate is fixed at 8.0%.

3.4 Liquidity risk

Liquidity risk relates to the ability of the Group to meet its contractual obligations on time. Liquidity risk is most relevant in the context of the Bank as there is a difference between the maturity of the Bank's assets (loans provided to customers) and liabilities (mostly deposits). The Group's liquidity risk management is documented in the Liquidity Risk Management Policy and other internal rules, providing for liquidity risk metrics, limits and internal procedures. As per policy statements, the Group's liquidity management reflects a conservative approach towards liquidity risk. The liquidity risk management framework includes stress testing, early warning indicators and business continuity plan for liquidity management. The key internal metric for liquidity risk management is survival period which is calculated both in stress as well as base scenario. Minimum required limit for the survival period is set out to ensure that the bank would have a sufficient liquidity buffer which would allow response time for the Bank in case of market-wide or idiosyncratic stress scenarios. Additionally, concentration risk of deposits is monitored and limited to avoid dependence on a small number of large depositors.

Internal metrics are complemented by the Basel III metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) which the Group is fully compliant with as of 31.12.2019 and 31.12.2018. The aim of the LCR standard is to ensure that the Group has an adequate amount of unencumbered assets of high quality and liquidity (liquidity buffer) that could be monetised without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The Group's liquidity coverage ratio level as at 31.12.2019 was 145% (31.12.2018: 148%).

The objective of the NSFR is to ensure that the Group has adequate stable funding sources to finance longer-term assets. According to the proposals published in the banking regulation and the banking committee of Basel in October 2014, the Group's NSFR level as at 31.12.2019 was 152,9% (31.12.2018: 148%). The net stable funding ratio will be imposed as 100% minimum requirement from the year 2018.

The Treasury of the Bank is responsible for the management of liquidity risk. One of the key instruments for managing liquidity risk is maintaining an adequate buffer of high quality and liquid instruments. The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Treasury, which can be readily sold or used as a collateral in funding operations with the central bank. For longer term liquidity planning, Treasury is involved in preparing the financial plan which includes a longer term view of the required funding to support the Group's business. As at 31.12.2019 and 31.12.2018, the Group does not have any debts past due.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and in a separate column the statement of financial position balance is disclosed. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows). Explanation of the fair value of these financial assets and liabilities is presented in Note 3.5.

31.12.2019

(in thousands of euros)	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Carrying amount	Total
Liabilities by contractual maturity dates								
Deposits from customers and loans received	17	2 189 665	41 522	476 248	18 721	2 906	**2 729 062**	**2 726 562**
Subordinated debt	20	0	1 244	3 731	19 500	85 575	**110 050**	**75 000**
Accounts payable and other financial liabilities	18	0	20 789	0	0	0	**20 789**	**20 789**
Unused loan commitments	23	0	359 230	0	0	0	**359 230**	**0**
Financial guarantees by contractual amounts	23	0	14 139	0	0	0	**14 139**	**0**
Foreign exchange derivatives (gross settled)		0	14 942	0	615	0	**15 557**	**0**
Financial liabilities at fair value	12	0	8	0	0	0	**8**	**8**
Total liabilities		**2 189 665**	**451 874**	**479 979**	**38 836**	**88 481**	**3 248 835**	**2 822 351**
Assets held for managing liquidity risk by contractual maturity dates								
Due from banks and investment companies	10	1 271 153	0	0	0	0	**1 271 153**	**1 271 153**
Financial assets at fair value (debt securities)	11, 12	0	10 883	13 018	8 429	0	**32 330**	**32 331**
Loans and advances to customers	13	0	113 590	251 806	1 029 520	582 889	**1 977 805**	**1 687 034**
Receivables from customers	14	0	3 551	0	0	0	**3 551**	**3 551**
Other financial assets	15	2 246	0	0	0	0	**2 246**	**2 246**
Foreign exchange derivatives (gross settled)		0	14 942	0	615	0	**15 557**	**0**
Total assets held for managing liquidity risk		**1 273 399**	**142 966**	**264 824**	**1 038 564**	**582 889**	**3 302 642**	**2 996 315**
Maturity gap from assets and liabilities		**-916 266**	**-308 908**	**-215 155**	**999 728**	**494 408**	**53 807**	

31.12.2018

(in thousands of euros)	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Carrying amount	Total
Liabilities by contractual maturity dates								
Deposits from customers and loans received	17	1 304 239	24 949	94 113	16 780	4 390	**1 444 471**	**1 443 782**
Subordinated debt	20	0	832	2 496	13 311	59 426	**76 065**	**50 900**
Accounts payable and other financial liabilities	18	0	21 428	0	0	0	**21 428**	**21 428**
Unused loan commitments	23	32 259	156 582	0	0	0	**188 841**	**0**
Financial guarantees by contractual amounts	23	0	9 314	0	0	0	**9 314**	**0**
Foreign exchange derivatives (gross settled)		0	18 559	0	610	0	**19 169**	**0**
Financial liabilities at fair value	12	0	11	0	0	0	**11**	**11**
Total liabilities		**1 336 498**	**231 675**	**96 609**	**30 701**	**63 816**	**1 759 299**	**1 516 121**
Assets held for managing liquidity risk by contractual maturity dates								
Due from banks and investment companies	10	682 658	0	0	0	0	**682 658**	**682 658**
Financial assets at fair value (debt securities)	11, 12	0	20 690	0	15 845	2 161	**38 696**	**38 697**
Loans and advances to customers	13	0	63 584	198 293	634 077	154 853	**1 050 807**	**918 761**
Receivables from customers	14	0	3 721	0	0	0	**3 721**	**3 721**
Other financial assets	15	2 936	0	0	0	0	**2 936**	**2 936**
Foreign exchange derivatives (gross settled)		0	18 559	0	610	0	**19 169**	**0**
Total assets held for managing liquidity risk		**685 594**	**106 554**	**198 293**	**650 532**	**157 014**	**1 797 987**	**1 646 773**
Maturity gap from assets and liabilities		**-650 904**	**-125 121**	**101 684**	**619 831**	**93 198**	**38 688**	

Initialled for identification purposes only
Initials I.S. Date 21.02.2020

The following table presents the distribution of assets and liabilities by classification of current and non-current.

(in thousands of euros)	Note	31.12.2019	31.12.2018
Current assets			
Due from central bank	10	1 232 733	639 862
Due from credit institutions	10	32 947	25 791
Due from investment companies	10	5 473	17 005
Financial assets at fair value through profit or loss	12	32 835	39 266
Loans and advances to customers	13	301 327	225 036
Receivables from customers	14	3 551	3 721
Other assets	15	1 961	1 651
Total current assets		**1 610 827**	**952 332**
Non-current assets			
Equity instruments at FVOCI	11	432	298
Financial assets at fair value through profit or loss	12	7 695	7 590
Loans and advances to customers	13	1 385 707	693 725
Other financial assets	15	2 246	2 936
Tangible assets	16	6 686	1 135
Intangible assets	16	14 705	15 470
Goodwill	6	3 614	3 614
Total non-current assets		**1 421 085**	**724 768**
Total assets	**5**	**3 031 912**	**1 677 100**
Liabilities			
Current liabilities			
Deposits from customers and loans received	17	2 704 935	1 422 988
Financial liabilities at fair value through profit or loss	12	8	11
Accounts payable and other liabilities	18	24 314	24 644
Total current liabilities		**2 729 257**	**1 447 643**
Non-current liabilities			
Deposits from customers and loans received	17	21 627	20 794
Subordinated debt	20	75 000	50 900
Total non-current liabilities		**96 627**	**71 694**
Total liabilities	**5**	**2 825 884**	**1 519 337**

3.5 Fair value of financial assets and financial liabilities

31.12.2019

(in thousands of euros)	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value	Difference
Financial assets at fair value through profit or loss							
Shares and fund units*	12	500	7 695	0	**8 195**	**8 195**	**0**
Equity instruments at fair value through other comprehensive income	11	0	0	432	**432**	**432**	**0**
Debt securities at fair value through profit or loss	12	32 331	0	0	**32 331**	**32 331**	**0**
Interest rate swaps and foreign exchange forwards	12	0	4	0	**4**	**4**	**0**
Total financial assets at fair value throught profit or loss		**32 831**	**7 699**	**432**	**40 962**	**40 962**	**0**
Financial liabilities at fair value through profit or loss							
Interest rate swaps and foreign exchange forwards	12	0	8	0	**8**	**8**	**0**
Total financial liabilities at fair value throught profit or loss		**0**	**8**	**0**	**8**	**8**	**0**
Financial assets at amortised cost							
Due from other banks	10	0	1 232 733	0	**1 232 733**	**1 232 733**	**0**
Due from credit institutions	10	0	32 947	0	**32 947**	**32 947**	**0**
Due from investment companies	10	0	5 473	0	**5 473**	**5 473**	**0**
Loans and advances to customers	13	0	0	1 707 842	**1 707 842**	**1 687 034**	**20 808**
Receivables from customers	14	0	3 551	0	**3 551**	**3 551**	**0**
Other financial assets	15	0	2 246	0	**2 246**	**2 246**	**0**
Total financial assets at amortised cost		**0**	**1 276 950**	**1 707 842**	**2 984 792**	**2 963 984**	**20 808**
Financial liabilities at amortised cost							
Deposits from customers and loans received	17	0	2 192 452	537 581	**2 730 033**	**2 726 562**	**3 471**
Subordinated debt	20	0	0	76 553	**76 553**	**75 444**	**1 109**
Accounts payable and other liabilities	18	0	20 789	0	**20 789**	**20 789**	**0**
Total financial liabilities at amortised cost		**0**	**2 213 241**	**614 134**	**2 827 375**	**2 822 795**	**4 580**

Total net gain recognised in OCI for level 3 financial assets amounted to EUR 134 thousand.

31.12.2018

(in thousands of euros)	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value	Difference
Financial assets at fair value through profit or loss							
Shares and fund units*	12	510	7 590	0	**8 100**	**8 100**	**0**
Equity instruments at fair value through other comprehensive income	11	0	0	298	**298**	**298**	**0**
Debt securities at fair value through profit or loss	12	38 697	0	0	**38 697**	**38 697**	**0**
Interest rate swaps and foreign exchange forwards	12	0	59	0	**59**	**59**	**0**
Total financial assets at fair value throught profit or loss		**39 207**	**7 649**	**298**	**47 154**	**47 154**	**0**
Financial liabilities at fair value through profit or loss							
Interest rate swaps and foreign exchange forwards	12	0	11	0	**11**	**11**	**0**
Total financial liabilities at fair value throught profit or loss		**0**	**11**	**0**	**11**	**11**	**0**
Financial assets at amortised cost							
Due from other banks	10	0	639 862	0	**639 862**	**639 862**	**0**
Due from credit institutions	10	0	25 791	0	**25 791**	**25 791**	**0**
Due from investment companies	10	0	17 005	0	**17 005**	**17 005**	**0**
Loans and advances to customers	13	0	0	924 825	**924 825**	**918 761**	**6 064**
Receivables from customers	14	0	3 721	0	**3 721**	**3 721**	**0**
Other financial assets	15	0	2 936	0	**2 936**	**2 936**	**0**
Total financial assets at amortised cost		**0**	**689 315**	**924 825**	**1 614 140**	**1 608 076**	**6 064**
Financial liabilities at amortised cost							
Deposits from customers and loans received	17	0	1 304 369	139 557	**1 443 926**	**1 443 782**	**144**
Subordinated debt	20	0	0	51 475	**51 475**	**51 214**	**261**
Accounts payable and other liabilities	18	21 428	0	0	**21 428**	**21 428**	**0**
Total financial liabilities at amortised cost		**21 428**	**1 304 369**	**191 032**	**1 516 829**	**1 516 424**	**405**

Total net gain recognised in OCI for level 3 financial assets amounted to EUR 42 thousand.

*Shares and fund units include the Group's subsidiary AS LHV Varahaldus investment into pension fund units in the amount of EUR 7 695 thousand (31.12.2018: EUR 7 590 thousand) euros. Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 0.5% of the number of units in each of the mandatory pension fund managed by it.

The management board of the Group has assessed the fair value of assets and liabilities carried at amortised cost in the statement of financial position. For estimating fair value, the future cash flows are discounted based on the market interest yield curve.

Levels used in hierarchy:

1. Level 1 – quoted prices in active market
2. Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)
3. Level 3 – other valuation techniques (a)Quantitative information about the significant unobservable inputs used in fair value measurement (if developed and available for the entity); b)a narrative description of the sensitivity of FV measurement to changes in unobservable inputs (if the change might result in a significant change in FV measurement); c)effect of reasonable possible changes to unobservable inputs.

Valuation explanations

Shares and fund units - Level 1 – quotes from active market. Level 2 - AS LHV Varahaldus' investments into pension fund units have quoted prices from the market, however the market is inactive and therefore these are classified as level 2 investments.

Equity instruments at fair value through other comprehensive income - the shares of Visa are not traded on an active market, therefore their value is based on market information on similar transactions and management estimates

Debt securities at fair value through profit or loss - Quotes from active market

Interest rate swaps and foreign exchange forwards - mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. Markets supply observable inputs to the valuation model, which is used for establishing the fair value. The fair value for such over-the-counter derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.

Due from other banks - Very liquid and short-term

Due from credit institutions - Very liquid and short-term

Due from investment companies - Very liquid and short-term

Loans and advances to customers – Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest rate of past 6 months prior to balance sheet date

Receivables from customers - Short-term receivables

Other financial assets - Short-term deposits

Deposits from customers and loans received - customer deposits and loans received with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount

Subordinated debt - Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade

Accounts payable and other liabilities - Short-term payables

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

3.6 Operational risk

Operational risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the segregation of duties principle is used in the Group's working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of the Group and to evaluate capital requirements. The analysis of cases collected into the database enables the Group to identify the flaws in business processes, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of Group is responsible for collecting information.

Compliance control and internal audit department have an important role in evaluating, monitoring and mitigating the operating risk. The main task of the Compliance Officer is to evaluate the activities of the Group in accordance with legislation, the supervision guidelines of the Financial Supervision Authority and procedure rules of the Group. Internal audit is an independent and objective function, assuring and consulting activity that is targeted at improving the Group's performance, processes and adding value. Internal audit helps achieving the goals of the Group, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.7. Compliance risk

Risk of compliance is the existing or potential risk to income and capital as a consequence of a failure to comply with laws, guidelines, standards or ethical principles. The realisation of a risk may result in fines, claims, loss in reputation, termination of contractual relationships and, in revocation of the licence.

The aim of managing compliance risk is to prevent the negative consequences from materialising.

Considering the volume and pace of changes to regulatory requirements LHV assesses compliance risk to remain high.

In order to manage the risk, the compliance function assesses changes to regulatory environment, evaluates their potential impact, informs management of changes and participates in the implementation thereof.

Monthly overviews to management include information collected from various sources, including supervisory guidelines,, EU, UK and Estonian regulatory acts. Board members take responsibility in implementing identified changes. In addition, the compliance function keeps track of all regulatory requirements applicable to LHV group entities.

The biggest challenges that LHV continues to face are similar to other market participants and include MiFID, GDPR, AMLD, PRIIP regulation and CRD-V package. Due to the nature of business model LHV places additional attention to changes in UK regulative environment, including those associated with UK leaving EU.

3.8. Anti-money laundering

AML/CTF Governance

LHV internal governance is based on three lines of defence principle. Business as first line of defence owns, takes and mitigates risks where AML, Compliance and Risk management as second line of defence are providing framework and guidance, also controlling first line. Internal audit as third line of defence is assuring that first and second line are set up and working properly, giving assurance to Supervisory Board.

All defence lines follow risk-based approach which is based on risk assessment of products, services, clients and countries, CDD and EDD measures depending on risk levels and on risk-based monitoring. High awareness and commitment from all employees and management is foundation on which is built strong AML culture supported by awareness rising, information sharing, training and reporting.

Management and Supervisory Board of LHV Group and LHV Bank have strong commitment towards implementing, maintaining and developing AML/KYC regime all over Group entities. There have been at least yearly updates in AML/CTF Policy and Customer Acceptance Principles. In 2019, Management Board approved Risk Assessment and Risk Appetite Framework. All internal AML/CTF procedures and guideline are constantly renewed.

Analytical and supported technical capabilities are key elements in AML system and LHV has invested a lot in 2019 into different new tools. AML monitoring is carried out by FICO Tonbeller software Siron and screening by Accuity`s Compliance Link. Both tools were launched in 2019. Beside Siron and Compliance Link analytical-visualisation software Tableau is used to monitor activities and trends. Co-operation with external experts from Salv (previous brand: Dataminer) is on-going in order to enhance further analytical capabilities of AML team. That co-operation includes testing Salv`s monitoring software with aim to enhance potentiality of analytics even more in future.

Beside investments into IT, also number of employees directly and indirectly related to the AML has significantly raised. Many new positions were generated both in to AML department and to KYC-EDD team in first line of defence.

AML Governance structure

Institution	Approves	Actions
Supervisory Board	- AML/CTF Policy and high-level risk appetite	- Monitors and supervises AML high-level area - Receives reports on AML
Management Board	- Customer Acceptance Principles - Risk assessment and risk appetite framework - AML framework - AML Committee procedure - High Risk Customer Acceptance Committee procedure	- Monitors and supervises AML area - Sets AML risk appetite - Regular reporting from AML and compliance - Sets AML risk appetite - Provides general guidance - Accepts high risk customers
AML	- AML internal guideline	- Co-ordinates AML procedures and processes - Gives guidance to first line of defence - Assesses AML risks (customer, product, service, channel, country) - Supports EDD measures (on-boarding risk assessment, on-site and off-site controls etc.) - Is responsible for monitoring - Is responsible for screening - Analyses all suspicious and unusual customers and transactions - Assesses AML risks associated with new services, products and processes - Reports to FIU - Reports to management - Provides training and raises awareness
Compliance		- Advises management bodies and the AML department to ensure compliance with applicable regulations - Assesses the potential impact of changes in the regulatory and supervisory environment - Carries out AML compliance controls and audits - Assesses compliance risks associated with new services, products and processes - Reports to the governing bodies
Internal audit		- Performs an independent evaluation of AML processes - Reports to the Supervisory Board and to the Audit Committee
Business	- Specific instructions on all work flows (including AML measures within)	- Performs KYC - Escalates internal SAR`s to AML

AML/KYC measures

LHV main principles:

- strong on-boarding CDD supported by Customers Acceptance Principles;
- conservative approach towards risk segmentation;
- regular CDD and EDD;
- robust risk based monitoring;
- screening of customers and transactions towards International financial sanctions lists and other sources (incl. US OFAC list and UK HM Treasury list);
- strong top and middle management commitment;
- regular training of employees;
- ongoing communication and cooperation with FIU and other relevant stakeholders;
- active participation in setting industry`s best practices.

LHV has implemented four levels of customer acceptance in on-boarding stage:

- Customer relationship manager
- Customer relationship manager and approval by senior employee (4-eye principle)
- Risk Customer Acceptance Committee
- Management

Combination of risk indicators determine with each customer which acceptance level is required.

Beside conservative and risk-based on-boarding procedures, also risk-based monitoring is implemented and regular updating of KYC information is carried out.

LHV has set risk tolerance towards non-resident legal customers' deposits outside of non-financial and non-governmental sectors to 25%. The cause of growth of non-resident deposits was related to the Banks decision to attract long term low risk deposits from German and Austrian market through deposit platforms Raisin and Deposit Solution.

Financial intermediaries

LHV is providing services to fin.tech companies who provide financial services to their customers. As providing service to fin.techs include different risks comparing to servicing regular resident customers, then Bank has dedicated special attention and measures to mitigate those risks. There are dedicated customer managers having area related competence. AML team constantly monitors trends, developments and threats coming from that sector and KYC measures are constantly updated. Bank has taken approach that all customers from fin.tech sector have to have same AML/KYC measures in place as does banking sector. During on-boarding and continuous KYC, Bank assesses customers business model, team, AML/KYC measures, technical capabilities for screening and monitoring, customer focus, customer risk segmentation, limit policy, source of funds and etc. LHV carries out on-site visits to ensure that measures on policies and procedures are implemented in reality and are really working. Special and continuous attention through dedicated monitoring is set on financial activities of such customers.

Country

Recent years money-laundering allegations have shaken Estonian and foreign media and Estonian reputation has been severely damaged. Still Estonian financial system and country itself is deemed one of the least risky ones in world. Basel Institute on Governance has ranked Estonia in 2019 as least risky country from money laundering risks perspective. Even if there have been shortcomings in KYC measures and setting proper risk appetite by some institutions historically, then in general Estonian AML system has been assessed as strong. Next significant evaluation will be against FATF standards in 2021-2022 by Moneyval.

Estonian regulator, FIU and financial sector have taken situation very seriously and a lot of different steps have been taken to improve AML system in all aspects. Banking sector has invested heavily in human resources, both from quantitative, but also from competence point of view. All market participants have been and are continuously improving usage of technology. Most of them are exploring ways to use modern technology (e.g. machine learning) to improve their technical and analytical capabilities. FSA has issued new AML guideline in March 2019. As new component is list of money laundering trends and methods in Estonia through all three phases of money laundering. FIU has updated reporting software, being now able to have quicker and automated overview of all data reported to them. From regulatory point of view, many legislative initiatives are ongoing in order to improve AML system and cooperation between all stakeholders.

3.9. Other risks

3.9.1 Strategic and business risk

Strategic risk is expressed mainly in wrong strategic decisions. Strategic risk is mitigated through well-considered business plans and analyses. In addition, members of both LHV Pank's and LHV Group's management (both Management Board and Supervisory Board) have long-term experience in the banking sector and/or entrepreneurship. Prior to entering new markets and sectors, professionals in the field will always be involved and a thorough analysis will be carried out.

3.9.2 Risk on reputation

Risk on reputation is defined as a risk, which arises from a loss of reputation for clients, business partners, owners, investors or supervisors. Risk on reputation is usually a result from realisation of other risks (for example operational risk or strategic risk). In order to mitigate the risk on reputation, LHV regularly carries out risk management trainings and also the framework of risk management is constantly improved which will provide a strong risk culture.

3.9.3 Country risk

Similarly to the risk on reputation, the country risk is usually expressed through another risk (operational risk, credit risk, strategic risk). In addition to Estonia, LHV is preparing to start a business in the United Kingdom.

3.10 Offsetting assets and liabilities

The group has offset the following assets and liabilities.

				Related arrangements not set off in the statement of financial position		
31.12.2019	Gross amounts before offsetting in the statement of financial position	Offsetting	Net amount of exposure presented in the statement of financial position	Financial instruments	Cash collateral received	Net amounts
ASSETS						
Derivatives	4	0	4	0	0	0
LIABILITIES						
Derivatives	8	0	8	0	0	0
31.12.2018						
ASSETS						
Derivatives	59	0	59	0	0	0
LIABILITIES						
Derivatives	2	0	2	0	0	0

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the end of the reporting period, and the reported amounts of income and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates. Management's estimates have been applied to valuation of loans, receivables and investments (Notes 10, 11, 12, 13 and 14) and the determination of useful lives of tangible and intangible assets (Note 16).

Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances. Changes in management's estimates are reported prospectively.

The most significant management estimates and assumptions are related with the financial instrument standard IFRS 9, namely the criteria for SICR, calculation of PD and LGD, business model and SPPI assessment for classification of financial assets. Please see more information in Note 3.2 and below. There were no significant other changes in management estimates and assumptions in 2019.

When calculating expected credit loss (ECL) there are a number of key concepts that require a high level of judgement. Estimating expected credit loss is, by its very nature, uncertain and the accuracy of these estimates depends on many factors, e.g. macroeconomic forecasts and involves complex modelling and judgements. The assessment of significant increase in credit risk is a concept under IFRS 9 Financial Instruments and requires significant judgement. At the end of each reporting period the Group performs an assessment of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument, using key risk indicators that are used in the Group's existing risk management processes. Another area requiring significant judgement is the incorporation of forward-looking information and macroeconomic scenarios. IFRS 9 requires an unbiased and probability-weighted estimate of credit losses by evaluating a range of possible outcomes that incorporates forecasts of future economic conditions. LHV uses internally developed macroeconomic forecasts as the basis for the forward-looking information in the ECL measurement. LHV uses both models and expert based judgement in order to determine ECLs. The objective of applying expert based judgement is to incorporate the estimated impact of factors not captured in the modelled ECL. The degree of judgement that is required to estimate expected credit losses depends on the outcome from calculations, materiality and the availability of detailed information. The models, assessment and assumptions are regularly reviewed by the risk organisation of the Group and approved by the Group Risk Committee.

NOTE 5 Operating segments

Bank divides its business activities by 3 main business segments: retail banking, financial intermediates and corporate banking. The business segments form a part of the Group, with a separate access to financial data and which are subject to regular monitoring of operating result by the Group's decision-maker. The full planning and KPI setting is done on segments level. For each of the segment full statement of financial position and profit and loss statement is prepared. In addition to these high-level segments, Group has planning/measurement on department level.

Grouping is done based on the client/product base, where similar departments are grouped under one segment.

Retail banking segment covers all private individuals and small legal entities with credit exposure under EUR 500 thousand. This is the regular universal banking segment offering payments, cards, credits etc. In 2018 Private banking was presented as separate segment, but this was included into Retail banking starting from 2019. Same time Financial intermediates were separated from Retail banking.

Corporate banking segment covers all corporate customers and other legal entities with credit exposure over EUR 500 thousand. The main products are credits and payments.

Asset management is the pension management segment covering pension second and third pillar.

Hire-purchase and consumer finance unit in Estonia is separate legal entity covering small loan business to private individuals. These portfolios are relatively small, but due to clients different payment history these segments have to be looked separately.

Financial intermediates cover fintech companies with large volume of payments both in Estonia and in United Kingdom. Under that segment LHV reports also regular payment services.

Other activites include treasury activities through providing internal bank function to segments and AS LHV Group solo based activities, which are mostly capital and funding related.

The management board of AS LHV Group has been designated as the decision-maker responsible for allocation of funds and assessment of the profitability of the business activities. The result posted by a segment includes revenue and expenditure directly related to the segment.

The revenue of a reported segment is based on the revenue per financial statements and includes gains from transactions between the segments, i.e. loans granted by AS LHV Pank to other group companies. The division of interest income and fee and commission income by customer location has been presented in Notes 7 and 8. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.

31.12.2019 *(in thousands of euros)*	Retail banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Financial intermediates	Other activities	Intra-segment eliminations	Total
Interest income incl.	18 907	35 107	0	11 209	752	10 626	-15 187	61 414
External interest income	13 358	33 416	0	11 209	0	3 431	0	61 414
Internal interest income	5 549	1 691	0	0	752	7 195	-15 187	0
Interest expense	-3 723	-6 071	-145	-1 691	-10	-17 573	15 187	-14 026
Net interest income	15 184	29 036	-145	9 518	742	-6 947	0	47 388
Fee and commission income	**6 754**	**2 147**	**12 869**	**602**	**14 654**	**0**	**0**	**37 026**
Fee and commission expense	-502	-363	0	-674	-9 797	-13	0	-11 349
Dividend income	0	0	0	0	0	6 630	-6 630	0
Net fee and commission income	**6 252**	**1 784**	**12 869**	**-72**	**4 857**	**6 617**	**- 6 630**	**25 677**
Net income	**21 436**	**30 820**	**12 724**	**9 446**	**5 599**	**-330**	**-6 630**	**73 065**
Net gains from financial assets	-10	-4	465	0	46	173	0	670
Administrative and other operating expenses, staff costs	-10 895	-7 661	-6 097	-1 881	-9 114	-3 536	0	-39 184
Profit before credit losses	**10 531**	**23 155**	**7 092**	**7 565**	**-3 469**	**-3 693**	**-6 630**	**34 551**
Impairment losses on loans and advances	-1 194	-1 736	0	-247	-33	0	0	-3 210
Profit before tax	**9 337**	**21 419**	**7 092**	**7 318**	**-3 502**	**- 3 693**	**-6 630**	**31 341**
Income tax	-803	-1 640	-972	-760	-74	0	0	-4 249
Profit from continuing operations	**8 534**	**19 779**	**6 120**	**6 558**	**-3 576**	**-3 693**	**-6 630**	**27 092**
Total assets	**1 075 705**	**1 613 557**	**31 221**	**65 506**	**298 806**	**179 686**	**-232 569**	**3 031 912**
Total liabilities	**1 992 547**	**450 089**	**2 100**	**50 548**	**388 317**	**75 577**	**-133 294**	**2 825 884**

The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

31.12.2018 *(in thousands of euros)*	Retail banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Financial intermediates	Other activities	Intra-segment eliminations	Total
Interest income incl.	10 944	25 359	0	9 380	1 211	5 634	-6 906	45 622
External interest income	6 802	24 125	0	9 380	0	5 315	0	45 622
Internal interest income	4 142	1 234	0	0	1 211	319	-6 906	0
Interest expense	0	-4 401	-168	-1 234	0	-8 574	6 906	-7 471
Net interest income	10 944	20 958	-168	8 146	1 211	-2 940	0	38 151
Fee and commission income	**14 256**	**1 910**	**13 942**	**517**	**2 132**	**87**	**0**	**32 844**
Fee and commission expense	-6 953	-65	0	-553	-200	-28	0	-7 799
Dividend income	0	0	0	0	0	6 578	-6 578	0
Net fee and commission income	**7 303**	**1 845**	**13 942**	**-36**	**1 932**	**6 637**	**-6 578**	**25 045**
Net income	**18 247**	**22 803**	**13 774**	**8 110**	**3 143**	**3 697**	**-6 578**	**63 196**
Net gains from financial assets	-15	0	-25	0	0	483	0	443
Administrative and other operating expenses, staff costs	-13 481	-5 503	-5 823	-2 058	-1 298	-3 118	0	-31 281
Profit before credit losses	**4 751**	**17 300**	**7 926**	**6 052**	**1 845**	**1 062**	**-6 578**	**32 358**
Impairment losses on loans and advances	351	-5 027	0	-171	0	-32	0	-4 879
Profit before tax	**5 102**	**12 273**	**7 926**	**5 881**	**1 845**	**1 030**	**-6 578**	**27 479**
Income tax	-563	-987	-1 100	-838	-106	-20	0	-3 614
Profit from continuing operations	**4 539**	**11 286**	**6 826**	**5 043**	**1 739**	**1 010**	**-6 578**	**23 865**
Total assets	**989 879**	**535 836**	**31 193**	**51 383**	**109 987**	**127 748**	**-168 926**	**1 677 100**
Total liabilities	**1 210 066**	**177 086**	**2 610**	**39 577**	**134 452**	**51 380**	**-95 834**	**1 519 337**

The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

pwc Initialled for identification purposes only
Initials I.S. Date 21.02.2020

NOTE 6 Subsidiaries and goodwill

As at 31.12.2019, the Group's subsidiaries, which have been consolidated in these financial statements include:

- AS LHV Pank (Estonia, ownership interest 100%)
- AS LHV Varahaldus (Estonia, ownership interest 100%)
- Cuber Technology OÜ (Estonia, ownership interest 100%)
- AS LHV Finance (Estonia, ownership interest 65% through AS LHV Pank)

AS LHV Pank paid in 2013 EUR 325 thousand euros of monetary contribution for 65% of ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand euros of monetary contribution for 35% of ownership. The contribution of the non-controlling interest has been reflected in the consolidated statement of financial position on the line "Non-controlling interest".

As at 31.12.2019 and 31.12.2018, the Group does not have any associates.

As at 31.12.2019, goodwill in amount EUR 3 614 thousand in the consolidated financial statements of AS LHV Group consists of:

- goodwill which had arisen on the acquisition of the ownership in AS LHV Varahaldus in the amount of EUR 1 044 thousand;
- goodwill which had arisen on the acquisition of the ownership interests in Danske Capital AS by AS LHV Varahaldus in the amount of EUR 2 570 thousand

Impairment tests were performed as at 31.12.2019 and as at 31.12.2018. The cash-generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions based on 5 year forecast:

- the volume of assets under management is expected to increase by 18% per annum (2018: by 16%);
- increase of income of fund manager is expected to be average of -4% per annum (2018:-10%);
- due to the economic environment, growth of 5% in indirect costs is expected per annum (2018: 2%);
- the discount rate used is 15% (2018: 15%).

When using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations. Expectations are more conservative due to the changes in the market situation and legislation. Based on the results of the impairment test performed as at 31.12.2019 and 31.12.2018, the recoverable amount of cash generating unit is higher than its carrying amount, as a result of which no impairment losses have been recognised.

As at 31.12.2019, the Group has one subsidiary that has non-controlling interests, AS LHV Finance.

Set out below are the summarised financial information for AS LHV Finance. The information disclosed is the amount before inter-company eliminations.

	AS LHV Finance	
Summarised statement of Financial Position	**31.12.2019**	**31.12.2018**
Loans and advances to customers and other current assets	65 415	51 338
Non-current assets	91	45
Current liabilities	1 966	1 996
Non-current liabilities	48 582	37 581
Total net assets	**14 958**	**11 806**

	AS LHV Finance	
Summarised statement of Profit or Loss and Other Comprehensive Income	**2019**	**2018**
Total net interest and fee income	9 446	8 110
Profit before income tax	7 318	5 881
Income tax expense	-760	-838
Profit from discontinued operations	0	0
Net profit	**6 558**	**5 043**
Total comprehensive income	6 558	5 043
Profit and other comprehensive income allocated to non-controlling interests	2 296	1 765

	AS LHV Finance	
Summarised statement of Cash Flows	**2019**	**2018**
Cash generated from operations	-4 925	-1 188
Interest paid	-1 636	-1 215
Income tax paid	-760	-838
Net cash generated from/(used in) operating activities	-7 321	-3 241
Net cash generated from/(used in) investing activities	-87	-28
Net cash generated from/(used in) financing activities	7 403	3 274
Net increase/(decrease) in cash and cash equivalents	**-5**	**5**
Cash and cash equivalents at beginning of year	5	0
Cash and cash equivalents at end of year	0	5

NOTE 7 Net interest income

Interest income *(in thousands of euros)*	Note	2019	2018
Interest income using effective interest calculation			
Corporate loans		37 129	27 048
incl. loans to related parties	24	27	31
incl. stage 3 interests*		164	340
Hire purchase		3 968	4 055
Consumer loans		7 240	5 313
Private loans		1 744	1 514
Mortgage loans		5 248	1 769
Leveraged loans and lending of securities		500	456
Credit card loans		813	770
From balances with credit institutions and investment companies		270	141
Other loans		893	1 981
Subtotal		**57 805**	**43 047**
Other similar interest income			
Leasing		3 253	2 439
incl. loans to related parties	24	3	4
From debt securities		356	136
incl. debt securities at FVOCI		-	13
incl. debt securities at fair value through profit or loss	12	356	123
Subtotal		**3 609**	**2 575**
Total		**61 414**	**45 622**
Interest expense			
Deposits from customers and loans received		-5 579	-1 880
incl. deposits from related parties	24	-8	-42
From balances with central bank		-4 264	-3 360
Subordinated debt	20	-4 183	-2 231
incl. loans from related parties	24	-373	-357
Total		**-14 026**	**-7 471**
Net interest income		**47 388**	**38 151**

Interest income of loans by customer location
(interests from bank balances and debt securities not included):

(in thousands of euros)	2019	2018
Estonia	60 788	44 822
Lithuania	0	523
Total	**60 788**	**45 345**

*As most of the stage 3 loans are sold to debt collectors, the stage 3 interests are marginal in all loan portfolios except corporate loans.

NOTE 8 Net fee and commission income

Fee and commission income	Note	2019	2018
Security brokerage and commission fees		3 658	3 687
incl. related parties	24	22	11
Asset management and related fees		15 831	16 371
Incl. funds managed by the Group*	24	12 860	13 922
Currency exchange fees		1 867	1 639
Fees from cards and settlements		12 485	8 766
Fees from consumer loans and hire purchase		602	518
Other fee and commission income		2 583	1 863
Total		**37 026**	**32 844**
Fee and commission expense			
Security brokerage and commission fees paid		-546	-544
Expenses related to cards		-3 979	-2 765
Expenses related to acquiring		-3 967	-2 834
Transaction costs		-692	-468
Costs related to ATM-s		-1 159	-649
Other fee expense		-1 006	-539
Total		**-11 349**	**-7 799**
Net fee and commission income		**25 677**	**25 045**

* Commission fees from pension and investment funds are calculated as a fixed percentage of total assets of the fund and varies between 0.39% -2% p.a. Fees for pension funds were decreased starting from September 2019 and are between 0.39%-1.2%.

Fee and commission income by customer location:	2019	2018
Estonia	36 978	32 677
Other	48	163
Total	**37 026**	**32 884**

NOTE 9 Operating expenses

(in thousands of euros)	Note	2019	2018
Wages, salaries and bonuses		14 883	12 190
Social security and other taxes*		4 382	3 566
Total staff costs		**19 265**	**15 756**
IT expenses		2 829	2 322
Information services and banking services		868	625
Marketing expenses		2 089	2 023
Office expenses		633	677
Transportation and communication costs		276	225
Training and travelling expenses of employees		690	626
Other outsourced services		3 324	3 136
Other administrative expenses		3 807	2 304
Depreciation	16	4 674	2 972
Operating lease payments		327	1 153
Other operating expenses		486	324
Total other operating expenses		**20 003**	**16 387**
Total operating expenses		**39 268**	**32 143**

* lump-sum payment of social, health and other insurances.

The average number of employees working for LHV Group in 2019 was 409 (2018: 366).

From 2018, the sales costs of pension fund client agreements have been capitalised as intangible assets based on their expected lifetime of customer relationship, ie 20 years

If these sales costs would have recorded as costs and not capitalised, the "Marketing expenses" would have been EUR 1 818 thousand higher.

NOTE 10 Due from central bank, credit institutions and investment companies

(in thousands of euros)	31.12.2019	31.12.2018
Demand and term deposits with maturity of less than 3 months *	38 420	42 796
Statutory reserve capital at central bank	29 426	14 280
Demand deposit from central bank *	1 206 307	625 582
Total	**1 271 153**	**682 658**
* cash and cash equivalents in the statement of cash flows	1 244 727	668 378

Distribution of receivables by countries is presented in Note 3.2. Mandatory banking reserve as at 31.12.2019 was 1% (2018: 1%) of all financial resources collected (deposits from customers and loans received). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 11 Equity instruments at fair value through other comprehensive income

Equity instruments 31.12.2017	**0**
Reclassification on 1 January 2018	**220**
Revaluation of equity instruments	78
Equity instruments 31.12.2018	**298**
Revaluation of equity instruments	134
Equity instruments 31.12.2019	**432**

As of 31.12.2019 the Group has VISA shares in the amount of EUR 432 (2018: 298) thousand. The balance of other reserves in equity as at 31.12.2019 is EUR 212 (2018: 78) thousand, see also Note 21.

NOTE 12 Investments in debt and equity securities

Mandatory measurement as fair value through profit or loss:	**31.12.2019**
Shares and fund units	500
Debt securities	32 331
Fund units	7 695
incl. investments in managed pension funds	7 695
Foreign exchange forwards	4
Total financial assets	40 530
Interest rate swaps and foreign exchange forwards	8
Total financial liabilities	**8**

Mandatory measurement as fair value through profit or loss:	**31.12.2018**
Shares and fund units	510
Debt securities	38 697
Fund units	7 590
incl. investments in managed pension funds	7 590
Foreign exchange forwards	59
Total financial assets	46 856
Interest rate swaps and foreign exchange forwards	11
Total financial liabilities	**11**

Financial assets at fair value through profit or loss 31.12.2017	**55 859**
Net changes of investment securities at fair value through profit or loss	-10 335
Interest income (Note 7)	123
Revaluation	1 209
Financial assets at fair value through profit or loss 31.12.2018	**46 856**
Net changes of investment securities at fair value through profit or loss	-6 869
Interest income (Note 7)	356
Revaluation	187
Financial assets at fair value through profit or loss 31.12.2019	**40 530**

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.5). In 2019, a gain of EUR 86 thousand was recognised on the revaluation of debt securities (2018: EUR 407 thousand). No profit or loss arose on the revaluation of interest rate swaps in 2019 and in 2018.

The volume of pension and investment fund assets managed by the Group as at 31.12.2019 was EUR 1 374 million (31.12.2018: EUR 1 214 million).

NOTE 13 Loans and advances to customers

(in thousands of euros)	31.12.2019	31.12.2018
Loans to legal entities	**954 986**	**714 335**
incl. corporate loans	763 163	624 425
incl. retail loans	40 967	16 200
incl. leasing	66 078	44 277
incl. overdraft	42 801	23 846
Incl. trade finance	32 761	0
incl. leveraged loans	3 148	1 997
incl. hire-purchase	277	249
incl. credit card loans	402	274
incl. credit letters	5 389	3 067
Loans to individuals	**738 152**	**214 702**
incl. hire-purchase	16 133	17 501
incl. mortgage loans	587 855	101 009
incl. consumer loans	49 412	33 989
incl. private loans	44 776	37 884
incl. leasing	23 410	15 888
incl. leveraged loans	2 840	1 733
incl. credit card loans	7 263	6 579
incl. overdraft	34	43
incl. study loan	750	76
incl. real estate leasing	5 679	0
Total	**1 693 138**	**929 037**
incl. related parties (note 24)	3 290	3 328
Impairment provisions	-6 104	-10 276
Total	**1 687 034**	**918 761**

LHV purchased from Danske Bank Estonian Branche retail portfolio, increasing the retail loan portfolio by EUR 393 million, from which 97% were mortgage loans.

Changes in impairments in 2019	Corporate loans incl overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leve-raged loans	Other loans incl mortgage	Credit letters	Total
Balance as at 1 January	**-8 751**	**-184**	**-568**	**-27**	**-140**	**-467**	**-3**	**-36**	**-100**	**-10 276**
Impairment provisions/ reversals set up during the year	-400	-11	-746	-98	-234	-233	-4	-834	100	-2 460
Written off during the year	5 485	42	690	72	262	61	1	19	0	6 632
Balance as at December 31	**-3 666**	**-153**	**-624**	**-53**	**-112**	**-639**	**-6**	**-851**	**0**	**-6 104**

Changes in impairments in 2018	Corporate loans incl overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leve-raged loans	Other loans incl mortgage	Credit letters	Total
Balance as at 1 January	**-4 594**	**-155**	**-1 255**	**-240**	**-858**	**-780**	**0**	**-243**	**0**	**-8 125**
Impairment provisions/ reversals set up during the year	-4 272	-54	226	47	91	183	-3	207	-100	-3 675
Incl Changes in initial application of IFRS 9	-403	-46	-53	-2	-50	-158	0	0	0	-712
Written off during the year	115	25	25	10	4	120	0	0	0	299
Discontinued operations	0	0	436	156	623	10	0	0	0	1 225
Balance as at December 31	**-8 751**	**-184**	**-568**	**-27**	**-140**	**-467**	**-3**	**-36**	**-100**	**-10 276**

Impairment losses accumulated during the year differ from the amount of impairment losses recognised in the statement of profit or loss, that have been written off earlier as uncollectible claims. These receipts were recorded among impairment losses in the statement of profit or loss.

Initialled for identification purposes only
Initials I.S. Date 21.02.2020

Net and gross investments on finance leases according to remaining maturity	**Gross investment**	**Unearned future interest income**	**Impairment loss provision**	**Present value of lease payments receivable**
up to 1 year	26 375	-2710	-164	23 501
1-5 years	68 211	-4 395	-457	63 359
over 5 years	2 753	-107	-18	2 628
Total as at 31.12.2019	**97 339**	**-7 212**	**-639**	**89 488**
up to 1 year	19 135	-1710	-134	17 291
1-5 years	43 901	-2 535	-319	41 047
over 5 years	1880	-39	-14	1 827
Total as at 31.12.2018	**64 916**	**-4 284**	**-467**	**60 165**

For credit risk exposures and loan collateral, see Note 3.2.

Distribution of loans granted by currencies is disclosed in Note 3.3.

Distribution of loans granted by maturity is disclosed in Note 3.4.

The geographical distribution of loans granted is disclosed in Note 3.2.

For interest income on loans granted, see Note 7

NOTE 14 Receivables from customers

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Asset management fees from customers	1 057	1 412
incl. related parties (Note 24)	835	1 227
Other fees for providing services to customers	2 494	2 309
Total	**3 551**	**3 721**

All fees, are collected within 12 months of the end of the reporting period and are considered as current asset.

NOTE 15 Other assets

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Financial assets		
Guarantee deposits of Baltic stock exchanges	10	11
Guarantee deposits of VISA and MasterCard	2 236	2 925
Subtotal	**2 246**	**2 936**
Non-financial assets		
Prepayments to Financial Supervision Authority	503	476
Other prepayments *	1 458	1 175
Subtotal	**1 961**	**1 651**
Total	**4 207**	**4 587**

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

Prepayments are expected to be received or used within 12 months of the end of the reporting period, and are therefore considered current assets. Guarantee deposits on the Baltic stock exchanges are held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions, and should therefore both be considered non-current assets.

NOTE 16 Tangible and intangible assets

(in thousands of euros)	Tangible assets	Right-of-use assets	Total intangible assets	Intangible assets	Costs incurred for the acquisition of cutomer contracts	Total intangible assets	Total
Balance as at 31.12.2017							
Cost	4 078	0	4 078	8 058	10 618	18 676	22 754
Accumulated depreciation and amortisation	-2 657	0	-2 657	-3 731	0	-3 731	-6 388
Carrying amount 31.12.2017	**1 421**	**0**	**1 421**	**4 327**	**10 618**	**14 945**	**16 366**
Purchase of non-current assets	396	0	396	1 236	0	1 236	1 632
Capitalised selling costs	0	0	0	0	1 818	1 818	1 818
Write-off of non-current assets	-5	0	-5	0	0	0	-5
Depreciation/amortisation charge (Note 9)	-510	0	-510	-1 031	-1 431	-2 462	-2 972
Assets of discontinued operations	340	0	340	371	0	371	711
Amortisation of discontinued operations	-168	0	-168	-304	0	-304	-472
Balance as at 31.12.2018							
Cost	4 129	0	4 129	8 923	12 436	21 359	25 488
Accumulated depreciation and amortisation	-2 994	0	-2 994	-4 458	-1 431	-5 889	-8 883
Carrying amount 31.12.2018	**1 135**	**0**	**1 135**	**4 465**	**11 005**	**15 470**	**16 605**
Purchase of non-current assets	1 336	0	1 336	864	0	864	2 200
Non-current assets sold	-15	0	-15	0	0	0	-15
Capitalised selling costs	0	0	0	0	1 584	1 584	1 584
Changes in accounting policies	0	5 676	5 676	0	0	0	5 676
Write-off of non-current assets	-338	0	-338	-1 435	0	-1 435	-1 773
Depreciation/amortisation charge (Note 9)	-562	-899	-1 461	-1 751	- 1461	-3 213	-4 674
Balance as at 31.12.2019							
Cost	5 112	5 676	10 788	8 352	14 020	22 372	33 160
Accumulated depreciation and amortisation	-3 203	-899	-4 102	-4 775	-2 892	-7 667	-11 769
Carrying amount 31.12.2019	**1 909**	**4 777**	**6 686**	**3 577**	**11 128**	**14 705**	**21 391**

Tangible assets include computer technology and office equipment, furniture, capitalised costs of office renovation. Intangible assets include licences, client contracts and development costs.

In 2019 and 2018, there was no indication of impairment of tangible and intangible assets.The reconciliation of the operating balance of right-of-use assets and changes during the year are disclosed in Note 19.

NOTE 17 Deposits from customers and loans received

31.12.2019

(in thousands of euros)	Individuals	Financial intermediates	Legal entities	Public sector	Total
Demand deposits	525 938	376 068	1 267 180	20 293	2 189 479
Term deposits	415 349	0	90 100	3 100	508 549
Loans received	0	0	25 643	0	25 643
Accrued interest liability	2 692	0	196	3	2 891
Total	**943 979**	**376 068**	**1 383 119**	**23 396**	**2 726 562**
incl. related parties (Note 24)	1 308	0	14 755	0	16 063

31.12.2018

Demand deposits	374 491	193 893	727 803	7 935	1 304 122
Term deposits	57 605	0	54 456	5 734	117 795
Loans received	0	0	21 528	0	21 528
Accrued interest liability	197	0	131	9	337
Total	**432 293**	**193 893**	**803 918**	**13 678**	**1 443 782**
incl. related parties (Note 24)	1 091	0	32 417	0	33 508

LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) in the amount of EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2019, the Bank had used EUR 12 250 thousand of the loan amount and repaid the principal in the amount of EUR 2 163 thousand. The outstanding balance as at 31.12.2019 is EUR 10 087 thousand. As at 31 12 2019, the Bank has received EUR 20 000 thousand loan from Nordic Investment Bank (NIB) and repaid the principal in the amount of EUR 4 444 thousand. As at 31.12.2019 the balance of the loan received from NIB is EUR 15 556 thousand. NIB loan will be fully repaid in 2023.

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

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

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

Distribution of deposits from customers and loans received by geography and Risk concentration is presented in Note 3.2.

NOTE 18 Accounts payable and other liabilities

Financial liabilities

(in thousands of euros)	Note	31.12.2019	31.12.2018
Trade payables		5 033	2 153
Other short-term financial liabilities		3 067	1 925
Accrued interest on subordinated loans	20	444	314
Lease liabilities	19	4 672	0
Payments in transit		7 395	16 800
Financial guarantee contracts issued		178	236
Subtotal		**20 789**	**21 428**
Non-financial liabilities			
Performance guarantee contracts issued		266	243
Tax liabilities		1 230	1 218
Payables to employees		1 705	1 488
incl. related parties	24	73	91
Other short-term liabilities		324	276
Subtotal		**3 525**	**3 216**
Total		**24 314**	**24 644**

Payables to employees consist of unpaid salaries, bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in the number of employees during the year. Payments in transit consist of foreign payments and payables to customers related to intermediation of securities transactions, for which the customer's current account have been debited. All liabilities, except for financial guarantees, are payable within 12 months and are therefore recognised as current liabilities.

NOTE 19 Right of use assets and lease liabilities

The Group leases office premises. Until 31 December 2018 leases of office premises were classified as operating leases. From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability from the date when the leased asset becomes available for use by the Group. All lease agreements are cancellable upon the consent of both parties. In 2019, the operating lease payments, i.e leases subject to low value items and short-term, for office premises were in the amount of EUR 327 thousand (2018: EUR 1 153 thousand).

As of 01.01.2019 the future non-cancellable lease payments in the amount of EUR 4 512 thousand were discounted at the Group's incremental borrowing rate of 3.75%. As a result the Group's total assets in the statement of financial position as at 01.01.2019 increased 4 042 thousand euros and liabilities increased 4 042 thousand euros. During the year 2019 EUR 1 634 thousand was additionally recorded as right-of-use assets and lease liability which was related to the new lease properties. The right of use assets balance as of 31 December 2019 is disclosed in the Note 16. The lease liability balance as of 31 December 2019 is disclosed in the Note 18. Interest expense on lease liabilities was EUR 81 thousand and the depreciation of the right of use assets was EUR 899 (Note 16). The repayments of principal of lease liabilities in 2019 were EUR 1 003 thousand.

The minimum unilaterally non-cancellable lease payable in the next period as of 31.12.2018 are disclosed in the table below.

(in thousands of euros)	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as of **31.12.2018**	**987**	**3 525**	**4 512**

NOTE 20 Subordinated debts

According to the Groups operations, only subordinated debts are recognised as loans received in the statement of cash flows, as other loans are received as part of ordinary business operations. The current note contains changes in subordinated debts, including monetary or non-monetary movements and effects of foreign exchange rates, if they have occurred during the reporting period or the reference period.

The Group has received subordinated debts in order to increase long-term capital. In the case of default of the Group, the subordinated debts are repayable after all other debts have been paid, but before debts to shareholders are paid. The balances of subordinated debt as at the end of each reporting period is disclosed in the table below.

Subordinated debts

(in thousands of euros)	Year of issue	Amount	Interest rate	Maturity date
	2015	15 000	6.5%	October 29, 2025
	2018	20 000	6.0%	November 28, 2028
	2019	20 000	6.0%	November 28, 2028
	2019	20 000	8.0%	-
Subordinated debt as at 31.12.2017		30 900		
Subordinated debt as at 31.12.2018		50 900		
Subordinated debt as at 31.12.2019		75 000		

In 2019 subordinated debts in the amount of EUR 15 900 thousand were redeemed. Group received the subordinated debts in the amount of EUR 40 000 thousand during the year 2019.

Interest expenses on subordinated bonds for each reporting period and accrued interest liabilities as at the end of each reporting period is disclosed in the table below. Interest liabilities are accounted in the statement of financial position using the effective interest rate.

Interest liability from subordinated debt

(in thousands of euros)	
Accrued interest on subordinated debts as at 31.12.2017 (Note 18)	**210**
Interest calculated for 2018 (Note 7)	2 231
Paid out during 2018	-2 127
Accrued interest on subordinated debts as at 31.12.2018 (Note 18)	**314**
Interest calculated for 2019 (Note 7)	4 182
Paid out during 2019	-4 052
Accrued interest on subordinated debts as at 31.12.2019 (Note 18)	**444**

NOTE 21 Shareholders' equity in the public limited company

Transactions with share capital and share premium

	Time	Share price	Number of shares	Share premium	Total
Share capital as at 31.12.2017			**25 767**	**46 304**	
Paid in share capital	July 2018	2.4	249	349	598
Share capital as at 31.12.2018			**26 016**	**46 653**	
Paid in share capital	July 2019	3.0	238	475	713
Paid in share capital	Sept 2019	11.5	2 200	23 008	25 208
Share capital as at 31.12.2019			**28 454**	**70 136**	

Share capital is paid in in full through cash contributions. The nominal value of the shares is 1 euro and as at 31.12.2019 the number of shares amounted to 28 454 079 (31.12.2018: 26 016 485). Each share gives one vote to the shareholder at the general meeting.

According to AS LHV Group's articles of association, the minimum share capital is EUR 15 million and the maximum share capital is EUR 60 million (31.12.2018: EUR 15 and EUR 60 million).

Rain Lõhmus who owns 23,7% of the voting rights and Andres Viisemann who owns 9.8% of the voting rights in AS LHV Group have significant influence over the company (31.12.2018: 24.9% and 9.8%).

In the reporting year, the Group issued 2 200 thousand new shares during the public share issue. The Group received EUR 25 300 thousand in total as share capital and share premium. Direct expenses related to the share issue in the amount of EUR 92 thousand we deducted from the share premium. As a result EUR 2 200 thousand was recorded as share capital and EUR 23 008 thousand was recorded as share premium.

In the reporting year, the Group paid dividends to shareholders of 0.21 (2018: 0.16) EUR per share, amounting to a total of EUR 5 463 (2018: 4 123) thousand.

As at 31.12.2019, the retained earnings of the Group totalled EUR 94 228 thousand (31.12.2018: EUR 75 430 thousand). As of 31.12.2019 it is possible to pay out dividends in amount EUR 75 605 (2018: 60 426) thousand. Part of the potential dividends (1/3 from dividends paid out in 2018-2019) would be taxed at a preferential rate of 14/86 and the remaining part 20/80.

The related income tax charge would be EUR 18 623 (2018: 15 004 with 20/80 tax rate) thousand.

Statutory reserve capital in equity is as follows:

(in thousands of euros)	
Statutory reserve as at 31.12.2017	**2 471**
Transferred from 2017 net profit	980
Statutory reserve as at 31.12.2018	**3 451**
Transferred from 2018 net profit	1 262
Statutory reserve as at 31.12.2019	**4 713**

Other reserves in the consolidated statement of Changes in Equity consist of:

(in thousands of euros)	31.12.2019	31.12.2018
Revaluation reserve of equity instruments at fair value through other comprehensive income (Note 11)	212	78
Reserve of share options granted to staff	3 068	2 012
Total	**3 280**	**2 090**

The Group is granting share options to the members of the Management Board and employees considered as such and department managers and employees considered as such of group companies that are part of AS LHV Group.

Initialled for identification purposes only
Initials I.S. Date 21.02.2020

	Number of shares	Strike price per share (EUR)	Weighted average share price of the exercise period	Expiry year	Number of people to whom the share options were granted
Outstanding amount of share options at 31.12.2013	**0**				
Granted amount during the period	411 336	2.0		2017	35
Outstanding amount of share options at 31.12.2014	**411 336**				
Granted amount during the period	278 594	2.4		2018	48
Outstanding amount of share options at 31.12.2015	**689 930**				
Granted amount during the period	270 330	3.0		2019	48
Cancelled amount during the period	-62 183				
Outstanding amount of share options at 31.12.2016	**898 077**				
Granted amount during the period	364 990	4.65		2020	69
Exercised amount during the period	-411 336		10.23		
Outstanding amount of share options at 31.12.2017	**851 731**				
Granted amount during the period	299 781	5.33		2021	72
Exercised amount during the period	-249 139		10.93		
Outstanding amount of share options at 31.12.2018	**902 373**				
Granted amount during the period	510 943	4.9		2022	89
Exercised amount during the period	-237 594		11.39		
Outstanding amount of share options at 31.12.2019	**1 175 722**				

The Group may issue share options for the results of 2019. The vesting period for all share options in the option program is 3 years. The right to subscribe will occur on the first day of the exercising period. The option strike price is calculated using Black-Scholes model based on LHV Group share price in Q4 2019 and volatility, risk free rate Latvian and Lithuanian government bonds used as proxy and dividendas yield as inputs. In 2019, share options issued in 2016 were fully exercised.

The members of the Management Board and employees do not have the possibility to take the specified amount in cash in lieu of the share options. Share options cannot be exchanged, sold, pledged or encumbered. Share options can be inherited. The contract for share options will expire upon premature termination of the employment contract on the employee's initiative, for which exceptions can be made by the Supervisory Board of AS LHV Group or the Remuneration Committee based on the decision of the Supervisory Board, and upon extraordinary termination of the employment contract by the employer due to reasons resulting from the employee. According to the Credit Institutions Act the Supervisory Board of AS LHV Group can reduce the number of share options issued or cancel the share options if the overall financial results of the Company have significantly deteriorated compared to the previous period, the member of the Management Board or employee no longer meets the performance criteria, the Company no longer meets the prudential regulations or the Company's business risks are not adequately covered by Company's own funds or the performance fee has been determined based on information, which proved to be substantially misstated or incorrect.

Total expenses arising from share-based payment transactions amounted to EUR 1 783 (2018: 1 208) thousand.

NOTE 22 Assets under management

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

(in thousands of euros)	31.12.2019	31.12.2018
Cash balance of customers	9 967	9 773
Securities of customers	1 385 746	1 383 157
incl. shareholders of the parent company and related entities (Note 24)	195 914	156 961
Total	**1 395 713**	**1 392 930**

Asset management fees for the management of these assets have been in the range of 0.015 – 0.025 % p.a. (for respective income, see Note 8).

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by the Bank, have been recognised as off-balance sheet assets. Due to the nature of the system, the Bank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by the Bank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. The Bank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the Group's financial statement. The Bank has provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), with the primary collateral being the securities used as collateral for leveraged loans. The customer has similar guarantee to the Bank and therefore, the Bank has in substance transferred the guarantee to end customer. To avoid potential losses, the Bank has a daily practice to monitor the potential decrease of collateral and deficiency of customer accounts. In its current practice, no such losses in respect of which the guarantee provided by the Bank would apply have incurred and the Bank has not paid any compensation relating to the guarantee.

NOTE 23 Contingent assets and liabilities

Non-cancellable agreements	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2019	11 078	14 139	10	359 230	**384 457**
Liability in contractual amount 31.12.2018	11 927	9 314	55	188 841	**210 137**

With the initial application of IFRS 9, financial guarantees and unused loan commitments are subject to ECL, see also note 3.2 for more information.

Tax authorities have the right to review the company's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Group during 2018-2019. The Group's management estimates that in 2020 there are no such circumstances which may lead the tax authorities to impose significant additional taxes on the Group.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the insured event (i.e. the failure to perform the contractual obligation by another party) occurs. The key risks the Group faces are significant fluctuations in the frequency and severity of payments incurred on such contracts relative to expectations. The Group uses historical data and statistical techniques to predict levels of such payments. Claims must be made before the contract matures and most claims are settled within short term. This allows the Group to achieve a high degree of certainty about the estimated payments and therefore future cash flows. The Group manages such risks by constantly monitoring the level of payments for such products and has the ability to adjust its fees in the future to reflect any change in claim payments experience. The Group has a claim payment requests handling process, which includes the right to review the claim and reject fraudulent or non-compliant requests. The exposure and concentration of performance guarantees expressed at the amounts guaranteed is as follows:

According to sectors	31.12.2019	31.12.2018
Construction	6 429	6 594
Water supplies	1 001	2 600
Manufacturing	1 045	623
Professional, scientific and technical activities	1 307	1 157
Other areas at activities	1 297	953
Total	**11 078**	**11 927**

According to internal ratings	31.12.2019	31.12.2018
5 low credit risk	300	257
6 low credit risk	4 206	1 799
7 medium credit risk	4 054	6 055
8 medium credit risk	779	1 622
9 heightened credit risk	603	625
10 high credit risk	268	187
11 high credit risk	0	0
12 non-satisfactory rating	0	21
13 non-satisfactory rating	9	405
Non-rated	859	956
Total	**11 078**	**11 927**

Performance guarantees are over-collateralised as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2019 nor in previous period.

NOTE 24 Transactions with related parties

In preparing the financial statements of the Group, the following entities have been considered related parties:

- owners that have significant impact on the Group and the entities related to them;
- members of the management board and legal entities controlled by them (together referred to as management);
- members of the supervisory board;
- close relatives of the persons mentioned above and the entities related to them.

Transactions	Note	2019	2018
Interest income	**7**	**65**	**67**
incl. management		33	29
incl. shareholders, their related entities and close relatives that have significant influence		32	38
Fee and commission income	**8**	**22**	**11**
incl. management		5	2
incl. shareholders, their related entities and close relatives that have significant influence		17	9
Interest expenses from deposits	**7**	**8**	**42**
incl. management		1	2
incl. shareholders, their related entities and close relatives that have significant influence		7	40
Interest expenses from subordinated debt	**7**	**373**	**357**
incl. management		8	7
incl. shareholders, their related entities and close relatives that have significant influence		365	350

LHV

pwc Initialled for identification purposes only
Initials I.S. Date 21.02.2020

Balances	Note	31.12.2019	31.12.2018
Loans and receivables as at the year-end		**3 290**	**3 328**
incl. management	14	2 399	2 079
incl. shareholders, their related entities and close relatives that have significant influence	14	892	1 250
Deposits as at the year-end		**16 063**	**33 509**
incl. management	17	283	222
incl. shareholders, their related entities and close relatives that have significant influence	17	15 780	33 287
Subordinated debt as at the year-end		**5 054**	**5 904**
incl. management	20	118	135
incl. shareholders, their related entities and close relatives that have significant influence	20	4 936	5 769

The table provides an overview of the material balances and transactions involving related parties. All other transactions involving the close relatives and the entities related to members of the management board and supervisory board and the minority shareholders of the parent company AS LHV Group have occurred in the course and on the terms of ordinary business. There are no doubtful debts or provisions recorded for related parties.

Loans granted to related parties are issued at market conditions.

As at 31.12.2019 and 31.12.2018, the management did not have term deposits and the interest rate on demand deposits corresponds to the terms applicable to customers.

The subordinated debts received in November 2018 have the interest rate of 6.0%. The subordinated debts received in October 2015 have the interest rate of 6.5%. The subordinated debts received in June 2019 have the interest rate of 8.0%.

The subordinated debts received in June 2014 with interest rate 7.25% where redeemed in 2019, refer to Note 20.

In 2019, salaries and other compensations paid to the management of the parent AS LHV Group and its subsidiaries totalled EUR 1 453 thousand (2018: EUR 1 471 thousand), including all taxes. As at 31.12.2019, remuneration for December and accrued holiday pay in the amount of EUR 73 thousand (31.12.2018: EUR 91 thousand) is reported as a payable to management (Note 18). The Group did not have any long-term payables or commitments to the members of the management board and the supervisory board as at 31.12.2019 and 31.12.2018 (pension liabilities, termination benefits, etc.). In 2019, the remuneration paid to the members of the Group's supervisory board totalled EUR 117 thousand (2018: EUR 37 thousand).

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

Management is involved with share option program. In 2019, the share options were granted to the members of the management board in the amount of EUR 675 thousand (2018: EUR 497 thousand).

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

NOTE 25 Basic earnings and diluted earnings per share

In order to calculate basic earnings per share, net profit attributable to owners of the parent has been divided by the weighted average number of shares issued.

	2019	2018
Profit (incl. discontinued operations) attributable to owners of the parent (in thousands of euros)	24 797	25 237
Profit attributable to owners of the parent from continuing operations (in thousands of euros)	24 797	21 913
Weighted average number of shares (in thousands of units)	27 235	25 892
Basic earnings per share (EUR)	0.91	0.97
Basic earnings per share from continuing operations (EUR)	0.91	0.85
Basic earnings per share from discontinued operations (EUR)	-	0.12
Weighted average number of shares used for calculating the diluted earnings per shares (in thousands of units)	27 828	26 373
Diluted earnings per share (EUR)	0.89	0.96
Diluted earnings per share (EUR) from continuing operations	0.89	0.83
Diluted earnings per share (EUR) from discontinued operations	-	0.13

Weighted average number of shares used as the denominator (in thousands of shares)	2019	2018
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	27 235	25 892
Adjustments for calculation of diluted earnings per share:		
Share options	593	481
Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share	27 828	26 373

NOTE 26 Discontinued operations

In 2018 LHV and Inbank reached an agreement, according to which Inbank paid EUR 2.9 million for the 50%+1 share of UAB Mokilizingas.

The table below summarises the financial results of UAB Mokilizingas for the first 4 months of 2018 until disposal of the subsidiary.

	2019	2018
Net interest income	-	1 619
Net fee and commission income	-	956
Personnel expenses	-	-535
Operating expenses	-	-1 131
Impairment losses on loans	-	-390
Income tax expenses	-	-144
Subtotal	-	375
Other financial income (gain on disposal)	-	2 949
Profit from discontinued operations	**-**	**3 324**

Summarised statement of Financial Position	30.04.2018
Loans and advances to customers and other current assets	67 477
Non-current assets	222
Current liabilities	6 897
Non-current liabilities	51 700
Total net assets	**9 102**

pwc Initialled for identification purposes only Initials I.S. Date 21.02.2020

LHV

NOTE 27 Income tax expense

The Bank is calculating 14% advance income tax. Advance corporate income tax for the year 2019 was EUR 2 517 thousand (2018: 1 676 thousand).

(in thousand of euros)	2019	2018
Advance corporate income tax	2 517	1 676
Income tax paid on dividends	1 732	1 938
Total income tax expense	**4 249**	**3 614**

NOTE 28 Separate primary financial statements of parent company

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

Statement of profit or loss and other comprehensive income of the parent

(in thousands of euros)	2019	2018
Interest income	3 801	1 530
Interest expense	-4 183	-2 231
Net interest expense	**-382**	**-701**
Dividends received	6 630	6 578
Net gains from investments to associates	0	6 400
Net gains/losses from financial assets	**6 630**	**12 978**
Operating expenses	-746	-666
Profit for the year	**5 502**	**11 611**
Total profit and other comprehensive income for the year	**5 502**	**11 611**

Statement of financial position of the parent

(in thousands of euros)	31.12.2019	31.12.2018
Assets		
Due from banks and investment companies	7 075	21 565
Loans granted	72 515	32 288
Other receivables and assets	144	75
Investments in subsidiaries	99 993	73 811
Total assets	**179 677**	**127 739**
Liabilities		
Accrued expenses and other liabilities	103	136
Subordinated debt	75 444	51 214
Total liabilities	**75 547**	**51 350**
Equity		
Share capital	28 454	26 016
Share premium	70 136	46 653
Statutory reserve capital	4 713	3 451
Other reserves	3 068	2 012
Accumulated deficit	-2 241	-1 744
Total shareholders' equity	**104 130**	**76 388**
Total liabilities and equity	**179 677**	**127 739**

Statement of cash flows of the parent

(in thousands of euros)	2019	2018
Cash flows from operating activities		
Interest received	3 524	1 530
Interest paid	-4 052	-2 231
Administrative and other operating expenses paid	-738	-583
Cash flows from operating activities before change in operating assets and liabilities	**-1 266**	**-1 284**
Adjustments		
Investments in subsidiaries from share options	-1 683	-1 156
Net increase/(decrease) in operating assets and liabilities:		
Net increase/(decrease) of other receivables	-19	-74
Net increase/(decrease) of other liabilities	1 648	1 308
Discontinued operations	0	2 454
Net cash from/(used in) operating activities	**-1 320**	**1 248**
Cash flows from investing activities		
Loans granted	-48 500	-10 000
Loan repaymens	8 550	0
Capital repayments from subsidiaries and associates	1 500	1 200
Capital contributions to subsidiaries and associates	-26 000	-10 000
Proceeds from disposal of subsidiary, net of cash received	0	5 046
Net cash from/(used in) investing activities	**-64 450**	**-13 754**
Cash flows from financing activities		
Subordinated loans received	40 000	20 000
Subordinated loans repaid	-15 900	0
Paid in to share capital (incl. share premium)	26 013	598
Dividends received	6 630	6 578
Dividends paid	-5 463	-4 123
Net cash from financing activities	**51 280**	**23 053**
Increase/(decrease) in cash and cash equivalents	**14 490**	**10 547**
Cash and cash equivalents at the beginning of the financial year	21 565	11 018
Cash and cash equivalents at the end of the financial year	**7 075**	**21 565**

Statement of changes in shareholders' equity

(in thousands of euros)	Share capital	Share premium	Statutory reserve capital	Other reserves	Accumulated loss/retained earnings	Total
Balance as at 01.01.2018	**25 767**	**46 304**	**2 471**	**1 413**	**-8 860**	**67 095**
Paid in share capital	249	349	0	0	0	**598**
Dividends paid	0	0	0	0	-4 123	**-4 123**
Transfer to statutory reserve capital	0	0	980	0	-980	**0**
Share options	0	0	0	599	496	**1 095**
Total other comprehensive income for 2018	0	0	0	0	11 611	**11 611**
Balance as at 31.12.2018	**26 016**	**46 653**	**3 451**	**2 012**	**-1 856**	**76 276**
Carrying amount of holdings under control and significant influence	0	0	0	0	-72 859	-72 859
Value of holdings under control and significant influence under equity method	0	0	0	78	150 145	150 223
Adjusted unconsolidated equity as at 31.12.2018	**26 016**	**46 653**	**3 451**	**2 090**	**75 430**	**153 640**
Balance as at 01.01.2019	**26 016**	**46 653**	**3 451**	**2 012**	**-1 856**	**76 276**
Paid in share capital	2 438	23 483	0	0	0	**25 921**
Dividends paid	0	0	0	0	-5 463	**-5 463**
Transfer to statutory reserve capital	0	0	1 262	0	-1 262	**0**
Share options	0	0	0	1 134	726	**1 860**
Total other comprehensive income for 2018	0	0	0	0	5 502	**5 502**
Balance as at 31.12.2019	**28 454**	**70 136**	**4 713**	**3 146**	**-2 353**	**104 096**
Carrying amount of holdings under control and significant influence	0	0	0	0	-99 110	**-99 110**
Value of holdings under control and significant influence under equity method	0	0	0	134	195 691	**195 825**
Adjusted unconsolidated equity as at 31.12.2019	**28 454**	**70 136**	**4 713**	**3 280**	**94 228**	**200 811**

Adjusted unconsolidated equity is the maximum amount that can be distributed to shareholders' according to Estonian legislation.

Signatures of the management board to the consolidated annual report

The management board has prepared the management report and the consolidated financial statements of AS LHV Group for the financial year ended 31 December 2019.

The management board confirms that the management report on pages 4 to 49 provides a true and fair view of the business operations, financial results and financial condition of the parent company and the entities included in consolidation as a whole.

The management board confirms that according to their best knowledge the consolidated financial report on pages 50 to 144 presents a fair view of the assets, liabilities, financial position and profit or loss of the issuer and the entities involved in the consolidation as a whole according to the International Financial Reporting Standards as they are adopted by the European Union and contains a description of the main risks and doubts.

20.02.2019

Madis Toomsalu

Independent auditor's report

To the Shareholders of AS LHV Group

(Translation of the Estonian original)*

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS LHV Group ("the Company") and its subsidiaries (together – "the Group") as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Our opinion is consistent with our additional report to the Audit Committee dated 21 February 2020.

What we have audited

The Group's consolidated financial statements comprise:
- the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2019;
- the consolidated statement of financial position as at 31 December 2019;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

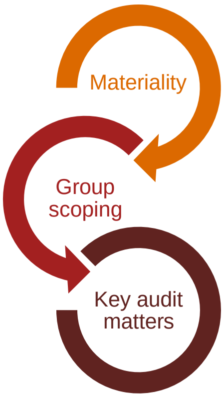
Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59[1] of the Auditors Activities Act of the Republic of Estonia. The non-audit services that we have provided to the Group in 2019 are disclosed in the management report.

Our audit approach

Overview



Overall group audit materiality is EUR 1,600 thousand, which represents approximately 5% of profit before income tax.

A full scope audit was performed by PwC Estonia for all Group entities covering substantially all of the Group's consolidated assets, liabilities, revenues and expenses.

- Impairment of loans and advances to customers

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall Group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall Group audit materiality	EUR 1,600 thousand
How we determined it	Approximately 5% of profit before income tax
Rationale for the materiality benchmark applied	We have applied this benchmark, as profit before tax is the key measure used both internally by management and, we believe, externally by shareholders in evaluating the performance of the Group.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the key audit matter
Impairment of loans and advances to customers (refer to Note 2 "Summary of significant accounting policies", Note 3.2 "Credit risk" and Note 13 "Loans and advances to customers" for further details) As at 31 December 2019 loans and advances to customers amounted to EUR 1,687 million and related impairment loss for 2019 amounted to EUR 3.2 million. We focused on this area because management makes complex and subjective judgments over both timing of recognition of impairment and the estimation of the size of any such impairment, using complex models with subjective inputs. IFRS 9 introduced a 3-stage Expected Credit Loss (ECL) model. ECL calculations are forward looking and probability-weighted, based on complex modelling and subjective inputs determined by the management. Key areas requiring significant management judgements and modelling in calculating ECL include: • the criteria for assessment of significant increase in credit risk for corporate and retail products (Note 3.2.3.1) for determining loan exposures in stage 1 and stage 2; • the modelling and calculation of key parameters of the ECL model, including probability of default (PD), loss given default (LGD) and exposure at default (EAD) (Note 3.2.3.3);	We assessed whether the Group's accounting policies and methodology applied for the calculation of impairment of loans and advances to customers are in compliance with IFRS 9. We assessed the design and operating effectiveness of key controls over ECL data and respective calculations. This included controls over the allocation of loans into stages, data accuracy and completeness, credit monitoring and overdue loans monitoring. We have also assessed the IT general controls over relevant systems. In addition, we tested the design and operating effectiveness of the credit file periodic review and rating assessment, and monitoring of collateral controls for corporate loans. We determined that we could rely on these controls for the purposes of our audit. We performed detailed testing over: • the completeness and accuracy of data used in the ECL calculation system; • the compliance of key inputs used in the ECL calculation system with IFRS 9 methodology; • the accuracy and compliance of 12-month and lifetime ECL calculations with IFRS 9 methodology; • the accuracy of discounting in the ECL system; • the accuracy and completeness of data used for staging of loans;

- incorporating forward-looking information into ECL model and the indicators selected for corporate and retail products; estimating those indicators for reliable future period and for three different scenarios (base, upside and downside scenario) with different probabilities (Note 3.2.3.4); and
- ensuring completeness of the customer accounts that are included in the expected credit loss calculation.

For defaulted corporate loans, an individual impairment is calculated based on the exposure and realisable value of the collateral at the balance sheet date and also requires significant management estimates.

- the internal assignment of credit ratings for corporate loan customers, which serve as inputs into the corporate loan ECL model;
- the correctness of information on collaterals and their values in the loan systems, which serve as an input into the ECL model; and
- the completeness of loans subject to stage 3 assessment and related ECL calculations.

We assessed the reasonableness of key assumptions made by management, which serve as critical inputs in the ECL model, such as weights of different scenarios, corporate portfolio point in time PD estimate, key forecasts of macroeconomic information and multipliers used for different scenarios.

We performed analytical procedures to evaluate the ECL of different products through the year.

We also analysed the results of back-testing performed by management and considered the results of this analysis in verification of the assumptions used for estimating ECL for current period.

In case of some impairment provisions, we formed a different view from that of the management, but the differences were within a reasonable range of outcomes in the context of the overall loans and advances and the uncertainties disclosed in the financial statements.

As a result of our work, we noted no material exceptions.

How we tailored our Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Group subsidiaries mostly operate in Estonia. A full scope audit was performed by us for the following Group entities covering substantially all of the Group’s consolidated statements of financial position and profit or loss:

- AS LHV Group;
- AS LHV Pank, including its branch in the UK and subsidiary AS LHV Finance; and
- AS LHV Varahaldus.

Other information

The Management Board is responsible for the other information contained in the consolidated annual report in addition to the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, the Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of AS LHV Group, as a public interest entity, for the financial year ended 31 December 2009. Our appointment has been renewed by tenders and shareholder resolutions in the intermediate years, recently on 11 April 2018, representing the total period of our uninterrupted engagement appointment for AS LHV Group, as a public interest entity, of 11 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of AS LHV Group can be extended for up to the financial year ending 31 December 2028.

AS PricewaterhouseCoopers

Ago Vilu
Certified auditor in charge, auditor's certificate no.325

Verner Uibo
Auditor's certificate no.568

21 February 2020

---

* *This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

Proposal for profit distribution

The management board of LHV Group proposes to the General Meeting of Shareholders to distribute the profit of the financial year 2019 as follows:

- pay dividends EUR 0.19 per share in the total amount of EUR 5 406 thousand; related income tax would be EUR 1 075 thousand
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 19 525 thousand to retained earnings.

Signatures of the supervisory board to the annual report

The supervisory board has reviewed the annual report which consists of the management report and the financial statements, the independent auditor's report and the profit distribution proposal, and approved it for presentation at the general meeting of shareholders.

20.02.2020

Chairman of the supervisory board:

Rain Lõhmus

Members of the supervisory board:

Raivo Hein

Heldur Meerits

Tiina Mõis

Sten Tamkivi

Tauno Tats

Andres Viisemann

Allocation of income according to EMTA classificators

Consolidated:

EMTAK	Activity	2019	2018
66121	Security and commodity contracts brokerage	5 052	5 111
64191	Credit institutions (banks) (granting loans)	77 266	56 974
64911	Finance lease	3 253	2 439
66301	Fund management	12 869	13 942
	Total income	**98 440**	**78 466**

Unconsolidated:

EMTAK	Activity	2019	2018
64201	Activities of holding companies	3 801	1 530
	Total income	**3 801**	**1 530**