

Report on the activities of the Supervisory Board and assessment of the Annual Report 2017 of AS LHV Group for submission to the annual general meeting of the shareholders

14 March 2018

The Supervisory Board of AS LHV Group (LHV), consisting of Chairman of the Supervisory Board Rain Lõhmus and members of the Supervisory Board Andres Viisemann, Tiina Mõis, Heldur Meerits, Raivo Hein, Tauno Tats and Sten Tamkivi, discussed the following issues:

1. Activities in the financial year 2017

LHV has had the strongest year on record. 2017 saw excellent results, strong growth in customer base, several new products and recognitions, and the first dividends paid. To provide relevant information, we started publishing our monthly results and financial plans.

LHV is currently managing customer assets amounting to a total of EUR 3.8 billion, with EUR 1.5 billion in deposits in the bank's balance sheet, EUR 1.1 billion in pension funds and EUR 1.2 billion in securities on customer accounts.

The year 2017 saw record-breaking results in all business areas. Year over year, deposits grew by EUR 760 million, loans by EUR 194 million and pension fund assets by EUR 129 million. We also achieved record levels of customer activity in payments, card transactions and acceptance of card transactions.

As busy as the year was, LHV also succeeded in becoming the first Estonian bank to adopt video identification in Q2 2017, along with the Smart-ID authentication solution and the chatbot in the LHV Facebook channel. In cooperation with the Tax and Customs Board, we launched an innovative salary payment solution for entrepreneurs, winning the innovation award of the Estonian Banking Association.

At the end of March, LHV Bank disclosed its plans of focusing on the provision of services to fintech companies. For this purpose, we are preparing for opening a branch office in the United Kingdom. We are planning to start offering real-time EUR and GBP payment services within the next 12 months.

We also upgraded LHV's private banking offers in 2017. New product launches included the car and renovation loan, as well as LHV home insurance, which was well received by customers. We also added purchase insurance to LHV Gold Card. We expanded our ATM network to Rakvere and Viljandi.

LHV pension funds have pursued an investment strategy that differs from the strategies of all competing pension funds. In 2017, LHV's funds significantly boosted investments in Estonia, with the related investment decisions amounting to EUR 170 million.

The efforts made by Mokilizingas in the last six months towards strengthening the team, enhancing efficiency and finding new business volumes, have borne fruit. A new management board was elected for Mokilizingas in December, clearly separating the functions and responsibilities of the supervisory board and management. In the second half of the year, Mokilizingas established a partnership with a local telecom company, acquiring on a monthly basis the credit portfolios financed by the partner to its customers.

LHV posted a net profit of EUR 22.2 million in 2017. This constitutes a EUR 2.3 million increase from last year, with a 17.6% return on equity for the shareholders of LHV. Profit was supported by good customer dynamics and credit quality. Business volumes and profits increased in all core business areas. As regards financial planning, we exceeded the consolidated profit plan by EUR 364 thousand (attributable to the better-than-expected results posted by Mokilizingas), though we still fell EUR 146 thousand euros short of the shareholder plan (attributable mainly to the lower-than-expected interest income from small financing products).

The capital requirements established for LHV were lowered in Q3. Based on the assessment of the Financial Supervision Authority, the Supervisory Board of LHV decided, by adding internal buffers, to establish the minimum total capital ratio at 15.06% (hitherto 16.19%) and the minimum Tier 1 capital ratio at 12.29% (13.29%). As a result of the dialogue between the European Central Bank and the

Financial Supervision Authority, LHV was designated a high-priority small bank, above all meaning more intensive supervision.

The net profit posted by the largest business unit - LHV Bank - amounted to EUR 15.5 million in 2017, having grown by EUR 2.3 million, year-over-year. Loans to customers increased by EUR 188 million and totalled EUR 719 million. EUR 766 million worth of new deposits were engaged during the year, with the total volume of deposits amounting to EUR 1.6 billion by the end of the year. The number of customers grew by 21 thousand, year-over-year, amounting to 165 thousand as at the end of the year.

The volume of deposits, including non-resident deposits, showed a significant growth in 2017. If these business trends continue, we can expect a higher volatility of the bank's liquidity indicators and a drop in the loan-to-deposit ratio.

At the beginning of the year, LHV Bank was recognised several times as the best with the best service in Estonia.

In 2017, LHV Asset Management posted a net profit of EUR 5.8 million. This constitutes a EUR 0.3 million increase from last year. For the first time in history, net profit was reduced by the amount of income tax paid on dividends in the amount of EUR 1.0 million.

The new Investment Funds Act, which entered into force at the beginning of 2017 lowered the capital requirements for management companies and abolished the exit fees for 2nd-pillar funds. In connection with the change in the capital requirements, LHV Asset Management reduced its share capital by EUR 6.6 million. LHV Asset Management also decided to pay dividends for 2016 in the amount of EUR 3.8 million.

Mokilizingas posted a net profit of EUR 1.9 million in 2017 - a EUR 0.1 million increase, year-over-year. The disposal of uncollectable receivables and reduction of write-downs had a positive impact on profit in Q4. The loan portfolio grew by EUR 13 million, totalling EUR 49 million. Mokilizingas' return on equity was 24.8%.

A total of eleven ordinary meetings of the Supervisory Board were held in 2017, and on one occasion, decisions were adopted electronically.

Within the framework of Supervisory Board meetings, the Supervisory Board was regularly briefed on the operating and financial results of LHV and its subsidiaries in 2017. Risk reports and internal audit reports were reviewed on a quarterly basis. Dozens of different procedures, policies and internal rules were reviewed, amended and approved during the year. Overviews were prepared of the activities and results in various areas, including the real estate market, real estate portfolio and Baltic banking.

- In Q1, the Supervisory Board approved the financial and capital plan as well as the financial calendar for 2017. The board made a decision of principle to start disclosing all monthly results and forecast summaries of LHV. The Supervisory Board also approved the proposals for specification of the dividend policy and amendment of the Articles of Association. At the beginning of the year, the Supervisory Board approved the Annual Report 2016, the report of the Supervisory Board and the profit allocation proposal, and proposed to pay dividends in the net amount of 15 cents per share. The ICAAP macro scenario for 2017 and the ICAAP report as a whole was reviewed. LHV's remuneration policy and the strategic principles for remuneration were carefully reviewed and the required documents adopted. The principles of remunerating members of management and persons equivalent to them were approved, along with the retention period for managers and persons equivalent to them. The option pricing and the issue of share options for the results posted in 2016 were approved, along with the initial realisation of options and the options of resigned employees. New members were appointed to the audit committee and the rules of procedure of the audit committee reviewed. The business continuity plan for liquidity was tested.
- In Q2, consent was given to the decrease of the share capital of AS LHV Varahaldus and increase of the share capital of AS LHV Bank, with LHV's share capital increased in connection with the realisation of the option programme. The financial recovery plan was introduced to the Supervisory Board. The authorisations of the members of the remuneration committee were extended.
- In Q3, the SREP report was reviewed, the capital targets changed, amendments to the money laundering and terrorist financing prevention policy reviewed. In August, a bulk of the meeting was spent on discussions on LHV's strategy.

- In Q4, the decision to disclose LHV's five(5)-year financial plan was taken, and the financial plan for 2018 approved. The requirements for the suitability of members of management bodies was reviewed, and the options for adopting IRB discussed. At the end of the year, the activity plans, financial plans and five-year financial forecasts of LHV, UAB Mokilizingas and AS LHV Varahaldus were examined.

Overall, the Supervisory Board is quite pleased with the management and economic activities in 2017.

2. Annual Report 2017

The Supervisory Board has examined the Annual Report 2017 prepared by the Management Board, and the auditor's report. In the opinion of the Supervisory Board, the Annual Report has been prepared in accordance with the generally accepted accounting principles, international standards and other acts regulating accounting.

The Supervisory Board is pleased with the work of the auditor in 2017.

3. Calling of the annual general meeting and submission of proposals regarding items on the agenda of the general meeting

The Supervisory Board proposes to call the annual general meeting on 11 April 2018, with the following agenda and with the Supervisory Board proposing to vote for all draft resolutions specified under the agenda items:

1. Approval of the Annual Report 2017

To approve the Annual Report 2017 of the Group, as presented to the general meeting.

2. Profit allocation for 2017

The profit attributable to the Group as the parent company of the consolidation group in the financial year 2017 amounts to EUR 14,500 thousand. To transfer EUR 980 thousand to the legal reserve. To approve the profit allocation proposal made by the Management Board and pay dividends in the net amount of 16 cents per share. The list of shareholders entitled to receive dividends will be established as at 26 April 2018 COB. Consequently, the day of change of the rights related to the shares (ex-dividend date) is set to 25 April 2018. From this day onwards, the person acquiring the shares will not have the right to receive dividends for the financial year 2017. Dividends will be disbursed to the shareholders on 27 April 2018.

3. Overview of the economic results for the first two months of 2018

An overview provided by the Management Board to the shareholders on the economic results for the first two months of 2018.

4. Overview of the business environment

An overview provided by the Management Board on the business environment and the Group's five-year financial forecast.

5. Appointment of the auditor for the financial year 2018/2019

To appoint AS PricewaterhouseCoopers (registry code: 10142876) as the auditor for the financial year 2018/2019, and to establish the procedure for remuneration of the auditor in accordance with the contract to be entered into with the auditor.