

Report on the activities of the Supervisory Board and assessment of the Annual Report 2018 of AS LHV Group for submission to the annual general meeting of the shareholders

13.02.2019

The Supervisory Board of AS LHV Group, 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 2018

LHV has had a strong and industrious year. A year characterised by good results, strong growth in customer base, various new products and recognitions. At the beginning of July, LHV was declared the best Estonian bank by the international Euromoney magazine. This was a follow-up to the title of the best private banking service provider in Estonia, awarded to LHV by Euromoney at the beginning of the year. Aimed at providing relevant information, we also started the publication of a long-term five-year forecast of LHV in addition to monthly results and financial plans.

LHV posted record-breaking results in all business areas in 2018. LHV Bank's customer numbers grew by 28 thousand, and the volume of loans by EUR 199 million, to EUR 919 million over the year. Even though the total volume of deposits of the bank shrank by EUR 103 million in the year, the volume of standard customer deposits grew by EUR 310 million, if we do not account for the planned drop in the volume of deposits of payment institutions. Pension funds grew by EUR 113 million, amounting to EUR 1,204 million as at the end of the year. Also, new record levels were achieved in customer activity in payments, card transactions and the conclusion of new investment agreements.

LHV posted a net profit of EUR 27.2 million in 2018. This constitutes a EUR 5.0 million increase from last year, generating a 20.9% return on equity before taxes and an 18.4% return on equity on net profit basis for the shareholders of LHV. We exceeded our financial forecasts by EUR 1.1 million. Profit was supported by high customer activity and revenue from capital market transaction consulting. Business volumes and profits grew in all core business areas.

The main keyword in corporate banking was one-third growth in corporate loans. More than before, corporate banking results were affected by impairment associated with a single customer. Nonetheless, this is no characterisation of the surrounding business environment or our loan portfolio, which continues to stand strong. To enhance the corporate banking offer, we started providing trade-financing products during the year. Above all, mention must be made of factoring. Our pursuit of growth in business volumes requires a credit rating, which was assigned to LHV Bank on level Baa1 by Moody's at the end of the year. A credit rating will ensure the acceptability of the guarantees provided by LHV Bank to beneficiaries beyond Estonian borders. We also concluded a EUR 20 million agreement with the Nordic Investment Bank this year, aiming to improve the credit capacity of small and medium-sized enterprises.

In retail banking, we focused on issuing home loans, enhancement of investment services and development of customer-orientated services. As a major innovation, we implemented the e-identification system, which allows customers to open a bank account without leaving the comfort of their home. We also expanded the ATM network, which is now composed of 21 LHV ATMs all over Estonia. We will continue installing new ATMs in 2019. In our home loan offers, we focused on big-city customers. The home loan portfolio grew by EUR 61 million, amounting to EUR 139 million as at the end of the year. We offer home loans at a price, which serves to secure the return on equity promised to the shareholders.

In the business area of financial institutions, we focused on searching for new customers and expanding the product portfolio. There is great interest in flexible banking services among financial institutions, with new customers constantly joining up. Our business in the United Kingdom is profitable, with revenues generated from payments, currency exchange, card payment mediation, credit services and maintenance fees.

The total volume of investment funds managed by LHV Varahaldus exceeded EUR 1.2 billion in 2018. Most of the fund volume is composed of actively managed pension funds, where LHV's investment strategy clearly differs from that of the competing pension funds. LHV's previous decision to direct pension investments in alternative asset categories and the local market was caused by the elongated rise in international securities markets, which LHV Varahaldus deemed too expensive to invest in. Acting as such helped LHV to maintain the assets of the actively managed funds in 2018, with the corresponding rate of return falling between -0.1% and 1.1%. These rates of return were among the highest amongst actively managed funds on the market.

The amendment of the Investment Funds Act in December will have a considerable effect on the fee structure of pension funds. Fixed fees will be significantly lowered, while providing the option of earning a success fee. At the same time, investment restrictions will be notably eased, allowing the funds to implement a wider range of investment strategies. A majority of the amendments will enter into force in September 2019.

In May, we sold the Lithuanian consumer credit company Mokilizingas, with the value of shares held by LHV in the transaction amounting to EUR 7.5 million and the profit earned from the transaction being nearly EUR 3 million.

At the year-end, we organised the issue of LHV Group's subordinated bonds, where, due to great interest, we raised the issue size to EUR 20 million. The subscription volume was the highest ever among our capital engagements and altogether 1,700 investors subscribed to LHV's subordinated bonds in a total amount exceeding EUR 51 million. Bonds formed a part of our EUR 45 million bond programme, aimed at securing LHV's growth targets.

A total of eleven ordinary meetings of the Supervisory Board were held in 2018, and on two occasions, decisions were adopted electronically.

Within the framework of these meetings, the Supervisory Board was regularly briefed on the operating and financial results of LHV and its subsidiaries in 2018. Risk reports and internal audit reports were reviewed on a quarterly basis. Dozens of different procedures, policies and internal rules of LHV and its subsidiaries were reviewed, amended and approved during the year. Overviews were prepared of the activities and results in various areas, including the real estate market and portfolio.

- In Q1, the Supervisory Board approved the 2018 financial plan and the five-year financial forecast and capital plan. At the beginning of the year, the Supervisory Board approved the Annual Report 2017, the report of the Supervisory Board and the profit allocation proposal, and proposed to pay dividends in the net amount of 16 cents per share. The option pricing and the issue of share options for the results posted in 2017 were approved, along with the realisation of options and the targets of the members of the Management Board in 2018. Also, the option programme was changed in connection with the deferral period established for managers. In Q1, consent was given to the increase of the share capital of AS LHV Pank and decrease of the share capital of AS LHV Varahaldus. An overview was given of the ICAAP macro scenario for 2017, the results of ICAAP in 2018, operational risk losses and of the test of business continuity plan of liquidity.
- In Q2, the sales contract of Lithuanian consumer credit company Mokilizingas was approved and the loan agreement to be signed with the Nordic Investment Bank in a total sum of EUR 20 million; the capital objectives were changed, the 2018 financial plan updated and a recovery plan established. Also, LHV's share capital was increased in connection with the realisation of the option programme. A EUR 45 million bond programme was approved, the mandates of the members of the remuneration committee were extended and the amendments in the rules of procedure of the remuneration committee, capital management policy, credit policy and the rule of procedure of the Supervisory Board, and the company's governance policy and information security policy were established. Proposed amendments to the Credit Institution Act and the Investment Funds Act were introduced. An overview was given on the capital requirements determined by Eesti Pank and the conducted reversed stress test and the targets of the return on LHV's capital were discussed.
- In Q3, the financial calendar and the terms and conditions of the first bond issue under the programme were approved, as well as the amendments to the risk management policy and money laundering and terrorist financing prevention policy. In addition, the Basel III requirements were reviewed. The Q2 part of the internal audit 2018 work plan was supplemented and an overview was provided of the changes in the customer acceptance

principles of as LHV Pank. Most of the meeting in August was devoted to LHV's strategy discussions.

- In Q4, the SREP report was reviewed and the capital management policy and capital objectives were changed respectively. The procedure rule for assessing the suitability of members of the management body and key function holders and amendments to the credit policy were approved. An overview was made of the assumptions of LHV's five-year financial plan, the initial 2019 activity and financial plan of LHV Varahaldus and LHV's 2019 financial plan and five-year financial forecast. A discussion on the investment strategies of pension funds was held in connection with the Investment Funds Act, amended in December.

All in all, the Supervisory Board is quite pleased with the management and economic activities in 2018.

2. Annual Report 2018

The Supervisory Board examined the Annual Report 2018 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 2018.

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 13 March 2019, 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 2018

To approve the Annual Report 2018 of the Group, as presented to the general meeting.

2) Profit allocation for 2018

The profit attributable to the Group as the parent company of the consolidation group in the financial year 2018 amounts to EUR 25,237 thousand. To transfer EUR 1,262 thousand to the legal reserve. To approve the profit allocation proposal made by the Management Board and pay dividends in the net amount of 21 eurocents per share. The list of shareholders entitled to receive dividends will be fixed as at 27 April 2019 COB. Consequently, the day of change of the rights related to the shares (ex-dividend date) is set to 26 March 2019. From this day onwards, the person acquiring the shares will not have the right to receive dividends for the financial year 2018. Dividends will be disbursed to the shareholders on 28 March 2019.

3) Overview of the economic results for the first two months of 2019

An overview provided by the Management Board to the shareholders on the economic results for the first two months of 2019.

4) Overview of the business environment and the five-year financial forecast

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 years 2020-2022

To appoint KPMG Baltics OÜ (registry code 10096082) as the auditor for the financial years 2020-2022, to establish the procedure for remuneration of the auditor in accordance with the contract to be entered into with the auditor and to authorize the Management Board to conclude the relevant contract.

6) Remuneration of members of the Supervisory Board

To establish the remuneration of the members of the Supervisory Board in the amount of 1,500 euros per each meeting of the Supervisory Board, where the member participates.