AS LHV Pank
Consolidated Annual Report 2021

(Translation of the Estonian original)

Consolidated Annual Report 01.01.2021 – 31.12.2021

Legal name	**AS LHV Pank**
Commercial Registry no.	**10539549**
Legal address	**Tartu mnt 2, 10145 Tallinn**
Phone	**(372) 6 800 400**
Fax	**(372) 6 800 410**
E-mail	**lhv@lhv.ee**
Main activities	**Banking**
	Security brokerage
	Financial advisory
	Finance lease and other lending
Financial year	**1 January – 31 December**
Management Board	**Kadri Kiisel (Chairman)**
	Andres Kitter
	Indrek Nuume
	Jüri Heero
	Meelis Paakspuu
	Martti Singi
Supervisory Board	**Madis Toomsalu**
	Rain Lõhmus
	Andres Viisemann
	Tiina Mõis
	Raivo Hein
Auditor's legal name	**KPMG Baltics OÜ**
Auditor's Commercial Registry no.	**10096082**
Auditor's legal address	**Narva mnt. 5, 10117 Tallinn, Estonia**

Company's consolidated financial statements in pdf-format without European Single Electronic Format (ESEF) markups.
The link to original document: https://investor.lhv.ee/en/reports/

Mandatory elements of the basic taxonomy of the ESEF

Name of reporting entity or other means of identification	**AS LHV Pank**
Explanation of change in name of reporting entity or other means of identification from end of preceding reporting period	**No changes**
Domicile of entity	**Tartu mnt 2, Tallinn, 10145, Republic of Estonia**
Legal form of entity	**Public Limited Company**
Country of incorporation	**Republic of Estonia**
Address of entity's registered office	**Tartu mnt 2, Tallinn, 10145, Republic of Estonia**
Principal place of business	**Republic of Estonia**
Description of nature of entity's operations and principal activities	**Banking, finance lease and other lending, financial advisory, security brokerage**
Name of parent entity	**AS LHV Group**
Name of ultimate parent of group	**AS LHV Group**

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Management report

LHV's mission is to provide better access to financial services and capital. LHV's vision is helping people and businesses dare to think big and act big, set ambitious goals, and invest in the future. LHV's values are simple, supportive, and effective.

LHV Pank ('the Bank') is the largest domestic bank in Estonia. We focus on active and independent customers with an entrepreneurial mindset. Our services for private customers include management of daily financial affairs and home loans. LHV's competitive edge is best customer experience and offering customers the best options for growing their money. Our services for business customers include flexible and tailored financing solutions and management of daily financial affairs and our services for financial intermediaries include a single banking platform for both EUR and GBP payments. LHV Pank's products and services are simple, transparent, and relevant. We communicate with customers mainly through modern digital channels and use the resulting cost savings for the benefit of our customers by setting affordable prices for our everyday banking services.

LHV Pank has more than 10% market share in the Estonian daily banking, deposit and business loan segments and is currently the third largest in the daily banking and deposit segments. Estonia is our home market where we wish to be as strong as possible. Our long-term goal is to become the largest and most profitable bank in Estonia, while focusing on efficiency, innovation and best-in-class service. By offering the best market expertise, a proactive approach and services, which are innovative and the fastest in the market, we influence entrepreneurship and people's financial behaviour. The Bank defines itself as a local bank offering the full range of services to customers that keep their funds at the bank and actively use the bank's services.

The Bank has offices in Tallinn, Tartu and London. In the first quarter of 2022, the Bank will also open an office in Pärnu. The Bank has close to 600 employees and more than 320,000 customers. The Bank's consolidated financial statements comprise the accounts of the Bank and its 65% subsidiary AS LHV Finance ('LHV Finance'), which specialises in consumer finance (together referred to as 'the Group').

1. Business activities

The Bank continued to grow rapidly in 2021. The number of customers increased by 63,000 to 321,000, i.e. by 24%. Customer activity and business volumes hit new records and the main drive for activity growth was triggered by the activity of retail customers towards investment services. The Bank's UK branch increased its number of customers to 200 financial intermediaries, who in turn have over 10 million end customers across the world.

Deposits from customers grew by 41% to EUR 5,847 million. Deposits from ordinary customers grew by 25% to EUR 3,592 million and deposits from financial intermediaries grew by 113% to EUR 2,248 million. The rise in deposits from financial intermediaries reflects the Q4 surge in the prices of virtual currencies and customers' increased interest in relevant investments. Deposits raised through deposit platforms decreased to EUR 7 million. In 2021, the Bank did not actively raise funds through deposit platforms as there was no real need for this.

The Bank's loan portfolio grew by 21% to EUR 2,677 million during the year. Corporate loans grew by 24% to EUR 1,479 million and retail loans by 18% to EUR 1,199 million. The retail loan portfolio broke down as follows: home loans 74%, leases 12% and other loans 14%.

The Bank's net profit for the year grew by 85% to EUR 64.1 million. Income grew by 44%, expenses grew by 36%. Net interest income increased mainly through growth in corporate and home loans and earlier conversion of the impairment of loans in the Danske portfolio on the modification of agreements. The rise in net fee and commission income was largely driven by growth in investment services and services provided to financial intermediaries. Loan provisions decreased by EUR 7 million over the year. Results for the year include advance income tax expense for 2021 of EUR 10.6 million payable on the expected future dividend, which has to be recognised in accordance with the amended accounting rules. The Bank's performance indicators were solid: return on equity (on net profit attributable to owners of the parent company) was 26.2%, the cost/income ratio was 38.6% and credit costs were 0.2%.

From April to the end of September in 2020, banks in Estonia applied a common policy on payment holidays. Customer requests for payment holidays surged in April, began to decrease in May and dropped to a minimum by the end of June. A major share of payment holidays expired already by the year-end of 2020 and the total amount of loans on payment holiday had dropped to EUR 30 million by the end of 2021. Although the credit ratings of some corporate customers directly affected by the crisis have been downgraded and we have had to recognise some additional loss allowances, the quality of the Bank's loan portfolio as a whole has remained extremely high and the share of overdue loans is very small. Most of the customers are servicing their loans according to the agreements and remain strong.

The Bank's total assets grew by 38% to EUR 6,809 million in 2021. Deposits growth has been the major factor behind the total assets' growth. All client groups balances increased.

2. Development activities

Numerous new products were introduced during the year. Since the beginning of the year, customers have been able to activate LHV permanent donation function in internet bank and mobile app and do a good deed with each payment. Opportunity was created for debit card holders and intended for all private individuals. Since March customers can view the PIN of a bank card in the LHV mobile app and we no longer send PIN codes to customers via post in an envelope. In April we introduced refinancing loan and started to provide LHV insurance products to customers. Since September smaller business customers can also open bank accounts in the LHV internet bank and mobile app and Kasvukonto investments can be used free of charge for home loan down payment.

Payment products and infrastructure developments in 2021 brought significant improvements to the LHV Banking Services product portfolio and further expanded the depth of the services that LHV can provide to the growing number of fintech customers. At the beginning of the year, we launched a new Anti-Money Laundering platform Salv which delivers state of art risk management and transaction monitoring capabilities. We have launched currency exchange functionality in LHV Connect API, which allows our customers to access currency exchange services fully automated way. Selection of the payment methods grew by adding the SEPA scheme direct debits, alongside SEPA direct debit we have made preparations for launching direct debits in the UK in 2022. Cards received several important updates first by enabling charity micropayments and rolling out functionality to receive and view PIN-code through internet bank and mobile app. Several updates were done to improve the feature set for open banking acquiring, most importantly simple refunding feature for e-commerce merchants.

From the beginning of 2020, users of our investment services are not charged service fees for trades in Baltic stocks. By abolishing the fees, we made investing accessible to everyone. The Mobile Bank app offers a convenient opportunity to open an account, sign an investment services agreement and start trading with Baltic stocks free of charge. Abolishment of the fees along with the volatility of stock markets boosted the volume of customers' securities transactions, which generated more fee income than expected. In addition, the Bank lowered the fees for holding foreign securities and trading in foreign stocks by 50% from the beginning of 2021. In connection with the amendment of the Funded Pensions Act, in January 2021, the Bank launched a pension investment account and a related marketing campaign. We have become the market leader in investment services: customer assets managed by us extend to EUR 3.7 billion and increased by 92% in 2021. As a bank with a technological and innovative mindset we introduced crypto trading to our customer in mobile app in November. Customers can buy and sell 10 most popular crypto assets, including Bitcoin and Ethereum cost-effectively and in fractions of units. In the beginning of 2022 income tax returns for private investors are made easy by declaring gains for each instrument not by each transaction to the tax office separately through summarized tax report.

We integrated new Estonian technology Salv to our systems for improving screening and monitoring of payments.

3. Organisation

The Bank is divided into six functional areas, each with its own departments. Business areas include Retail Banking, Corporate Banking and Financial Intermediation, support areas include IT, Financial Management and Support Services, and Risk Management. Human Resource Management, Marketing and Communication, Compliance and Environmental, Social and Corporate Governance (ESG) are bank-wide activities. The Bank's UK branch is part of the Financial Intermediation area.

On 20 January 2021, the Supervisory Board of LHV Finance passed a resolution to remove Kadri Kiisel as Chairman of the Management Board as from 29 January 2021 and to appoint Mari-Liis Stalde as a new Member and Chairman of the Board. On the same day the shareholders passed a resolution to remove Erki Kilu as Chairman of the Supervisory Board as from 29 January 2021 and to appoint Kadri Kiisel as a new member of the Supervisory Board.

On 29 January 2021, the Supervisory Board passed a resolution to appoint Kadri Kiisel as the new Chairman of the Supervisory Board.

In 2021, the number of the Bank's staff increased by 115 to 622, including inactive and part-time staff and the 20 employees of LHV Finance. The number of active staff converted to the full-time equivalent was 571.

The year brought several awards and accolades. Once again, LHV Pank was named the bank with the best customer service in Estonia in a survey conducted by the market research company Dive. The Bank ranked second in the Most Attractive Employers survey conducted by the job portal CVKeskus.ee and first in financial sector in the survey conducted by the job portal CV-Online Estonia. The Bank's staff satisfaction survey Q12 reflected a very high level of satisfaction. City Plaza building, where Bank's Tallinn office is established, received BREEAM (Building Research Establish Environmental Assessment Method) certificate. Both Euromoney and The Banker magazine of The Financial Times named LHV Pank the best bank in Estonia, for the fourth and third year in a row, respectively.

4. Sustainability at LHV Pank

Estonia has decided to support the EU climate strategy and has made commitments that can be achieved only with the united effort of the whole society and all sectors. The financial sector plays a central role in the adjustment of the economy – through lending and investing banks can channel cash flows into sustainable activities that support transition to a climate-neutral economy.

LHV has taken the approach to support the strategic approach towards a more sustainable and inclusive economy. In March 2020, LHV Group officially joined the United Nations (UN) Principles for Responsible Banking and prepared an action plan for delivering on the promises made.

The UN Principles for Responsible Banking provide a single framework for sustainable banking, developed through a partnership between banks worldwide and the UN Environment Programme Finance Initiative. The Principles for Responsible Banking set out the banking industry's role and responsibility in shaping a sustainable future, and in aligning the banking sector with the objectives of the UN Sustainable Development Goals and the Paris Climate Agreement. They also enable banks to embed sustainability across all its business areas, and to identity where it has the potential to make the most impact in its contributions to sustainable development. They also position financial institutions to leverage new business opportunities with the emergence of a sustainable economy.

In 2021, the Bank moved a considerable step closer to our suitability goals in regard to metrics, regulatory understanding as well as ESG governance, credit portfolio analysis and risk management processes. While in recent years, the Bank has already evaluated the environmental impacts of its products and services, updated its credit policy and started to offer sustainable financial products, 2021 took us deeper into integrating ESG into our business. We made significant progress in our ESG data gathering and analysis processes, improved sustainability governance by launching a group wide ESG steering committee and started integrating ESG into our credit decision-making process. A sustainability related questionnaire was added into our credit application in the Summer of 2021 and to date, we have completed the first phase of ESG risk management framework by building an ESG risk assessment tool for the credit area. The methodology will help us determine more sensitive sectors in our portfolio and move toward a more sector-specific approach in assessing our customers ESG efforts as well as impact and risk level. The next step will be to build a comprehensive ESG score for our credit business line.

LHV is committed to its positive social impact and responsibility. We continue to be one of the most attractive employers in Estonia and take seriously our responsibility to focus on organizational development and employee well-being even through the uncertainties and physical limitations the past few years have brought about. Where possible, the Bank supports enterprises and initiatives that contribute to the development of the Estonian society. In leading the discussions on inclusive economies and supporting various culturally and socially important initiatives, LHV continues to contribute to the pursuit of innovative ideas and projects which improve life in Estonia.

Business environment

The increase of global economic activity slowed down in the autumn. The faster spread of the virus once again forced many factories in Asia to halt their work, and many commercial ports were also temporarily closed. In developed countries with higher vaccination rates and less stringent restrictions on the economy, the demand remained strong, but due to global supply issues, further development is also endangered there. In addition, accelerated inflation, mainly driven by the rise in price of energy and raw materials, has increasingly started to hinder economic development.

Year-on-year, the European economy grew 5.3% in the first nine months. Quarter-on-quarter, growth remained at around 2% in the second and third quarter. With this, the pre-crisis size of the economy was achieved, i.e., recovery from the crisis has been rapid. Estonia's main trading partners have fared better than average, since in Finland, Sweden and Latvia, the pre-crisis size of the economy has already been exceeded by a couple per cent; even more in Lithuania. This also created good prospects for the Estonian economy, which has been at the forefront in Europe in terms of recovery.

The recovery of the labour market has also been remarkable. In the last months of the year, unemployment in the European Union fell to 6.7%; historically, a lower figure than that has only been recorded immediately before the pandemic broke out in later 2019 and early 2020. Within the year, 1.3 million people have once again found a job; compared to the low point of the crisis, the same figure is 2.1 million. Across countries, developments have been different – in most countries (incl. Estonia) unemployment is currently still a touch higher than before the pandemic, but in Greece and Italy, for example, which are countries with some of the highest unemployment rates in Europe, it has already decreased to below pre-crisis levels.

Inflation has accelerated across Europe within the year and reached 4.9% in the euro area in November. Across countries, Estonia and Lithuania have had to witness the highest increase in prices, reaching 9% at the end of the year, whereas in Malta, Portugal and Switzerland, the increase in prices has remained at a maximum of 2–3%. Inflation mainly relies on the rapidly increasing gas and electricity prices, caused partly by unfavourable weather conditions, partly by bad luck, and partly also by politics. There is no quick solution to the normalisation of the price level, which is why we must come to terms with high energy prices in the following quarters as well. In the past months, the appreciation of food products has also contributed to the rise in prices, and this will also carry over into year 2022.

In the conditions of quick inflation, the European Central Bank has also gradually started to change the monetary policy. At a session of the Governing Council of the Central Bank, held in December, it was decided to significantly decrease the asset purchases made within the pandemic emergency purchase programme (PEPP) in Q1 of year 2022, and to end these purchases by the end of March. To balance the discontinuation of PEPP, asset purchases made within the general Asset Purchase Programme (APP) will be increased somewhat from Q2, but the volume of purchases will remain lower, comparable to about half of the current volume (about 40 billion per month). From October 2022, purchases will be decreased even more (about 20 billion per month) until base interest rates are subject to increases.

Regarding increasing interest rates, the ECB has not provided a clear timeframe, and market expectations are variable in this regard. While in early December, the first interest increases were expected to happen later in 2022, in the light of messages from the last sessions of the Governing Council, these expectations have rather been postponed for a year. This is also reflected by the Euribor rate, which sunk to a record low mid-December (3-month Euribor –0.6%). Theoretically, an earlier increase in interest is still possible. According to ECB communication, interest will start to be increased after ending asset purchases which, according to current information, could also happen at the end of year 2022.

Year-on-year, the Estonian economy grew 8.5% in the first nine months. This makes Estonia one of the fastest-recovering countries in Europe in terms of the economy, already exceeding the pre-crisis size of the economy by about 5%. Among the fields of activity, IT, industry, and construction have certainly driven the growth, but quick growth is also partially the result of Government decisions, which have somewhat redistributed tax receipts between the years, and inflated the 2021 figures. The real estate and transport sectors also presented strong growth in the second half of the year. The situation has also strongly improved in the accommodation and catering sector that suffered most from the crisis, although the gross product there still remains under the pre-pandemic level.

The rapid economic growth is driven by strong domestic demand and also strong demand regarding the trading partners. The reopened economy increased the people's demand for different goods and services, while consumption was supported by the increase in bank deposits that occurred during the lockdowns. In the autumn, disbursement of the second pension pillar funds gave an additional boost, with slightly over one billion euros having been handed over to the people. Investments in the economy have been more volatile than usual, growing by more than 50% in the first half of the year; however, the growth rate decreased in the second half of the year. In both cases, the dynamics have been guided by the software investments of one company, the scale of which is unprecedentedly high in the Estonian context. The actual effect of these investments on the economy will only be revealed in the coming years. Other investments by companies in means of transport and production equipment have steadily increased throughout the year, which shows that companies are engaged in increasing the production capabilities, which have started to hinder economic development in recent years.

While the manufacturing sector has usually been driving Estonian export growth, in 2021, the IT sector also made a significant contribution here, with its export growing by about 75% across 9 months, year-on-year. All in all, the growth of export of services has been quicker and also more broad-based than the export of goods, which has mainly relied on the export of mineral fuels. At the same time, there was a very low reference base from the last year for many service types. Export growth has also been supported by the increase in export prices of about 20%.

Inflation in Estonia has mainly followed the regional trends and reacted more strongly than average, as customary. This means that in Estonia as well, the general increase in prices in the last quarters has been shaped by the increase in energy prices, but price fluctuations have been higher than the European average. While in the first half of the year, the price increase remained at around 2%, from July, inflation has crossed the 5% threshold and steadily accelerated.

According to the last survey, consumer prices increased by a whole 8.8% in November, year-on-year. Over half of the increase in prices can be attributed to energy, which is manifested in the higher electricity, gas and motor fuel prices. Food and leisure services have also increased more in price than others. Looking ahead, we can expect inflation to become increasingly more broad-based, as higher energy costs are increasingly making their way into the final prices of other products and services. In the first half of 2022, the increase in prices will remain rapid, but should start to gradually subside after that.

Different forecasts show that economic growth in 2021 could have remained at around 8–9% all in all. Looking ahead, the growth will surely slow down, as there is now a clearly stronger reference base and the internal capacity for growth is also limited due to the available workforce and existing production resources. On the background of this, both manufacturers and consumers are suffering from continuously high energy prices. According to the Bank of Estonia, economic growth could reach 2.8% in 2022, with consumer prices increasing by 6.9% at that. Wage growth will remain quicker than inflation, meaning that the actual income of people will also increase this year.

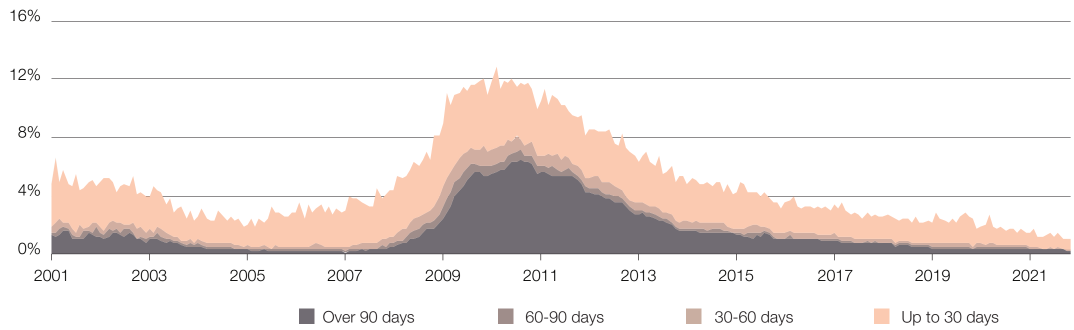
Key economic indicators of Estonia* | **Bank of Estonia forecast**

	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E	2024E
Nominal GDP (EUR billion)	20.63	21.75	23.83	25.82	27.73	26.83	30.37	33.02	35.48	37.82
GDP volume**	1.9%	3.2%	5.8%	4.1%	4.1%	-3.0%	8.0%	2.8%	3.9%	2.9%
Private consumption expenditures***	4.9%	4.5%	2.5%	4.3%	4.1%	-2.5%	7.3%	4.0%	3.6%	3.9%
Government consumption expenditures	3.1%	2.5%	1.9%	1.0%	3.0%	3.0%	4.8%	-0.9%	-1.3%	0.1%
Fixed capital formation	-3.2%	5.1%	13.9%	-0.1%	6.1%	19.9%	7.4%	-14.5%	6.9%	1.2%
Exports	-1.5%	4.8%	4.8%	3.9%	6.5%	-5.0%	15.2%	4.9%	4.8%	3.4%
Imports	-1.9%	6.5%	4.0%	5.7%	3.8%	0.9%	19.5%	-0.9%	4.8%	2.8%
CPI	-0.5%	0.1%	3.4%	3.4%	2.3%	-0.4%	4.4%	6.9%	3.0%	2.6%
Unemployment rate (% of the labour force)	6.2%	6.8%	5.8%	5.4%	4.4%	6.9%	6.2%	5.5%	5.3%	4.7%
Current account (% of GDP)	2.2%	1.9%	3.3%	1.8%	2.0%	-0.3%	-3.2%	0.0%	-0.2%	0.4%
Budget balance (% of GDP)****	0.1%	-0.3%	-0.4%	-0.5%	0.1%	-5.6%	-3.6%	-2.0%	-1.6%	-0.7%

* 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 available at the date of the forecast.

Sources: Bank of Estonia, Statistics Estonia

Overdue loans share in loan portfolio



Source: Bank of Estonia

Financial results

In 2021, net profit of the Bank increased by 85% compared to the previous year, amounting to EUR 64.1 million (2020: EUR 34.6 million). Net interest income increased by 41% and net fee and commission income increased by 70%.

Net interest income increased mainly through growth in corporate and home loans and earlier conversion of the impairment of loans in the Danske portfolio on the modification of agreements. The rise in net fee and commission income was largely driven by growth in investment services and services provided to financial intermediaries.

Credit losses decreased by 64% or EUR 7 million over the year.

The Bank's loan portfolio grew by 21% to EUR 2,677 million during the year (31.12.2020: EUR 2,209 million). Corporate loans grew by 24% to EUR 1,479 million and retail loans by 18% to EUR 1,199 million. The retail loan portfolio broke down as follows: home loans 74%, leases 12% and other loans 14%.

Deposits from customers increased by 41% to EUR 5,847 million (31.12.2020: EUR 4,141 million). Deposits from ordinary customers increased by 25% to EUR 3,592 million and deposits from financial intermediaries increased by 113% to EUR 2,248 million. The rise in deposits from financial intermediaries reflects the Q4 surge in the prices of virtual currencies and customers' increased interest in relevant investments. Deposits raised through deposit platforms decreased to EUR 7 million. In 2021, the Bank did not actively raise funds through deposit platforms as there was no real need for this.

The proportion of demand deposits increased significantly and accounted for 97% of all deposits as at the end of December (31.12.2020: 88%).

Statement of profit or loss

(EUR million)	2021	2020	change
Net interest income	97.66	69.05	41%
Net fee and commission income	31.17	18.38	70%
Net financial income	-1.54	0.88	-276%
Total net operating income	127.29	88.31	44%
Other income	0.60	0.21	189%
Operating expenses	-49.34	-36.27	36%
Income tax expense	-10.56	-6.75	56%
Credit losses	-3.95	-10.90	-64%
Net profit	**64.05**	**34.60**	**85%**
Net profit attributable to owners of the parent	61.76	32.51	90%

Key figures

(EUR million)	2021	2020	change
Return on equity (ROE) %	25.6	17.3	48%
Return on assets (ROA) %	1.1	0.9	22%
Net interest margin (NIM) %	1.62	1.87	-13%
Spread %	1.60	1.84	-13%
Cost / Income ratio %	38.6	41.0	-6%

Volumes

(EUR million)	31.12.2021	31.12.2020	change
Loan portfolio	2,677.2	2,208.8	21%
Deposits	5,846.6	4,141.4	41%
Equity	280.0	214.7	30%
Number of bank customers	321,424	258,962	24%

Liquidity and capitalization

The Bank is mainly funded by deposits. Customer deposits are complemented by covered bonds, unsecured bonds and secured funding from the European Central Bank's TLTRO facility.

The Bank runs a conservative liquidity risk profile. The main liquidity risk inherent in the Bank's business is the risk of deposit outflows in LHV Pank. The Group monitors a number of internally defined and regulatory liquidity risk metrics on a regular basis.

The liquidity coverage ratio (LCR) of the Bank stood at 141% at the end of December (31.12.2020: 147%), well exceeding the regulatory 100% requirement. The Bank's liquid assets accounted for 60% of the balance sheet total (31.12.2020: 55%). The Bank's loan-to-deposit ratio at the end of 2021 was 46% (31.12.2020: 53%).

The Bank has a relatively low loan-to-deposit ratio and a high share of liquid assets out of total balance sheet. This reflects the fact that the deposits collected from financial intermediaries are matched with a liquidity buffer (primarily composed of central bank deposits) and are not used for the lending business.

The Bank's regulatory net stable funding ratio (NSFR) equalled 164% as at the end of December 2021 (31.12.2020: 154%), illustrating the Bank's solid funding base.

The Bank's level of net own funds amounted to EUR 331.0 million as at 31.12.2021 (31.12.2020: EUR 289.5 million). The Bank's common equity was increased by EUR 5 million in 2021, as a result of the contribution from the sole shareholder.

The Bank is well capitalized as at the end of the reporting period with a total capital adequacy level of 17.51% (31.12.2020: 19.66%). The Bank's internal target for total capital adequacy was changed in January 2022 by Supervisory Board and stands now at 16.5%. The Bank 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 Bank 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.

The Bank's leverage ratio stood at 4.04% as at the end of 2021 (31.12.2020: 4.36%). The Bank is not subject to MREL requirements on an individual basis.

Capital base *(in thousands of euros)*	31.12.2021	31.12.2020
Paid-in share capital	111,500	106,500
Statutory reserves transferred from net profit	5,648	4,022
Accumulated profit/(deficit)	91,126	62,972
Intangible assets (subtracted)	-1,243	-807
Profit for accounting period (COREP)	37,249	32,514
Deductions	-1,317	-4,223
Tier 1 capital	**242,963**	**200,978**
Additional Tier 1 capital	38,000	38,000
Total Tier 1 capital	**280,963**	**238,978**
Subordinated debt	50,072	50,500
Total Tier 2 capital	**50,072**	**50,500**
Net own funds for capital adequacy calculation	**331,035**	**289,478**

Capital requirements		
Central governments and central bank under standard method	0	363
Credit institutions and investment companies under standard method	10,390	8,004
Companies under standard method	1,141,853	865,772
Retail claims under standard method	212,860	197,592
Public sector under standard method	6	3,250
Housing real estate under standard method	291,338	243,971
Overdue claims under standard method	19,331	13,668
Other assets under standard method	82,510	42,915
Total capital requirements for covering the credit risk and counterparty credit risk	**1,758,288**	**1,375,535**
Capital requirement against foreign currency risk under standard method	3,489	618
Capital requirement against interest position risk under standard method	0	0
Capital requirement against equity portfolio risks under standard method	2,079	972
Capital requirement against credit valuation adjustment risks under standard method	1,211	82
Capital requirement for operational risk under base method	125,729	95,104
Total capital requirements for adequacy calculation	**1,890,796**	**1,472,311**
Capital adequacy (%)	**17.51**	**19.66**
Tier 1 Capital Ratio (%)	**14.86**	**16.23**

Management and compensation policy

LHV Pank is a public limited company and its governing bodies are the General Meeting of shareholders, the Supervisory Board and the Management Board.

1. General Meeting

The General Meeting of shareholders is the highest governing body of LHV Pank where shareholders invoke their rights.

The primary duties of the General Meeting of shareholders are amendment of the articles of association, increase and decrease of share capital, decisions on issuance of convertible bonds, election and extension of terms of Supervisory Board members, premature removal of Supervisory Board members, approval of the annual report and profit allocation, determining the number of auditors, appointment and recall of auditors and other decisions that are within the powers of the General Meeting of shareholders pursuant to law.

The Management Board calls General Meetings of shareholders. The annual General Meeting of shareholders for approval of the annual report is held at least once per annum.

The sole shareholder of LHV Pank is LHV Group. The shareholder with a significant ownership interest in LHV Group is Rain Lõhmus and persons related to him, owning a total of 22.68% of the share capital of LHV Group.

2. Supervisory Board

The Supervisory Board is the governing body of LHV Pank that plans the activities of LHV Pank, organizes the management of LHV Pank and supervises the activities of the Management Board. The Supervisory Board determines and regularly reviews the strategy, general plan of action, risk management policies and the annual budget of LHV Pank. The Supervisory Board consists of five to seven members. Supervisory Board members have terms of up to five years. Members of the Supervisory Board elect the Chairman of the Supervisory Board from among themselves who organizes the Supervisory Board's activities.

The Supervisory Board of LHV Pank has six members. The Supervisory Board is comprised of Madis Toomsalu, Rain Lõhmus, Andres Viisemann, Tiina Mõis, Heldur Meerits and Raivo Hein.

3. Management Board

The Management Board is the governing body of LHV Pank that represents and manages LHV Pank. The Management Board has three to seven members. Management Board members have term of up to five years. The Chairman of the Management Board organizes the work of the Management Board. The company may be represented by two Management Board members jointly.

The Management Board of LHV Pank has six members from January 2021. Until January 2021 the Management Board had seven members, comprising of Erki Kilu, Andres Kitter, Indrek Nuume, Jüri Heero, Meelis Paakspuu, Kadri Kiisel and Martti Singi. Starting from January 2021 Erki Kilu was recalled from the Management Board and Kadri Kiisel elected as the new Chairman of the Management Board.

4. Committees

The Supervisory Board of LHV Pank has formed one committee on the LHV Pank level, the aim of which is to advise the Supervisory Board of LHV Pank in matters described below. The Supervisory Board of LHV Group, the sole shareholder of LHV Pank, has formed additional three committees on the LHV Group level, the aim of which is to advise the Supervisory Board of LHV Group in matters described below concerning all of the group companies.

4.1 Risk and Capital Committee

The Risk and Capital Committee, which has been formed at the level of LHV Pank, is a functional body responsible for advising the Supervisory Board and Management Board of LHV Pank in matters related to risk management principles and risk tolerance, assessing the risks taken by LHV and monitoring implementation of the risk policy at the group companies. The Risk and Capital Committee has at least three members who are elected from among the members of the Supervisory Board of LHV Pank.

4.2 Audit Committee

The Audit Committee is above all an advisory body to the Supervisory Board of LHV Group in the fields of accounting and reporting, audit, risk and capital management, internal control system and internal audit as well as legal and regulatory compliance. The Audit Committee has at least three members, who are appointed for a term of three years. The duties of the Audit Committee are to monitor and analyse the processing of financial information to the extent necessary for preparing quarterly and annual financial statements, effectiveness of risk management and internal control, the audit process of financial statements or consolidated financial statements and the independence of the auditor and independent auditor who represents it on the basis of law and compliance of its activities with provisions of the Auditors Activities Act. The Audit Committee is responsible for making proposals to the Supervisory Board of LHV Group and provide recommendations for the appointment or removal of the auditor, appointment or removal of the internal auditor, prevention or elimination of problems or ineffectiveness in the organization and compliance with legislation and good professional practice.

4.3 Nomination Committee

The purpose of the Nominating Committee is to support the Supervisory Boards of LHV Group, LHV Pank and LHV Finance in issues concerning the selection process and fit-and-proper requirements. The Nominating Committee is comprised of at least three members, who are selected from among the matching members of LHV Group and LHV Pank Supervisory Boards.

4.4 Remuneration Committee

The Remuneration Committee is a body established by the Supervisory Boards of LHV Group, LHV Pank, LHV Finance and LHV Kindlustus for the development, implementation and supervision of a remuneration strategy for the employees and members of the Management Board of the group companies. One of the tasks of the Remuneration Committee is to evaluate the impact of any remuneration-related decision on compliance with the requirements established for the management of risks, own funds and liquidity. The Remuneration Committee consists of at least three Supervisory Board members of LHV Pank.

5. Remuneration policy

The policy of compensating members of the Management Board and employees of LHV Pank is set and its implementation is evaluated by the Remuneration Committee established on the level of LHV Group. A monthly base salary is paid to members of the Management Board and employees of LHV Pank. The Supervisory Board determines the base salaries of members of the Management Board and the Management Board determines the base salaries of employees. Management board member agreements have been concluded with the Management Board members; everyone else is employed under employment contracts. LHV Pank has made no major severance payments nor significant non-cash compensations.

6. Share options

LHV Group shareholders have approved two share option programmes that were relevant in 2021. The share option programme for the management board members of the group companies and key employees that was approved in 2014 was implemented until 2019, hence the share options to that were exercised in 2021 were granted in 2018 for the results of 2017 on the basis of that option programme. In 2020 a new result-based share option programme for management board members of the group companies and equivalent staff as well as key employees was adopted to be implanted from 2020 until 2024. In 2021 the recipients and amounts of share options to be granted for the results for 2020 were based on the latter programme.

The aim of issuing share options is to create conditions where the long-term objectives and interests of the management and equivalent staff as well as key employees of the group companies would be harmonised with the long-term interests of the shareholders of LHV Group. 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 collective objectives of the group companies. 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 have been applied 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 Group 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 Group 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.

In 2021, the options issued in 2018 were fully exercised. The share options issue for the results of 2021 is presumably decided in 2022 by the Supervisory Board of LHV Group.

The granting and size of share options granted in 2021 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 2021, share options were granted to six members of the Management Board of LHV Pank and 113 in the total amount of EUR 2,747 thousand.

In the beginning of 2020, share options were granted to seven members of the Management Board of LHV Pank and ninety employees in the total amount of EUR 2,119 thousand. In the beginning of 2019, share options were granted to seven members of the Management Board of LHV Pank and 71 employees in the total amount of EUR 1,786 thousand. In the beginning of 2018, share options were granted to seven members of the Management Board of LHV Pank and 56 employees in the total amount of EUR 1,166 thousand. LHV Group has entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of the share options.

Share options issued in 2021 can be exercised between the period of 01.04.2024–30.04.2024 and shares with nominal value of 1 euro can be acquired for 9.23 euros per share. Share options issued in 2020 can be exercised between the period of 01.04.2023–30.04.2023 and shares with nominal value of 1 euro can be acquired for 5.96 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 EUR 1 can be acquired for EUR 4.90 per share.

Members of the Management Board and employees were unable to opt for the determined amount in cash instead of share options. Share options cannot be exchanged, sold, pledged or encumbered. Share options can be inherited. The share option agreement will become void upon premature termination of the employment contract at the employee's initiative, exemptions to which can be made by the Supervisory Board of LHV Group and due to termination of employment contract on an extraordinary basis by the employer for a cause related to the employee. Pursuant to the Credit Institutions Act, the Supervisory Board of LHV Group may reduce the number of share options issued or cancel share options if the overall financial results of the company have materially deteriorated compared to the previous period, an entitled member of the Management Board or employee of the group company no longer meets award criteria, the group company no longer meets the prudential ratios or the risks of the relevant company are not adequately covered with own funds or determination of the performance pay was based on information which was inaccurate or incorrect to a material extent.

7. Wages and salaries

The table below provides wages, salaries paid, and the number of employees who received salaries and wages during the year (including trainees).

Calculated gross salaries and wages *(in thousands of euros)*	Base salary	Incentive salary	Total	Number of employees
Retail banking	4,948	0	4,948	295
Private and corporate banking	1,692	0	1,692	51
Financial intermediates	1,651	0	1,651	47
Support services	5,940	0	5,940	237
Information technology	3,897	0	3,897	127
Total	**18,128**	**0**	**18,128**	**757**

Sustainability report

1. Sustainability at LHV

1.1 Sustainability mission statement

Sustainability is a constant learning process in which we engage stakeholders and external experts to better understand the consequences of our decisions and create long-term value. We aim to strategically enhance in-house competencies, develop sustainable financial products and services, improve business processes, and develop sector wide partnerships to work toward more responsible business operations.

- We realize the extent to which our business decisions affect society and the environment, and as a result, focus on managing these impacts.
- We aim to be a leader in sustainable development in the financial world by striving toward initiating systemic change and creating possibilities for innovative and sustainable solutions that guide society toward sustainable development.
- We will bring our activities into conformity with the UN Sustainable Development Goals and the Paris Agreement.
- We operate transparently and publicly account for our progress and obstacles in various sustainability reports and through our corporate communication channels. We are continually improving our know-how on sustainability reporting standards and which to move towards a more comprehensive GRI reporting in our annual reports.
- We are committed to creating the necessary conditions for adhering to our sustainability strategy. This can be achieved by internal capacity building and integrating ESG aspects into the business lines.

1.2 LHV Group CEO letter on sustainability

We are living in extraordinary circumstances and facing challenges many of us would not have thought we would face. The changes in our everyday life, the natural environment as well as the economy are not only noticeable but imminent. Desperate times might call for desperate measures, but extraordinary times require innovation, positive change, cooperation, and creativity more than anything else. Extraordinary times also make us see clearer and steer our focus to what matters most. Focus on our employees, our customers, and our shareholders. But also, on our health and well-being, and the well-being of the world around us.

LHV has always paid a lot of attention to the impacts of governance and social risks and has proven to be one of the best places to work in Estonia. In recent years, we have expanded our focus to environmental risk management. Climate change and other ecological problems received considerable attention in 2021 and it is not surprising that the financial sector is also increasingly concerned with sustainable development and understanding the urgency of these issues.

But amid this urgency, for many, 2021 was also a year of obvious limits – personal limits, professional ones, business-related, mobility-related, and even related to creativity and innovation.

What limits us as people and individuals, limits us as organizations, nations, communities, and economies. Our constant attempts for “back to normal” have perhaps inhibited our creativity and constrained us from fully adapting to a present that can, under the right circumstances, push us further into a more sustainable, economically beneficial future. Under the right circumstances, unexpected change can be a catalyst for innovation, creativity, and even more urgency. But acting upon urgency in isolation, without collaboration, can limit the collective brain integral for achieving the global goals.

When we look back at extraordinary historic people, we learn, that collaboration can be the very foundation of success. Leonardo Da Vinci, for example, was a brilliant inventor and artist. Buried in one of his many notebooks dated back to the 1490s is a to-do list titled “It is useful to constantly observe, note, and consider.” What is interesting, is that over half of the to-do list was about engaging with other people to teach him new things and steer him to the right direction. The to-do list of one of the most genius men who ever lived was largely about collaboration with other people, which just might have been the key to his success.

Observe, note, and consider are underrated skills in the world where action defines success. LHV’s journey toward a more inclusive and greener economy and operations will be thoroughly explained in the report below. In 2022, we will continue to do our part and work towards our goals and setting even more ambitions ones. We will be further integrating sustainability into our core processes and strategy building. We will act in urgency. But we will also work even more with our customers on the issues of sustainability, collaborate with experts on the field and considerably increase our internal capacity and knowledge on the issues. So that we can observe, note, and consider in urgency as well, and in a way that makes all our stakeholders experience the extraordinary, even amid obvious limits and challenges.

2. Global sustainability frameworks

2.1 UNEP FI PRB

The principles of responsible banking The UN Principles for Responsible Banking give banks a framework for sustainable operation and sets out guidelines for promoting life in society. We joined with the initiative to show our commitment to the UN Sustainable Development Goals and align our activities with the Paris Climate Agreement's goals. We take part in international cooperation in the financial sector and sharing best practices.

Principle 1
Alignment

We will align our business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks.

Principle 2
Impact & target setting

We will continuously increase our positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.

Principle 3
Clients & customers

We will work responsibly with our clients and our customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations.

Principle 4
Stakeholders

We will proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals.

Principle 5
Governance & culture

We will implement our commitment to these Principles through effective governance and a culture of responsible banking.

Principle 6
Transparency & accountability

We will periodically review our individual and collective implementation of these Principles and be transparent about and accountable for our positive and negative impacts and our contribution to society's goals.

2.2 PCAF

At the end of 2021 we joined with Partnership for Carbon Accounting Financials (PCAF) initiative. While we have measured our scope 1, 2 and 3 emissions in operational level, we have struggled to find the best practice to measure our scope 3 emissions in category 15 (investments). We see that joining with PCAF standard helps us to disclose our scope 3 emissions (category 15, investment activities) which are relevant but have not been calculated yet.

The standard, which is reviewed by GHG protocol, has developed a consistent methodology for measuring and disclosing such emissions, which include those associated with corporate/business loans, commercial real estate loans, residential mortgages, motor vehicle loans, project finance and even the equity and bond positions that banks hold on their balance sheet.

This metric provides us the starting point to assess and disclose climate-related issues; set science-based targets using emission-based methods developed by organizations like the Science Based Targets initiative (SBTi); and set the baseline emissions for target setting in alignment with the Paris Agreement. For us it is the step forward to understand our impact and measure our customers and work together with them while reducing our impact to the environment.

3. ESG strategy and materiality

3.1 Material ESG and sustainability aspects

We want to achieve real change through our sustainability efforts. The basis for that is a sufficient knowledge of the most material ESG and sustainability aspect for LHV. Above all, we want to devote our resources to addressing the environmental, social, and economical sustainability matters that are most affected by our business decisions, and that tackle major societal needs.

For the first time, we went through a comprehensive materiality analysis process in 2020 in partnership with an independent external ESG advisory firm. We built the analysis mostly on UNEP FI Portfolio Impact Analysis Tool. Considerations of the materiality review included:

- potential positive and negative environmental and social impacts due to the portfolio allocation of LHV Pank, drawing on the UNEP FI Portfolio Impact Analysis Tool;
- expectations of external stakeholder groups (experts on social and environmental impact, customers and partners);
- opinions of internal stakeholder groups (LHV management, key persons, and employees);
- proper ESG management approach according to dedicated standards and frameworks, and market practice among peers.

The materiality process and portfolio impact analysis

In 2020 we went through a comprehensive portfolio impact analysis process which is the core of our materiality process. We built the analysis based on UNEP FI Portfolio Impact Analysis Tool. The process of the analysis included:

- All core business areas, i.e. business banking, corporate banking, and consumer banking (excluding asset management), and services of LHV in its major location (Estonia) were considered in the scope of the analysis (excluding United Kingdom where LHV was at the time at the very early stages of increasing its presence).
- Based on the portfolio allocation the most significant industries were identified based on where LHV has the major impact through its services (based on the cartography the share of different industries in the portfolio).
- The most relevant societal, economic, and environmental challenges related to sustainable development were defined in the countries of operations (Estonia). The sources for such "country needs" were major global data sources provided by the UNEP FI tool (e.g. UN, OECD, WHO, ILO, FAO, World Bank, etc), complemented with the best location-specific data mapped in cooperation with leading local scientists (where global data was insufficient for local reality).
- In total, 22 environmental, social, and economic aspects got such country scores (on a 4-point scale).
- The outcome of the analysis was discussed, validated, and elaborated with external experts and stakeholders, including the expectations of customers and partners (there were two panels around environmental and social aspects).
- The impact analysis was conducted with independent external sustainability advisors.

Materiality and impact analysis findings

The results of the process were completed and validated by the management team during ESG strategy development process. As an outcome, we identified two environmental and two socioeconomic impact areas as the most material where LHV could achieve the largest impact on sustainable development through its core work across the value chain and portfolio:

- Climate and biodiversity
- Circular economy
- Inclusive and cohesive economy
- Financial literacy and economic sense of security

On top of these four impact areas the fifth, internally relevant material aspect was identified - honest and transparent organizational culture (covering both employee related social, and governance aspects).

These 4+1 impact areas are the starting point for the sustainability strategy of LHV – the basis for strategic directions, KPI-s, targets, green products and services development, and roadmap 2021-2023 for identifying strategic business opportunities, and improving the impact.

All these focus areas are managed through three levels:

- Positive and negative impact areas of LHV's operating activity (e.g., the impact of financial decisions on the environment and society);
- LHV as an organization (i.e., management and organizational impacts, e.g., "house in order" activities);
- LHV's broader impact in society (activities supporting and guiding a more comprehensive, systemic change in Estonian society).

The current report gives an overview of our current state and initial dedicated steps in managing these impact areas more systematically than before.

3.2 Contribution to sustainable development

Our major ESG and sustainability impact areas clearly address relevant sustainability related challenges of the society. Our self-confidence lies in the fact that we considered comprehensive global and local statistics about the current state and needs in various environmental and social aspects in the process of defining material impact areas. We spotted the most burning needs in the society that are related to our business activities.

This gives us a proper starting point to tie our ESG and sustainability strategy with the societal development needs highlighted by UN Sustainable Development Goals (SDG). We are committed to bring our activities into conformity with the UN SDGs.

Working with our most material sustainability aspects contributes to these UN SDGs and its specific sub-targets

Sustainable Development Goal (SDG)	Specific SDG target to which LHV contributes	How LHV contributes?
SDG 1. End poverty in all its forms everywhere	1.2. By 2030, reduce at least by half the proportion of men, women and children of all ages living in poverty in all its dimensions according to national definitions 1.4. By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance	• Integrating social and environmental considerations into the core of our business. • Investing in spreading financial literacy.
SDG 8. Promote sustained, inclusive, and sustainable economic growth, full and productive employment and decent work for all	8.3. Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity, and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services 8.10. Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance, and financial services for all	• Driving sustainable growth, creating jobs, encouraging entrepreneurship, and fuelling innovation.
SDG 7. Ensure access to affordable, reliable, sustainable, and modern energy for all	7.1. By 2030, ensure universal access to affordable, reliable, and modern energy services 7.2. By 2030, increase substantially the share of renewable energy in the global energy mix	• Offering customers a choice of green financial products. • Improving processes of ESG-related due-diligence for corporate customers and partners.
SDG 12. Ensure sustainable consumption and production patterns	12.2. By 2030, achieve the sustainable management and efficient use of natural resources 12.6. Encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle	• Considering environmental factors in business decisions. • Advocating for responsible lending and consumption.
SDG 13. Take urgent action to combat climate change and its impacts	13.2. Integrate climate change measures into national policies, strategies, and planning 13.3. Improve education, awareness-raising and human and institutional capacity on climate change mitigation, adaptation, impact reduction and early warning	• Encouraging environmentally sustainable business practices within the sector and the State level through supporting sustainable financial sector development.

3.3 Stakeholder engagement

In LHV we believe that sustainability is a constant learning process. We keep on asking ourselves and our stakeholders how we could make the most impactful efforts. We engage stakeholders and external experts to better understand the wider sustainability context, challenges and trends, expectations of the members of the society to us, and the wider consequences of our decisions.

For us, stakeholders are the groups and individuals that LHV affects through its activities, and that, in turn, may affect LHV`s operations in short or long run.

We regularly hold dialogue with stakeholders with whom we have the most direct relations and with whom LHV could collaborate for better impact in the society. But we also keep in touch with the stakeholder groups that are part of shaping the trends and set requirements for the financial market.

Engagement of stakeholder groups

Our major stakeholder groups, ways of their engagement, and their major expectations to LHV:

	How we engage?	Main expectations and key topics raised?
Customers	Active communication and discussions, ESG questionnaire in credit application, green products, and services	Engagement, knowledge building, ESG integration into business and decision making
Employees	Annual survey, individual development and performance reviews, informative sustainability seminars	Feedback, engagement, internal capacity building
Shareholders	Annual shareholder meeting, active communication, ESG reporting	Profitability, engagement, feedback
Policy makers, regulators	Memberships in State level sustainability focused working groups, direct communication with government officials	Policy making input and information about EU legislation on the issues of sustainability and reporting
Business networks, financial sector	Active membership in Estonian Banking Association, Finance Estonia and Rohetiiger	Leadership in ESG promotion
Suppliers, cooperation partners	Direct communication	Sustainability integration into value chain
Sustainability organizations	Active membership in local sustainability focused initiatives and organizations, leading the ESG working group in Estonian Banking Association, member of UNEP FI PRB	Financing sustainable development, enabling green transition
Wider public and society	Active communication, public events and conferences, universities, press and media	Transparency, fair and ethical business conduct

Stakeholder engagement in ESG and sustainability materiality analysis and strategy process

Some of the most important societal and environmental impact experts of Estonia were involved in verifying the results of our ESG materiality analysis and creating the LHV ESG strategy and action plan. During several workshops, about 20 experts (researchers, representatives of the public sector, cooperation networks and NGOs, entrepreneurs) worked on LHV's strategical action plan. The collected input was considered to assess the LHV Group's current activities in managing the company's social and environmental impacts and planning strategic activities.

Leadership for sustainable business development in Estonia

- LHV is the signatory and active member of several working groups of The Principles for Responsible Banking by UNEP FI. We are the only Estonian bank in the network which represents almost half of global banking assets.
- We are leading the Estonian Banking Association sustainable banking committee that represents Estonian banks and their involvement in ESG implementation.
- As an active member of FinanceEstonia (organization that supports the development of the financial sector, innovation, and the export of services in Estonia) and its ESG working group we contribute to the spread of sustainable banking principles throughout the financial sector.
- We are a founding member of Green Tiger, which is a local initiative that contributes to improving local organizations' knowledge regarding environmental issues, keeps tight contact with the state, and educates businesses to make the best environmental-related changes within the organization and their suppliers.
- We cooperate with other organizations on sustainability initiatives and regularly share about our ESG journey to other businesses. Our management and ESG team members share at conferences and seminars about our ESG experience and the importance of moving towards a greener economy and more inclusive society.
- We cooperate with universities in spreading the word about sustainability in the finance sector and the need for more capacity building on corporate ESG issues in Academia.
- We continuously collaborate with external experts to better implement our ESG project and research best practices.
- We regularly engage with non-profit organizations and with the public sector (especially in terms of ESG regulatory aspects).
- We regularly speak at national conferences and events about ESG and sustainable finance.
- We hold seminars and workshops to or with other companies and organizations and talk about our progress, the importance of corporate sustainability and the future of green finance.

4. Management of ESG

At the end of 2020, we adopted a group wide ESG policy which sets the goals, ambitions, and approaches for our sustainability activity in all the subsidiaries of the group. At the same time, we also approved an ESG KPI roadmap for 2021-23 which will help us move closer to a measurable sustainability management and will help us achieve our SMART targets moving forward. The roadmap will be annually updated considering that the needs for data and the availability for data is changing constantly.

The ESG policy also sets a high-level structure and responsibilities for ESG governance group-wide – Head of ESG being responsible for all everyday ESG matters, Group CEO as governing body member ultimately responsible for ESG supervision, all Heads of LHV Group's subsidiaries as responsible for supervision over everyday ESG matters. ESG activities in their respective subsidiaries and the Communications Manager as responsible for external communication related to environmental and social matters and serving as a contact person for all sustainability-related public enquiries. As of 2020, we have a dedicated ESG team who reports directly to the Bank CEO. In 2021, we started considerably growing and developing the ESG competencies in-house, resulting in the growth of our ESG team as well as ESG-focused professionals in the compliance, credit, risk, asset management departments.

The main aim of the management of ESG Group wide is a smooth integration of sustainability principles into all relevant business lines, processes, strategy building, and risk management.

4.1 ESG Steering Committee

In March 2021 we launched an ESG steering committee, which serves as a high-level governing body for ESG issues in LHV Group. The Committee follows the ESG policy adopted by the Supervisory Board of the LHV Group and was launched to ensure the development and implementation of various ESG projects and processes group-wide so that all our objectives can be met. The Committee also coordinate the flow of information on ESG projects, legislation and developments and advises members of the management of LHV's subsidiaries on ESG-related activities to be in line with LHV's business strategy, values, ESG strategic goals and best ESG management practices. We are currently in the process of setting up proper ESG governance system within LHV, with an aim to integrate ESG and sustainability matters to all relevant business functions and processes, and to involve all relevant managers in business units. We have conducted an analysis of the best practices among financial firms internationally and are working on improving our own ESG Governance structure and practice to support us moving closer to our PRB and sustainability goals.

The committee meets up once a month and the members include the Group CEO, the Chairman of the Management Board of LHV Pank, the Chief Risk officer of LHV Pank, LHV Chief Financial Officer of LHV Pank, Chairman of the Management Board of LHV Kindlustus, Chairman of the Management Board of LHV Varahaldus and the Head of ESG.

4.2 Alignment with policies and procedures

Apart from the ESG Policy and the KPI roadmap, that LHV has adopted, we have also made considerable improvements and additions into our Credit Policy (including exclusion list of activities we do not finance) and HR & Remuneration policies as well as the Ethics Policy to support the implementation of sustainability principles and our ESG goals. LHV Varahaldus has adopted and follows a separate Responsible Investment Policy for the management of Pension Funds. We are currently also in the process of reviewing and renewing our Risk Policy and making ESG related updates, while the Group Code of Ethics was updated in 2021 to represent an even more inclusivity and diversity in our operations and culture.

As of June 2021, we also have ESG questionnaire integrated into our credit application for our corporate customers onboarding process. Group wide, we have approximately 10 ESG project streams currently running to integrate ESG into our business and operations. The project streams include policy implementation, data & KPIs, ESG governance structure, communications, ESG reporting standards, internal capacity building, credit granting processes, ESG compliance and regulatory gap analysis, portfolio, and customer ESG assessment activities and the building of ESG risk management framework. In 2022, we are planning to update Portfolio Impact Analysis by integrating asset management into the scope as well. Our goal is to regularly re-assess our impact and keep our strategic sustainability activities aligned with the most recent results of portfolio analysis.

4.3 ESG risk management

We understand the need of assessing risk related to ESG and being more transparent and accountable in our decision-making processes. Based on sustainability and responsibility principles, we have supplemented and published a list of business areas that contradict our credit policy and our goals for sustainability. We also realize that an adequate ESG risk management framework is the core of responsible customer relations, and essential for supporting our customers in their own sustainability journey and mitigating sustainability anu risk related to ESG. Hence, we will continue working on integrating sustainability into our risk management practices and policies and we are planning to work out a separate ESG risk management framework going forward.

In addition to the above, we are looking thoroughly into current legislative processes which will affect our sustainability efforts moving forward. One of them being the EU Taxonomy. Taxonomy implementation is also one of the current focuses and will be the foundation for creating our Taxonomy alignment and ESG scoring criteria and methodology. Taxonomy implementation will not only challenge our ESG data analysis and scoring methodologies and processes but will be the bridge between helping our corporate customers become more transparent in their sustainability efforts and knowledgeable in managing their own ESG risks and disclosures.

4.4 Responsible investments

The principles of responsible investment and analysis of ESG factors are part of the investment analysis process at LHV. By integrating it into the process, the analysis is comprehensive and considers ESG factors as well as traditional investment analysis factors such as fundamentals and valuation. ESG assessment as one part of the analysis is divided into subgroups, based on the sectors, and needs of each existing or new potential investment (considering the most relevant ESG risks of the company). We aim to generate a list of material ESG issues for relevant sectors. The sources for ESG information are based on public information, including periodic financial reports, ESG, and sustainability reports, press releases, company management meetings, and other relevant material. We regularly educate our customers and the public about the potential benefits of and the future of green investing, and believe following sustainability principles in investing and promoting them to the customer-base is in the best long-term interests of our customers.

5. Management of impact areas

5.1 Environmental

We realize that business enterprises and economic progress can often draw on natural resources. However, we also recognize that there is an alternative, more sustainable way to achieve growth and create value. Through their business and offerings, financial institutions have a transformational capacity to create positive change and scale sustainable business practices through innovation, creativity, and the entrepreneurial spirit. LHV desires to operate sustainably, and as an Estonian company, we want to help the Estonian economy to adapt to meet the climate targets.

To do so, LHV is

- Contributing to achieving the goals of the Paris Climate Agreement;
- Supporting Estonia's goal of attaining a climate-neutral economy by 2050;
- Open to the opportunities afforded by the new economy;
- Working together with external stakeholders to bring about more positive change (i.e., Estonian Banking Association, external consultants, and organizations to help build capacity);
- Following green office principles and monitoring its annual carbon footprint. LHV to become carbon-neutral in its office operations in 2022;

A financial institution's sustainable business operation means consistently incorporating ESG-friendly practices into its offering and product development. To date, we have developed special loan offers that motivate our customers to make environmentally responsible consumer decisions. We have also created and disclosed an exclusion list of activities that are not in accordance with our credit policy and the principles of sustainable and responsible operations.

5.1.1 Green office operations

The idea of LHVs Green Office project came in 2019, after hackathon which was targeted at employees. Besides other environmentally oriented activities we considered important to take care of our office. 5Our priority was to make office activities clean and environmentally friendly. We wanted to involve workers in the process to raise their awareness.

Our Green Office project first important step was making the structure to lay the basis for further activities. We convened a Green Office working group, with whose help we complied primary documentation: Green Office principles, reminder, and action plan.

LHVs Green Project starts already its third full year. During that time, we have been achieved quite a lot. The Green Office certificate received in 2020, the title of the best Green Office of the year and the BREEM certificate issued in 2021 will give us further motivation to move forward.

Besides small daily activities there are some larger projects that have gained more attention. For example, we pay close attention to waste generation. LHV has developed a solid waste sorting procedure. We have got rid of our own garbage bins and created garbage sorting sections in the kitchens. In cooperation with Nutriloop, we recycle our own biowaste, which we use to produce plants on the balconies of our office. We organize calls for employees, allowing them to bring stalled clothes or hazardous waste to the office in collection boxes.

At the end of each year, we measure our CO2 footprint. We collect data about business travels, consumption of office buildings, ordered paper, fruits etc. Based on this, we can make comparisons from previous years and introduce new points in the Green Office's action plan to further reduce our footprint.

For the second year in a row, we are organizing information mornings entitled "What is really important?" to raise the awareness of employees. This is an event where we invite two foreign guests to the office to talk on a topical issue with LHVs moderator. It takes place every month.

The journey of LHV's Green Office has been short but comprehensive. Already achieved things on this journey gives us the motivation to move forward to achieve the most environmentally friendly operations possible with all our offices. At the same time, we do not forget our own employees, to whom we offer good opportunities to get involved and educate themselves.

In our supply chain we only consider the usual criteria (e.g., quality, price) but also environmental criteria. The main purpose of such activities is to reduce the cost of products and services, environmental impacts resulting from production, use and disposal, i.e. the total environmental impact of the product/services during its life cycle. Through that it is possible to reduce the risks to human health and the environment. Other than mentioned above, there were no significant changes in the supply chain.

Even though our greatest environmental impact comes from financing and investing activities, it is no less important how we administer our business every day. That’s why we wanted to make sure that our own consumption is sustainable, that we keep our house in order and serve as an example on all fronts of the effort to meet climate goals.

LHV has decided to take steps towards more environmentally friendly operations. This has been done by improving the office environment and involving employees in the Green Office process by awareness-raising. In 2020, LHV's Tallinn office was awarded the Green Office Certificate, which confirms our office operations environmentally sustainable activities. In December 2020, LHV’s Tallinn Office was awarded Best Green Office of the Year award by the Estonian Association for Environmental Management.

5.1.2 Our carbon footprint

Greenhouse gas emissions must be reduced significantly to avoid the worst consequences of climate change. Our office activity also generates emissions - both directly and indirectly. Mostly, due to the use of heating, power, employee commute, and business travel. What have we already accomplished? At the beginning of 2020, we started collecting emissions data for the first time and ran the calculations for our carbon emissions for 2019. We did the same for 2021 at the beginning of 2022. In 2020, LHV's office activity had a greenhouse gas emission footprint of 865 tonnes of CO2-equivalent, which is 1.7 tonnes per employee at the time of calculation. For 2021 the results were 1,447 tonnes, or 2.2 tonnes per employee. We see the increase in our operational level CO2 footprint and the main reason is that we have gone more specific in our data collection. In 2021 we added several categories to our operational level calculation. One of the main additions is the adding of home office calculation to our scope 3 calculation. As the pandemic of Covid-19 increased the need of working remotely we realized that we need to take the home office into account as well.

Another important addition to our scopes is IT servers and IT operations. These are the main reasons why our CO2 footprint has significantly increased in 2021.

Our aim is to reduce our CO2 footprint as much as possible but on the way, we have to understand that adding more categories to the scope our CO2 footprint will increase as the measurement system is improving.

LHV's climate impact for the 1 January 2021 to 31 December 2021 period was calculated based on the "GHG Protocol Corporate Accounting and Reporting Standard", which is internationally recognized and the most widely used greenhouse gas accounting standard. The standard encompasses seven kinds of greenhouse gas emissions – carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), hydrofluorocarbons (HFC), perfluorocarbons (PFC), sulphur hexafluoride (SF6) and nitrogen trifluoride (NF3).

The results are expressed in CO2 equivalents, the universal greenhouse gas unit of measurement, indicating their different potential for causing global warming. The values expressing global warming potential are based on reports from the UN's IPCC and take into account the impact of GHG in the atmosphere over a 100-year period.

Specialized and recognized databases were used to determine emission factors (e.g. Ecoinvent v3), reports of international studies and scientific literature, government greenhouse gas inventory reports, data on suppliers, and other relevant sources.

The results of the analysis covered the following Scope 3 categories: 1. Purchased goods and services (paper, water consumed, server hosting, customer keepsakes, foodstuffs and miscellaneous products); 2. Capital goods (office furnishing and equipment); 3. Fuel and energy related impacts (not included under Scope 1 and 2); 5. Waste generated in operations; 6. Business travel (flights, train, bus, ship, subway and taxi rides and personal car); 7. Employee commuting (between home and work).

To evaluate the impacts of employee commuting, a web survey was conducted among the employees, which inquired about the distance between home and work (direct route, without possible interim stops) and modes of transport ordinarily used. A total of 67% of employees responded and the results were extrapolated to the number of employees working for the company.

Differences between the 2021 analysis and the 2020 analysis:

- in 2021, there were a number of purchased goods and services and capital goods as additional emissions sources;
- the fuel and energy related impacts previously shown under Scope 2 emissions are now a part of Scope 3 and the impact of network losses has been added based on use of more accurate Estonian-based emissions factors;
- the thermal and electrical energy coefficients were refined using Estonia-based data.

The analysis covered the activities of LHV Group's Tallinn and Tartu offices. Similarly, to analyses of years past, the 2021 analysis did not take into account LHV's UK office (based on the complicated availability of data). Due to the small size of the office, the representation in London would not be expected to have a significant impact on the carbon footprint of LHV Group as a whole.

To perform the calculation of intensity of carbon footprint per employee, the aggregate result was divided by the number of LHV Group employees at the end of the reporting year.

Emissions (GRI 305:2016)

		2021	2020	2019
	Direct (Scope 1) GHG emissions	0	0	0
	Energy indirect (Scope 2) GHG emissions	445 t/CO_2e	572.7 t/CO_2e	742.6 t/CO_2e
	Other indirect (Scope 3) GHG emissions	983 t/CO_2e	292.5 t/CO_2e	467.47 t/CO_2e
	GHG emissions intensity	1,428 t/CO_2e	865.2 t/CO_2e	1,210.0 t/CO_2e
	Waste generated	16 t/CO_2e	24.6 t/CO_2e	4.0 t/CO_2e
	Water consumption	1 t/CO_2e	2.6 t/CO_2e	2.6 t/CO_2e

*Calculation is based on the whole LHV Group

		2021		2020	
Scope 1	**Type**	**tCO_2 e**	**Share %**	**tCO_2 e**	**Share %**
1 - Direct emissions		**-**	**-**	**-**	**-**
Total Scope 1		-	-	-	-
2 - Indirect, emissions related to purchased electricity and heat	Electricity (renewable electricity): Tallinn office	0	0	7	1
	Electricity (non-renewable electricity): Tallinn office	-	-	82	9
	Total electricity Tallinn Office	0	-	89	-
	Electricity (non-renewable electricity): Tartu office	78	5	52	6
	Thermal energy: Tallinn office	357	25	407	47
	Thermal energy: Tartu office	9	1	24	3
Total Scope 2		**445**	**31**	**572**	**66**
3 - All other indirect emissions in the value chain	*Outsourced materials (trading assets)	25	2	-	-
	*Client related product marketing materials	3	0	-	-
	*Office furniture	29	2	-	-
	*Office equipment	238	17	-	-
	Generated waste	16	1	26	3
	Water consumption	1	0	3	0
	Business travel: plane	54	4	22	3
	Business travel: train	1	0	1	0
	Business travel: bus	1	0	2	0
	Business travel: taxy	1	0	0	0
	Business travel: personal car	10	1	6	1
	Drive home to work: 2021 (634 employees)	308	22	234	27
	Indirect energy and fuel effects				
	*Electricity grid loss	5	0	-	-
	*Grid loss of heat energy	56	4	-	-
	*Indirect effects related to heat production	237	17	-	-
	Home office	19	1	-	-
Total Scope 3		**1,002**		**293**	
Total		**1,447**		**885**	

We have put together a climate neutrality achievement plan to operate more sustainably and reduce our negative environmental impact. In 2020 we made the transition to electricity furnished with a green energy certificate, which has cut emissions by 30%. In addition to that, working towards the Green Office Principles, we have also organically reduced our emissions.

We are also working on developing a local and ethical project for carbon offset which we can contribute to offset CO2 which we cannot offset through our everyday office operations. We calculated our footprint based on the internationally recognized Greenhouse Gas Protocol. We will repeat and refine the calculation each year. Based on which additional categories we can gather reliable data in, we will strive toward a fuller picture.

5.1.3 Offsetting our carbon footprint locally through innovation

In 2021, we started a local pilot program with our partner eAgronom. eAgronom is an agricultural start-up whose methods are still being verified by Verra. But eAgronom provides us a local solution to achieve our first emissions related target - to become net-zero in our operational level by 2022. Although we have another 12 months to achieve our target and we can lower our operational level emissions by at least another 15%, we see the rise of demand for trustworthy offset projects.

Working together with eAgronom helps us to understand the offset business a lot better, we can improve local soil quality, store more nutrients in the soil and increase water holding capacity while supporting local farmer to apply to the new approach which eAgronom helps them to implement into their everyday farming habits.

We are using eAgronom's newly developed solution to buy carbon credits from Estonian farmers who sequester carbon dioxide from the air into the soil and thereby improve the soil quality of their fields. We will receive the first carbon credits from eAgronom in October 2022, after what we are able to declare that we have reached Net-Zero in our operational level.

5.1.4 Green products and services

LHV's influence in the Estonian financial sector is growing. As part of an industry that is vital for society, we, directly and indirectly, affect our surroundings and make our most significant contribution through investing and financing. That is why we have decided to channel cash flows from our core activities more concertedly to activities that support the transition to a climate-neutral and sustainable economy. We have developed unique green products that motivate our customers to make everyday consumer and investment decisions that are as environmentally responsible as possible. In this way, we do our part to support economic growth, which at the same time reduces greenhouse gas emissions, pollution, and waste generation.

Green Home Loan

One of the most important consumer decisions a person will ever make – in terms of the financial cost and the environmental impact – is regarding purchasing their home. One-third of the average Estonian's annual CO2 footprint is related to their home – mostly deriving from energy used for heating and emissions arising from use of household electricity.

We would like to promote the building and buying of the most energy efficient homes, so we're offering our customers the possibility to leverage Estonia's first green home loan.

Green Car Leasing

We aim to promote the purchase of energy-efficient vehicles. The most energy-efficient vehicle you can choose to drive is a fully electric car. But to be sure of its sustainability level, the energy needs to derive from renewable sources entirely. From 2026 onwards, only cars with zero CO2 emissions per kilometer are considered clean vehicles. Only electric and hydrogen vehicles will meet this standard. We, therefore, offer car leasing for new fully electric vehicles purchased for general use. In line with a longer-term strategy and the desire to contribute to Estonia's climate objectives, LHV Pank has decided that LHV will no longer finance the purchasing of new diesel passenger cars from 2030 onwards.

Green hire-purchase

Renewable energy sources are undeniably an investment for the future. Using solar panels for generating energy and heating homes and household water with geothermal energy is a smart choice. Instead of driving vehicles that run on fossil fuels, we want our customers to try considering electric monowheels or two-wheeled vehicles. We want to make it easier to make energy-efficient choices.

Green Investment Loan for Companies

The Estonian economy is very carbon-intensive. Therefore, investing in lower energy consumption, production of renewable energy, or daily resource efficiency is very profitable and will increase any company's competitive advantage.

Green Loan for Housing Development

For people to have energy-efficient apartments, someone has to build them. Therefore, we offer investment loans for energy class A housing developers with a lower-than-usual interest rate.

5.2 Social

While banks and financial institutions play an integral part in driving economic growth in a society, they also have the power to impact individual lives and communities' overall wellbeing. Our business is always conducted with integrity, transparency, and ethics in mind, with the utmost emphasis on fair dealing and respect towards our partners, customers, and employees.

By acknowledging our role and societal influence on the local level, we

- Preserve a budget to support the advancement of music or arts, education, sports, and community events;
- May provide support to external movements and partners to promote the cultural and economic development of local communities;
- Stand for the equal opportunities of people and companies active in the economy;
- Build the confidence of our customers toward LHV as a non-discriminatory financial services provider;
- Encourage financial literacy and economic knowledge-sharing;
- Continuously improve our competencies in the field of ESG to further advance the cohesion of society. The prosperity and welfare of our people is the core of our business operation.

We realize that good business results and growth do not happen in isolation of people who create value, are well taken care of, and are engaged in their personal and collective mission, and feel highly valued.

5.2.1 Social responsibility

Along with the growth of LHV, we are also becoming increasingly aware of our growing role in the Estonian economy and society in general. Based on our mission, we support activities that allow Estonian people and businesses to think more boldly about the future and realize their plans. We consider it important to increase the feeling of economic security and make the economic environment more coherent. In society at large, we primarily support ventures that make Estonia bigger and contribute to the capabilities of our communities. In addition to contributing to investor education and recognition of entrepreneurs, we have several longer-term and more recent cooperation projects, helping to achieve said goals.

5.2.2 Financial literacy

Since its establishment, LHV has been part of the Estonian investor community. As a market leader in investment services and as a listed enterprise that values investor relations simultaneously, we actively contribute to educating the investor community. In our relations with more than 10,000 shareholders, we are open, transparent, and inclusive.

- We organize free seminars as part of the Investment School, where over 8,200 people participated in 2021 (the number of participants in 2020 was 7,400). This year, most seminars were held in the form of webinars.
- We also carry out the annual stock market game Börsihai. This year, the number of participants reached 9,387 (the number in 2020 was 6,576).
- For the third year in a row, we organized an advertising campaign on financial literacy, but this time targeted it at mostly Russian-speaking youth in Estonia, with insightful videos on money management on our social media platforms.
- In cooperation with the University of Tartu, we prepared an elective subject 'Functioning of a modern banking company on the example of LHV Pank for which 39 students registered.
- We participated in projects for improving financial literacy organised by the Estonian Banking Association.
- We supported the Investor Toomas - a conference organised by Äripäev and the Investment Festival carried out by the Investment Club, the Women's Investment Club, and the stock training.

5.2.3 Sponsorships

Within its means, LHV supports activities that 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 six years now we have supported the publication of the Au Award for new Estonian music, which was awarded to Rasmus Puur in 2021.
- Enn Soosaare Foundation - the prize for supported ethical essays was awarded to Jüri Saar in 2021.
- Festivals Sõru Saund ja Mägede Hääl - music festivals that bring music to small places.
- 53 community initiatives applied for support from the Who's Who? The Järva-Jaani Firefighting Society received the main grant for the renovation of the local rescue team.
- We launched a charity function for LHV bank cards, with the help of which customers can conveniently donate to a charity they like with each use of the card. By the end of the year, customers raised a total of 64,000 euros for 12 organizations.

Sport & healthy lifestyle

- Estonian Football Association - LHV Pank has been the main sponsor of the Estonian Football Association and the Estonian national team since 2010. In addition, in 2021, we supported football clubs with 90,502 euros through the LHV football card support system.
- Estonian Optimist Class Union - we support the growth of Estonian sailing.
- Rally Estonia - we supported the organization of the stage of the World Rally Championship in Estonia for the second year.
- Simple Session - we were one of the main sponsors of the top extreme sports event for the third year.
- Estonian Biathlon Federation - we signed an agreement to support Estonian biathlon during the Olympic season, when the Estonian MK stage will be held.
- We are organizing the inter-company football tournament LHV Cup, which took place for the fifth time.

Estonian economy and business

- EY Estonian Entrepreneur of the Year competition - we are one of the main sponsors since 2012, in 2021 Priit Kallas was named Entrepreneur of the Year.
- Young Entrepreneur Award - in cooperation with the Estonian Chamber of Commerce and Industry, we awarded the prize to an outstanding and innovative young entrepreneur, who was Martin Vares this year.
- Conferences Business plan, Investment festival, Investor Toomas conference - in cooperation with Äripäev, we supported the organization of Estonia's leading business and investment conferences.

We also support smaller local initiatives with our knowledge, gifts about LHV, advice and the presence of our people. We work with universities. We are a member of the Estonian Information Technology and Telecommunications Association, the Estonian Chamber of Commerce and Industry and the Estonian Employers' Confederation. We consider it important to help Estonian producers and entrepreneurs by consciously consuming their products and services.

5.2.4 Social impact through sales and channels

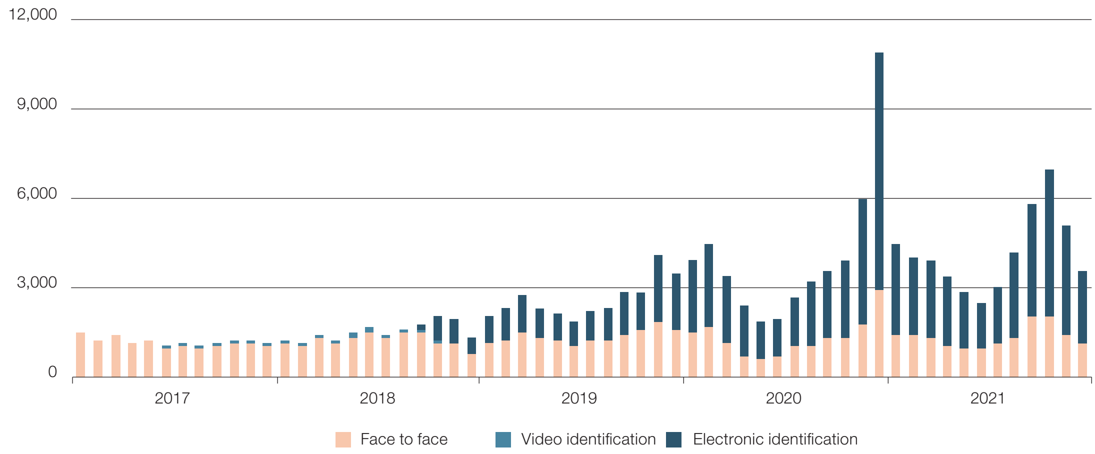
We aim to offer the best and most straightforward use of all our products and services to our customers. The years 2020 and 2021 were remarkable due to COVID-19 and because social distancing made electronic channels play an even more critical role in business and society. This clearly demonstrates that our focus on digital channels is the right way forward in making our services available to everyone.

The best e-channels in Estonia

For LHV, it is continually essential to develop our e-channels so that our internet bank and mobile app will support the availability of all our services. For the past few years, our main target has been the services targeted at private customers, but clearly, we want to offer the same experience to our business customers.

In 2021, we have onboarded about 3,000-5,000 new customers every month. More than half of our new customers open their bank accounts through our e-channel. We have seen this growing trend in previous years, but 2021 has shown that most of our customers can use our services remotely and online.

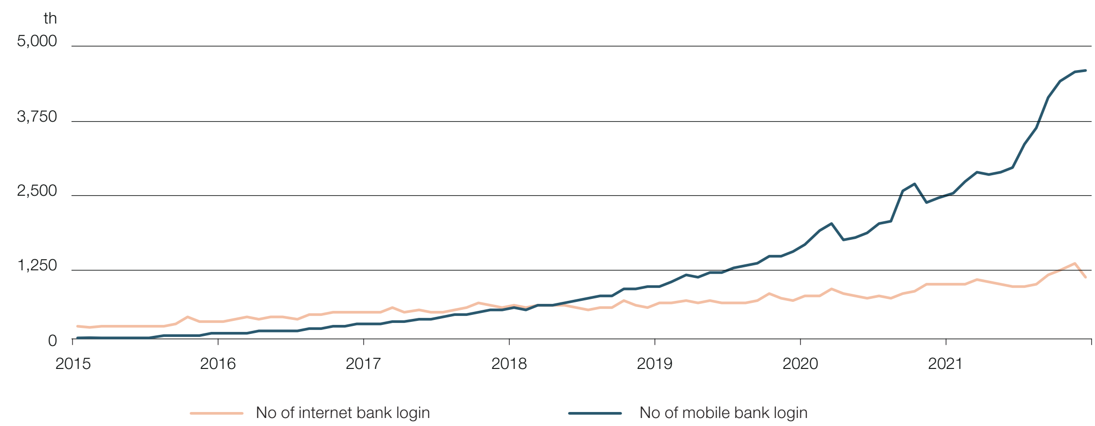
Identification upon onboarding of customers (private customers)



Our mobile bank app is gaining popularity rapidly, but during the upcoming year we are also advancing the look and feel of our internet bank by making it more user friendly. The customers use electronic channels more with every year and we continue putting a lot of effort into making user experience in our electronic channels as seamless as possible.

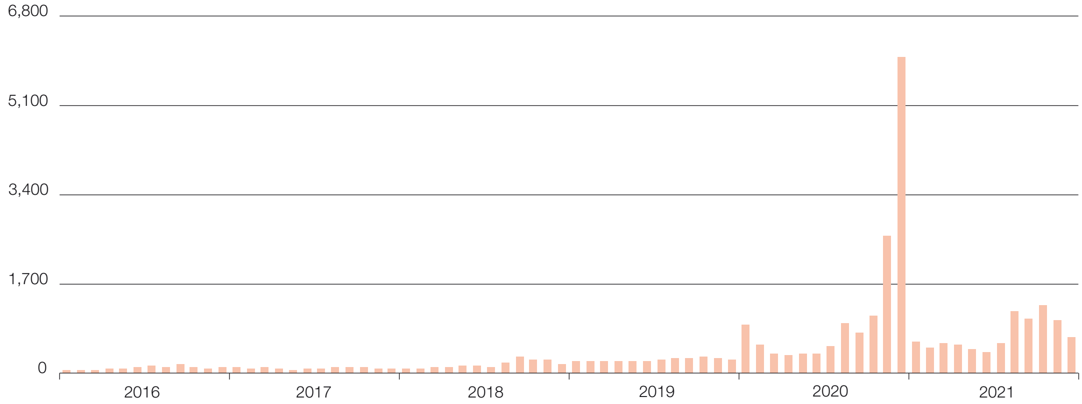
The increase of new customers login into the internet bank and mobile app was 40% and 82% in the past year. This means that customers use electronic channels even more than before.

LHV online banking and mobile bank usage activity



Through LHV it is possible to smoothly open a bank account for underage children through our internet bank or mobile app. Only the child's ID card, passport, or residence permit card issued in Estonia is required for opening the account. We have seen positive trends, meaning that opening bank accounts to children is only gaining popularity.

New Child Accounts



LHV is the first bank in the world to offer virtual ISIC Student card orders via its own mobile app. Virtual card means the students no longer need to have an extra plastic card to prove their student status or get international discounts. All our customers who have bank cards can see their card PIN code in our mobile app. That means we have reduced the number of notifications significantly that we usually send my mail. Our customers can also use ApplePay and Google Pay in their mobile app – so there is no need to carry plastic bank cards with them.

Based on customer segments and the unique needs of those segments. Our goal is to offer all our products and services online and plan our sales activities by segments even more to support a positive customer experience.

We have made the life easier for our business customers by developing a convenient bank account opening flow in our mobile bank. This leaves our customers more time on their hands to deal with activities that help their business succeed.

Focus on customer experience

A positive customer experience is critical to the sustainable growth of any business. And customer experience is essential for us. A positive customer experience promotes loyalty, helps us retain customers, and encourages brand advocacy. Therefore, we have also considered the needs of visually impaired people when developing our channels.

As in previous years, we also focus on promoting financial literacy. For that, we will develop an Assistant Budget Planner tool in our e-channel for our customers to act even smarter in their financial decisions. For the next year, we are aiming to build a flow that encourages customers to save money, while learning about the importance of investing.

We are always responsible in planning our sales and marketing campaigns and trying to offer the best possible solution for the customer. We try to listen to our customer opinion and preferences as much as possible. All our activities are based on customer segments and the unique needs of those segments. Our goal is to offer all of our products and services online and plan our sales activities by segments even more to support a positive customer experience.

5.2.5 Our societal impact as an employer

LHV, as a large employer and an important part of the society, has a responsibility for its actions, words, and ways of working. LHV is using leverage to promote high ethical standards and inclusive approach in all customers, investor, and employee relations. We aim to be a responsible organization, but also hope to contribute to systematically change towards more sustainable approach and inclusive society in general.

In our employees we look for the same values and follow the mindset in all our practices processes and daily actions internally. We carry out different surveys, during the employee lifecycle to evaluate how we are doing in the eyes of our employees, and where we could do better, for example during exit interviews, end of probation talks, etc. We have set up a quarterly best practices seminar for team leads, where many team leads share their own experiences and ideas, of how to make the workplace better.

In 2020 we introduced a new employee engagement survey – Gallup's Q12. This is an international format developed to measure employee engagement. The format consists of 12 questions, which all measure factors that are influencing employee happiness. The format has proven results internationally to bring out greater performance and help communication between managers and employees. We have concluded 2 surveys this year, in May and in October. The results were very high, 4.6 out of 5 in May and 4.5 out of 5 in October. In addition to the results, we have seen a better communication within teams about important matters and many teams have had changes towards better working climate thanks to the conversations raised within the Q12 format.

Equality and non-discrimination

LHV is an equality-driven, fair, and inclusive employer, we foster and maintain non-discriminatory business and HR practices. In the leadership and recruitment process, we are guided by the highest of ethical standard, human rights, and equal opportunities. Guided by the "Personnel policy" in all recruitment and promotion decisions, we take a gender-neutral, non-discriminatory approach and base the decisions on equal, measurable qualities, such as experience, education, skills and, if necessary, requirements from applicable regulations.

It is important for LHV not to discriminate against people with disabilities. In recruitment processes we choose the best person for the given role, not considering their disabilities. If the person is fit for the job, no other aspects will play a role. Currently, unfortunately the physical office space is not ready for anyone with a physical disability but working remotely is given as an alternative.

LHV has not found it necessary to implement diversity of equality policies but covers guidelines in different internal documents. In 2021, working relations paragraph "Working relationships" was added in the "Rules of organization of Work", which sets Whistleblowing procedure. This year, there has been no notifications of any violations in LHV. There were no labour disputes, discrimination cases, or violations of human rights. In addition, in 2021 the "Code of Ethics" was updated to reflect equal rights and non-discrimination guidelines.

The remuneration policy sets, the guidelines to follow in determining the renumeration, the decision must be objective and unaffected by the person. If required, a compliance to legislations is checked. In 2021, LHV has set a process for calculation of equal pay. We are using analytical job evaluation method, which has been created and developed by Fontes and bases on ILO recommended method. It is used in all three Baltic States for market benchmarking. LHV has used Fontes' benchmarking method 2011, for yearly evaluation. In this method jobs are evaluated based on education and professional experience, work characteristics and accountability. Analytical job evaluation method is universal and is applicable in every organization and with all jobs. Fontes analytical job evaluation points scale and job family classification scale are compatible. This way we are comparing similar value jobs with each other. The analysis showed that in specialist categories, where the job requirements and the work more comparable, the salary ratio from women to men ranged from 0.97 to 0.80, in the very top specialist category. In the manager categories the range was slightly higher, from 0.98 to 0.74, but these roles are often more specific, incomparable with each other. However, as a part of the analysis the problems were taken into consideration and further activities have been set.

Breakdown of the company employees by gender – 59% Female (318), 41% Male (223).

Age group	Women (%)	Men (%)	Total
19-25	59 (64.1%)	33 (35.9%)	92
26-40	202 (58.2%	145 (41.8%)	347
41-55	54 (55.1%)	44 (44.9%)	98
56-…	3 (75%)	1 (25%)	4
Total	**318 (59%)**	**223 (41%)**	**541**

Inclusive workplace

It is important to us that our employee's ideas, thoughts, and statements are heard and taken into considerations. We believe that great success comes from working together and with a "collective brain". Therefore, it is important that employees feel free to have a say and for their words to reach up to the top management. LHV has included all employees in the process of setting goals for each team. These are done as a team effort.

Even though the conversation and opportunity to give your thoughts is daily, the subject is very much in focus at least twice a year, during our engagement survey Q12. The 7th question in the survey is – At work, my opinions seem to count. The average of this question was 4.6 out of 5, both in May and In October. As the format also includes one on one conversations for every team member with their manager the subject is discussed, and actions taken to improve, if anything needs to be improved. Furthermore, LHV has set up several informative and inclusive "coffee morning" series – best practices series for all team leads, information series "what is really important?" for all employees.

LHV employees are not covered by collective agreement, as this is not a very common practice in financial sector in Estonia. However, we are a member of the Estonian Employers' Confederation.

Employee development

Professional and personal development is a part of LHV culture, we strive to innovate and be better at providing smarter solutions to our customers. The ideas for the solutions come from our employees, therefore developing one's skills is part of the daily job. The training approach is guided by individual's needs, motivation, and goals as well as regulative guidelines for professional development. In addition to professional trainings, we have contributed to team training with a goal to help teams work better together. We have also focused more intensely on leadership development with a set leadership training program. The next step in the program is working with strengths and setting out internal career development plans.

In addition to personal and professional development, we have started with informational mornings in various subjects about sustainability – for example circular economy, transport and mobility, natural resources and the environment, electricity and energy consumption, and conscious consumption.

Our employee engagement survey measures the satisfaction with one's development. There are three questions focused on development. First is asking if there is someone at work who encourages your development, the second asks if anyone has talked to you about you progress and last one asks if you have had opportunities to learn and grow in the past year. All the questions have seen an increase in the average result, with the last question answered with 4 or a 5 by 95% of the respondents in the October 2021 survey.

Work-life balance

As an employer it is very important to us that our employees have a well-balanced life. When a life is unbalanced, it will affect both private life and work life. Therefore, LHV does not promote working overtime and offers flexible working hours. The general culture within company does not promote an unbalanced work life. During the pandemic we have bettered a hybrid-workplace solution, but in doing this have not closed our office, so if anybody feels they can do their work better at the office this has always been a possibility. This year we have conducted a re-assessment with the Ministry of Social Affairs for family-friendly employer program. We were awarded golden level in 2019, which we were able to retain in 2021. This certificate evaluates all areas of work-life balance and shows that LHV cares for their employees in every stage of their life. We have not added any new perks to promote this subject as many of them have been implemented already – for example we offer part-time and flexible working schedule for students, new parents and to anyone, who feels the need for part-time working, we offer an allowance for a new child and when the child starts school. We offer free time for parents to attend their child's start of school or graduation, reduced hours on their child's birthday. We have 3 free personal days to use, 3 free days for weddings or if you need to organize a funeral. We also offer an allowance to use with mental health professionals, if needed. The usage of this has grown each year, as the employees feel more comfortable using professional help with also private worries.

Promotion of employees' health

LHV has an extensive occupational health package, which is important to keep our employees healthy. We contribute to physical and mental health of its employees. As well as keeping the balance between work and private life, it is important make sure the mental, and physical working environment endorses and supports our employees. LHV provides employees some healthy snacks at the office, promotes physical activity during the working day and offers an allowance for sporting and rehabilitation. This compensation has been used actively: 74% in LHV Pank. In addition to the mandatory occupational health survey, LHV offers an extensive health survey for employees over the age of 40. The additional survey has been very popular and the usage percentage for the included is over 90%.

A recognized employer

It has never been a goal to be awarded for being a desirable employer, but it is a very nice acknowledgement. LHV has for the past few years gained an increasingly better reputation for being a desirable employer. Our goal has been to offer our employees self-development and culture that inspires. This year we have had many opportunities to share our experiences and our leadership culture in podcasts, at conferences and in schools and universities. All of which has helped in being noticed. We have received acknowledgements in CV-Online's TOP employer, being named the 1st choice in financial sector. CV Keskus named LHV as 2nd most desirable employer. We were also recognized as an attractive employer by students and experienced employees in Instar's survey.

5.3 Governance

LHV is committed to always acting with integrity and in good faith and ensuring that our management policies, business mechanisms, and structures are transparent and reflect accountability, equality, and the highest ethical standard. We are carefully managing all potential conflicts of interest, avoid bribery, money-laundering, unlawful behaviour, and corruption. To encourage the sustainability mindset across all management levels and the organization, we:

- Maintain a flat, non-hierarchical organizational structure to promote the importance of employees taking individual responsibility.
- Continuously enhance the integration of ESG factors into our everyday work, management style, recruitment processes, and strategy building.
- Focus on engagement and cooperation.
- Recognize the integration of ESG factors into our business processes as a change management effort and understand the importance of collaboration to achieve our set goals.
- Work toward better analysing and reporting our ESG activities and progress and appropriately disclosing our metrics and achievements to regulators, partners, and the public.

- In order to ensure a transparent management culture, we follow the Good Corporate Governance Practices recommended by the Financial Supervision Authority and the Nasdaq Tallinn Stock Exchange.
- Report regularly on the UNEP FI Principles of Responsible Banking.
- Have integrated ESG targets into executive compensation program.

5.3.1 Responsible management culture

Responsibility and openness in management are the core pillars of our operating principles and are firmly rooted in our mission and values. We strongly believe that our high ethical standards and consideration of all stakeholders, high-level risk management, and lawful behaviour are critical to our success in the long-term. All managers and employees of LHV must behave ethically and responsibly and following the Code of Ethics is mandatory. LHV's Code of Ethics is the foundation of LHV's various policies, including the Company Governance Policy, internal regulations, and procedures governing the specifics of adherence to the Code of Ethics, which was updated in 2021. In 2020, we also created and published our very first ESG Policy, where our responsibility and commitment to social and environmental issues are clearly stated and explained. Primarily we rely on the lawfulness, best practices, and common-sense principle, doing our job responsibly, transparently, and with a fundamental goal to "do no harm." 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 underlying governance principles are described in more detail in the "Best Practice of Corporate Governance." The LHV management structure is easy-to-understand and includes clear lines of responsibility. An essential part of responsible governance is meticulous risk management and critically analysing our own activities. The mapping and mitigation of credit risks, liquidity risks, market risks, crime risks, and operational risks are taken very seriously at LHV. 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. We have 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."

5.3.2 Investor relations

LHV actively contributes to developing good relations with the investor community, and we have set high standards for ourselves in being open, transparent, and raising the awareness of our investors. We have set up an investor relations website, making all documents and information available to the shareholders following the Corporate Governance Recommendations and statutory requirements. LHV treats all shareholders equally and notifies all relevant essential circumstances, ensuring equal and quick access to the respective information and being open to questions. Information is disclosed in accordance with the rules set forth for publicly traded companies.

5.3.3 Transparency through sustainability reporting

We have taken it a goal to improve our sustainability reporting and non-financial disclosure practices and know-how in the coming years. In 2020, we started improving our know-how on reporting ESG metrics and also contributed to several voluntary non-financial disclosure initiatives like the Nasdaq Environmental and Social Disclosure Form and an Estonian banking-sector spBecific ESG disclosure project led by a local Estonian NGO Estwatch. We continued this practice in 2021 as well and the year 2021 was our first year of reporting to UNEP FI about our progress with the UNEP FI Principles of Responsible Banking. Starting from 2021, our ESG reporting practices will be aligned with GRI requirements and the Nasdaq ESG Reporting Guide for Nordic & Baltic Market. We will also keep up regular reporting on the UN Principles of Responsible Banking as required by the Initiative. We understand that aligning our reporting practices with international standards also means disclosing more non-financial information than we do right now.

To do that, we will put much more effort into gathering and analysing ESG data, improving ESG communication and internal processes, developing and publishing more sustainability-related materials and reports, and building in-house capacity on globally recognized ESG reporting standards.

5.3.4 ESG governance and metrics

To meet our goals for more sustainable business development, we comprehend the challenges of ESG governance and measuring or impact and setting KPIs to sustainability goals. In order to manage our impacts, we need to be able to measure them. For that, we must invest more time and effort in the future on the governance structures of ESG as well as and build internal capacity to measure our success better. We have today set key indicators to all our impact areas and developed a plan on what data we need to start gathering and measuring in the coming years to understand and meet our targets. We have also developed an ESG roadmap for 2021-2023 that will help us move closer to our goals in a more structured manner. Incorporating ESG in all our business decisions and business lines will need to go hand in hand with comprehensive mechanisms for measuring our impact across the board and reporting on it correctly. This will be one of the key goals for LHV regarding ESG moving forwards. The goal of 2022 and onward would be to set a more specific target setting plan for these metrics and start setting business specific ESG targets which and tangible and aligns with both our ambition as well as the global goals.

Below in the GRI context index, we have also reported on both GRI as well as voluntary ESG indicators.

5.3.5 Taxonomy reporting

Article 8 of the Taxonomy Regulation (the TR or Taxonomy) obligates any undertaking which is subject to an obligation to publish non-financial information pursuant to Article 19a or Article 29a of Directive 2013/34/EU to include in its non-financial statement or consolidated non-financial statement information on how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9 of the TR.

Publication pursuant to Article 8 explained in Commission Delegated Regulation 2021/2178 (Delegated Regulation). It is important to note here that the Delegated Regulation will enter into force in several stages in 2022-2026.

LHV Pank taxonomy eligibility

As the Bank is treated as a financial undertaking based on the Delegated Regulation, the Bank must disclose the following information in 2022-2023 (Article 10 (3)):

- the proportion in their total assets of exposures to taxonomy non-eligible and taxonomy-eligible economic activities;
- the proportion in their total assets of the exposures referred to in Article 7, paragraphs 1 and 2 of the Delegated Regulation (exposures to central governments, central banks and supranational issuers, and derivative instruments);
- the proportion in their total assets of the exposures referred to in Article 7(3) of the Delegated Regulation (exposures to undertakings that are not obliged to publish non-financial information pursuant to Article 19a or 29a of Directive 2013/34/EU);
- the qualitative information referred to in Annex XI of the Delegated Regulation.

Regarding portfolio management, portfolios are not included in total assets in the meaning of Delegated Regulation Article 10 (3). Therefore, these assets are not subject of disclosure at this stage.

Although, responsible investing activities and the assessment of the ESG factors is a part of the process of analysing the investments made in the process of portfolio management, Bank does not currently rely on the EU criteria for environmentally sustainable economic activities.

In the table below you can find our portfolio compliance to the EU taxonomy environmental goals on climate change mitigation and climate change adaptation:

			Eligible	Non-eligible	% coverage
Art 10	3a	Total assets	889,004	5,899,548	13.1%
		Of which trading portfolio and on demand interbank loans in total assets	-	112,647	1.7%
	3b	Government & Central Bank	-	3,874,284	57.1%
		Total exposure to derivatives	-	-	0.0%
		Total exposure to non-NFRD companies	-	12,348	0.2%

5.3.6 ESG metrics

To meet our goals for more sustainable business development, we comprehend the challenges of measuring or impact and setting KPIs to sustainability goals. For that, we must invest more time and effort in the future and build internal capacity to measure our success better. For that, we have today set key indicators to all of our impact areas and developed a plan on what data we need to start gathering and measuring in the coming years to understand and meet our targets. We have also developed an ESG roadmap for 2021-2023 that will help us move closer to our goals in a more structured manner. Incorporating ESG in all our business decisions and business lines will need to go hand in hand with comprehensive mechanisms for measuring our impact across the board and reporting on it correctly. This will be one of the key goals for LHV in regard to ESG moving forwards. Below are some of our key ESG indicators we are working on with respective data:

ESG Key performance indicators

1. Climate and biodiversity	2021	2020	2019
Proportion of diesel car leasing in the vehicle leasing portfolio (€)	38.39%	46.18%	-
Proportion of green car leasing in the vehicle leasing portfolio (€)	2.77%	1.73%	-
Average CO2 emissions in Group's car leasing portfolio (gCO2/km)	134.86	140.83	143.65
Proportion of clients with FSC certification	0.8%	0.8%	-
Home loan portfolio divided into energy groups (new sales since 07.2021)	C	-	-
Energy class share in home loan portfolio (since 07.2021)	5.9%	-	-
"A" energy class share in home loan portfolio (new sales since 07.2021)	12.9%	-	-
Proportion of home loans for renovation of buildings	4.85%	3.29%	-
Proportion of private loans for renovation of buildings	8.18%	8.67%	-
Proportion of microloan for renovation of buildings	3.12%	2.66%	-
Proportion of SME-loan for renovation of buildings	10.26%	7.68%	-
Home loan outside of Harju County	32.5%	32.9%	-
Proportion of green home loans in the total home loan portfolio	2.1%	-	-
Share of corporate banking loan portfolio to the biomethane industry	0.35%	1.25%	0.55%
Share of loan portfolio to solar energy industry in corporate banking credit portfolio	2.34%	2%	0.05%
Share of loan portfolio to wind turbine industry in corporate banking credit portfolio	0.27%	-	-
Total share of renewable energy production in corporate banking portfolio	2.96%	-	-
Renewable energy loan share in SME portfolio	4.8%	5.6%	-
Solar park loan share in SME portfolio	4.8%	5.5%	-
EMAS certificate share	2.7%	3.4%	--
Proportion of customers with an environmental impact management certificate (EMAS, ISO)	2.7% (EMAS)	-	-
Share of corporate banking loan portfolio to agriculture-related projects	3.9%	5.6%	-

2. Inclusive and cohesive economy			
Use of digital channels among different customer groups	64.48%	60.28%	60.25%
Share of loans issued to companies established outside Harju County	38.6%	43.8%	40.7%
Share of retail customer base outside big cities (Tallinn, Tartu, Pärnu)	32.1%	31.3%	30.6%
Success rate of applications	52.94%	55.13%	-
Share of retail loans issued outside big cities (Tallinn, Tartu, Pärnu)	21.8%	21.5%	21.0%
Share of corporate banking loan portfolio to education and public administration projects	6.2%	10.3%	0.2%
Share of corporate banking loan portfolio to local governments	5.9%	9.0%	0

3. Financial literacy and economic sense of security			
Coverage of young people (up to 26 years old) with investment products	45.7%	29.8%	28.8%
Share of customer base with native language other than Estonian	15.3%	13.9%	13%
Share of use of investment products agreement among clients with native language other than Estonian	22.8%	17.8%	16.5%
Private customers with an investment services contract	41.1%	30.8%	29.2%
Private customers with a growth account agreement	14.9%	10.1%	7.6%
Total number of Investment School attendees	12,000	7,420	6,000
Number of microloans	1,001	948	-

4. Honest and transparent organizational culture			
Confirmed incidents of corruption and actions taken	0	0	0
Customer satisfaction index	95.8%	94.9%	93.5%
Number of legal proceedings pending against the company as of end of year	1	0	0
Proportion of female employees in LHV Pank	60%	60%	-
Percentage of female employees in leadership positions	48.3%	-	-
The ratio of LHV Pank CEO's salary to median FTE salary at LHV	4	-	-
Employee satisfaction indicator	4.5	4.6	-

Consolidated financial statements

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, responsible for ownership, continuous review and implementation of a robust risk management framework in the Group, including ownership of the relevant methodologies defined in the policies and holistically ensuring identifying, assessing, measuring, managing, mitigating, and monitoring and reporting on risks is well executed in the Group.

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 independent Risk Management Unit, LHV has developed a group-wide risk appetite framework, approved by the Supervisory Board. The risk appetite reflects LHV readiness to take certain kinds of risks. The larger the risk appetite, the more risk can be assumed. The risk appetite is set to reflect the desired risk profile, reflecting the nature of the LHV business model.

Risk framework

Risk management principles, roles and responsibilities

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

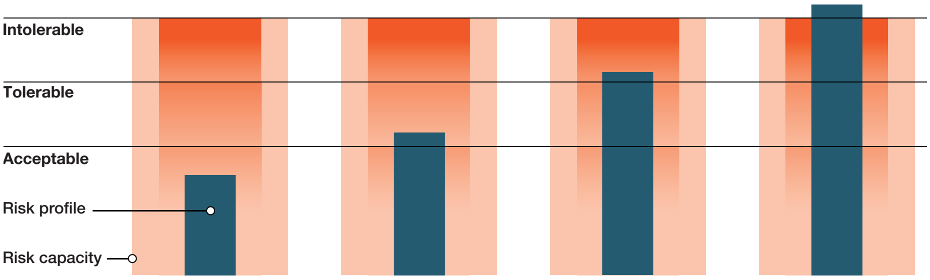
Goals, measures and controls

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

Internal and external reporting, disclosure

Risk appetite is defined as a Risk Appetite Statement for all risks that the LHV is materially exposed to. Risk appetite is defined both by qualitative guidance and quantitative limits, considering the following principles:

- The qualitative guidance is worded in simple terms and in close connection with the terminology commonly used in the organization and in the business plan.
- The quantitative limits as a part of risk appetite are set at a sufficiently detailed level, to capture key sub-categories of addressed risks, but at a sufficiently aggregated level to maintain each metric of importance to the group-wide risk profile of LHV. Where it is possible to quantify the risk, there is accordingly defined the acceptable, tolerable, and intolerable amount of risk.
- Acceptable level is the amount of risk that is allowed to be taken under normal business conditions.
- Tolerable is the amount of risk that represents a warning indicator, the increase of risk must be properly assessed, and action plan defined to return to the acceptable area; the assessment and action plan reported at least to the Management Board of LHV.
- Intolerable limit reflects the amount of the risk LHV does not want to breach under any circumstances, that represents a hard limit violation, immediate action must be taken to return at least to the tolerable area; violation, assessment and action plan reported to the Supervisory Board of LHV.



The actual risk profile is inside the acceptable range. Risk profile is under control and no specific action needed.

The actual risk profile is inside tolerable range which indicated early worning signal. Action plan to the management is needed.

The actual risk profile is inside the intolerable range. Action plan has been launched to reduce the risk profile.

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

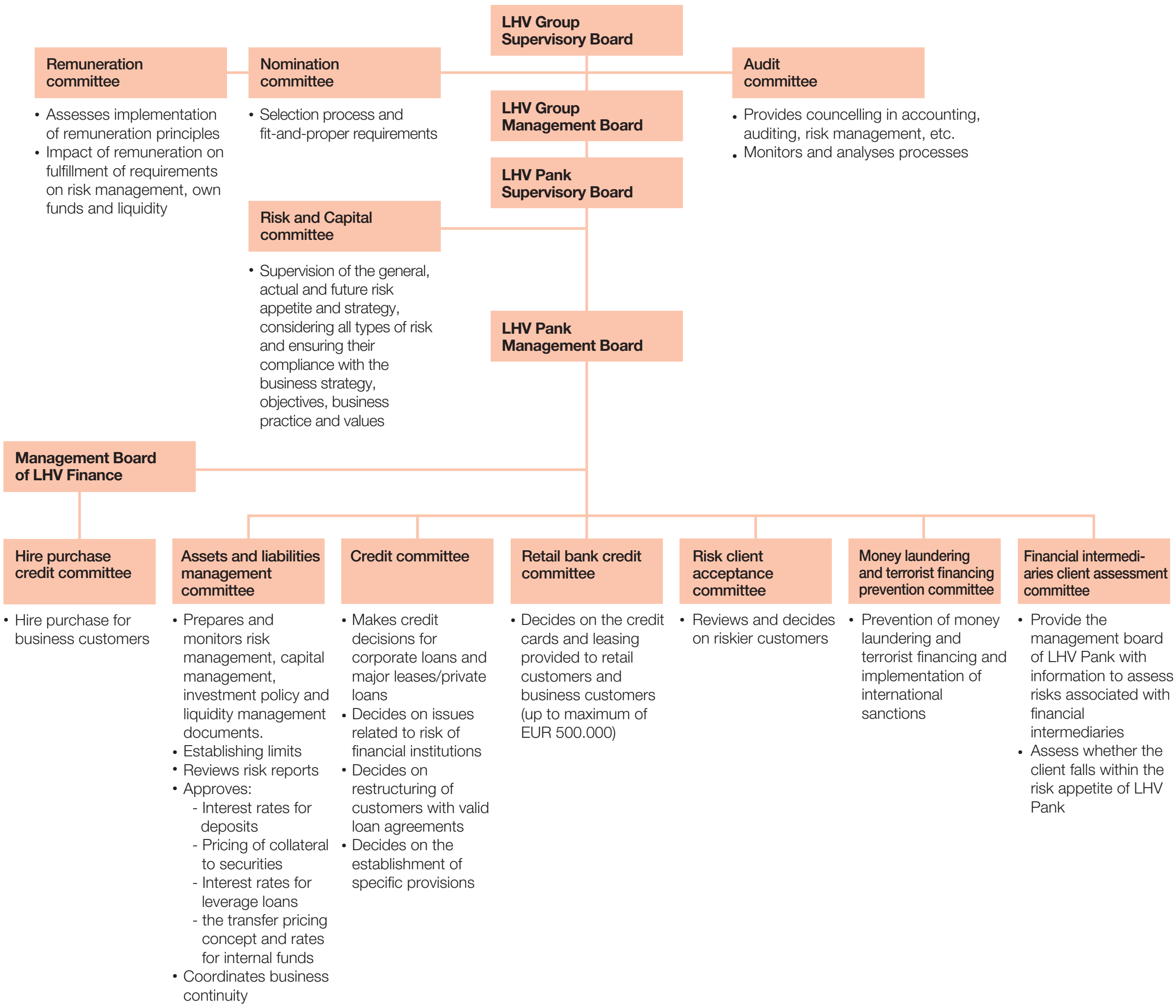
Risk capacity – is the maximum amount of risk LHV is capable to take given its capital base, its risk management and control capabilities, and its regulatory constraints.

Risk appetite means the aggregate level and types of risk LHV is willing to assume within its risk capacity, in line with its business model, to achieve its strategic objectives.

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

As seen from the figure, if the actual risk profile remains within the limits of the acceptable risk appetite range, it is a foreseeable situation and no further action is needed. If the actual risk profile is inside tolerable risk appetite range, it is an early warning signal and an action plan is put in place to reduce the risk profile. It is also necessary to inform the Management Board in that case. If the actual risk profile is above tolerable level, it indicates that risk appetite level is exceeded and an action plan has been 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 quantitative risk appetite levels must be specified at minimum for capital risk, credit risk, market risk, operational risk, liquidity risk and money laundering risk. The limits of risk appetite 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, operational 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 Bank	All the members of the supervisory board of the Bank	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operational risk, anti-money laundering risk, monitoring of legislation
		Risk management overviews	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 Bank	Rain Lõhmus, Andres Viisemann, Tiina Mõis Madis Toomsalu	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operational risk, anti-money laundering risk, monitoring of legislation
		Problematic loan customers	Quarterly	Credit risk
Audit committee	Kristel Aarna, Urmas Peiker, Tauno Tats	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operational risk, anti-money laundering risk, monitoring of legislation
CEO of the Group, Chairman of the Supervisory Board of the Bank	Madis Toomsalu	Risk report	Monthly	Credit risk, market risk, interest risk, The liquidity risk, operational risk, anti-money laundering risk, compliance risk, monitoring of legislation
Asset and Liability Committee of the Bank	Management board members of the Bank, Kadri Haldre	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operational risk, anti-money laundering risk, compliance risk, monitoring of legislation
		Business continuity test and planning	After every test	Operational risks
		Risk self-assessment	After assessment	Operational risks
Management Board of the Bank	Management board members of the Bank	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.

Within the overall risk management framework, separate risk types are managed via dedicated frameworks. As the business model of LHV and the external environment is continuously developing, the type and size of LHV's risk exposures is continuously changing. Accordingly, the risk management framework is continuously adapted as well.

Specifically, the risk management framework is created in consideration of the relative materiality of the current and estimated future risk exposures, as illustrated in the risk heat map on the right. Risk types where exposures are material, i.e. the possible losses are substantial and the likelihood of such losses materializing is higher, are managed more closely. The specific framework elements, including methodology, processes, tools, people, and perimeter of application, reflect the specific nature of these risks.

The frameworks for addressing the main risk types the Group is more materially exposed to, including solvency risk, credit risk, market risk, liquidity risk, and operational risk, are in detail described in the following sections.

Within the overall risk management framework, dedicated attention is devoted also to ESG risk management, i.e., managing the risk of losses resulting from current or prospective impacts from environmental, social and/or governance factors. LHV recognizes the growing materiality of this risk going forwards and is strengthening its risk management framework accordingly.

This includes, similarly to all material risk categories, definition of risk appetite and ensuring the Group stays within that risk appetite. Where appropriate, ESG perspective is included in the aspects of risk management framework directly addressing credit, market, operational, liquidity and funding, and strategic risk. Definition of a common taxonomy and consideration of emerging regulation and best practice are parts of strengthening this framework. LHV maintains a no-go list of industries and types of transactions that are not eligible for financing due to negative environmental or social impact.

1. Capital management

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. The capital of banks and investment firms in the European Union are 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 defines 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. Due to COVID-19 pandemic the implementation has partially been postponed and now completely updated regulation will be valid started from 2025.

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 31.12.2021 was EUR 331,035 thousand (31.12.2020: EUR 289,478 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 capitalized 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 core tier 1 own funds, because only core tier 1 own funds can absorb losses. All other capital layers in use are dependent of core 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;

- MREL ratios can be fulfilled with suitable liabilities instead of own funds.

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 minimizing 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)	31.12.2021	31.12.2020
Paid-in share capital	111,500	106,500
Statutory reserves transferred from net profit	5,648	4,022
Accumulated profit/(deficit)	91,126	62,972
Intangible assets (subtracted)	-1,243	-807
Net profit for accounting period (COREP)	37,249	32,514
Deductions	-1,317	-4,223
Tier 1 own funds	**242,963**	**200,978**
Additional Tier 1 capital	38,000	38,000
Total Tier 1 capital	**280,963**	**238,978**
Subordinated debt	50,072	50,500
Total Tier 2 own funds	**50,072**	**50,500**
Total net own funds	**331,035**	**289,478**

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), systematically importance buffer 1.5% (imposed by Bank of Estonia). Another two buffers systematic risk buffer and contra-cyclical buffer imposed by Bank of Estonia are currently set at 0.0% and (imposed by Financial Supervisory Authority), respectively. In addition, grouping of the capital requirements has 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.

LHV has received the SREP report in early 2022. An overview of capital requirements based on that report is provided in the table below:

Requirements	CET1	Tier 1	CAD
Base capital requirement	4.50%	6.00%	8.00%
Pillar 2 capital charge	1.54%	2.06%	2.74%
Total SREP capital requirement	**6.04%**	**8.06%**	**10.74%**
Capital conservation buffer	2.50%	2.50%	2.50%
Systemically importance buffer	1.50%	1.50%	1.50%
Systemic risk buffer	0.00%	0.00%	0.00%
Contra cyclical buffer	0.00%	0.00%	0.00%
Capital requirements total	**10.04%**	**12.06%**	**14.74%**

In addition to Capital requirement FSA has set Pillar 2 guidance for LHV at 1.00% on each capitalization level. LHV is fulfilling this as part of internal buffers.

LHV has been keeping conservative approach in capital management and keeps additional internal buffers compared to regulatory ones. Capitalization requirements have been increased mainly due to increasing market share of the Bank. In 2018 LHV was considered as one of four systematically important bank in Estonia and in 2021 Bank of Estonia increased the systematically importance buffer from 1.00% to 1.50% for LHV.

Starting from 2022 LHV has to fulfil om group consolidated level two separate MREL requirements, one against risk weighted assets and the other against total assets. The first one MREL-TREA has been calibrated to 19.08% level and second one to 5.91% level. Each year FSA will recalibrate the MREL requirements.

Internal capital adequacy targets for 2022 are as follows:

- Core Tier 1 capital adequacy 11.50% (11.40% in 2021)
- Tier 1 capital adequacy 13.50% (12.10% in 2021)
- Total capital adequacy 16.50% (16.00% in 2021)
- Leverage ratio 3.50% (not changed)

The Group uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement. The Group and its subsidiaries have complied with all capital requirements during the financial year and in previous years.

Each year, the Group's Supervisory Board confirms the goals of capitalization 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.

Capital adequacy and the use of regulatory capital are managed by the Finance Department based on the prudential reporting for capital requirements submitted regularly to supervision. The Bank follows both regulatory requirements and Group capitalization targets in daily capital management.

2. Credit risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, customers 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 risks for the Group's business; management therefore carefully manages its exposure to credit risk. A central principle for LHV is that each of LHV´s credit business units have full responsibility for their credit risks, that credit decisions adhere to the credit process and decisions are in line with LHV`s business and credit strategies. The credit risk management and control are distributed across the three lines of defence, including concentration of responsibilities in a dedicated independent credit risk management unit which reports regularly to the Management Board and Supervisory Board. Since 01.01.2022 the dedicated credit risk management unit directly reports to the CEO of LHV Pank. The responsibilities of the dedicated credit risk management unit include debt and risk assets management, real estate collateral assessment, corporate (exposure to LHV > EURt 500) credit risk analysis and first line credit control and monitoring units.

Depending on the size and nature of each credit the credit process is performed based on the principle that low-risk credits can be approved through more cost efficient and faster credit process and for riskier and larger exposures more in-depth analysis and process is carried out. Accordingly, the lending decisions are made by credit committee (exposures > EURt 500), by retail banking credit committee or by lower decision level which includes decisions made by credit officers or fully automated decisions made by system for small financing. For credit decisions either rating or scoring systems are used to assess customer credit risk (see sub paragraph 2.1 credit risk measurement). In the credit decision-making process LHV considers important to take into account the principles of responsible lending and sustainability, including environmental considerations, social responsibility, and business ethics (see also sub paragraph General ESG principles).

For early identification of significant increase in credit risk a continuous monitoring is carried out after issuing the credit. Quarterly monitoring is performed based on the customer´s financial position for corporate customers (exposure to LHV > EURt 500). In addition to that also information from external sources like credit bureaus, tax office and other public registers are used. At least annually all ratings of corporate customers, financial institutions and sovereigns are individually reviewed. Customers with significant increase in credit risks are listed in watchlist. The financial position, liquidity and collateral value of watchlist customers is thoroughly monitored and overview is given to credit committee on a monthly basis. For retail business, after the date of initial recognition 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. The management of customers with increased credit risk in retail portfolio is generally based on the customer´s payment behaviour.

The Group employs a range of policies and practices to mitigate credit risk. 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 realization 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. Collaterals for loans with higher credit risk is more frequently revalued.

Covid-19 impact

The coronavirus outbreak, which started 2020, had significant impact both on LHV and its customers in 2020. A swift and coordinated response from monetary, fiscal and regulatory authorities substantially smoothed the potential impact for the whole economy.

The measures included, in many instances, some forms of moratorium on payments of credit obligations, with the aim of supporting the short-term operational and liquidity challenges faced by borrowers.

On the onslaught of the Covid-19 crisis, LHV quickly and proactively offered to its customers moratoria on payments which took away the immediate pressure from the customers and offered them to pile up the necessary reserves. The peak of payment holidays was reached in summer 2020 and almost all customers have returned to scheduled repayments and which has not led to deterioration of credit quality.

From credit risk measurement side, LHV continued using conservative approach in credit risk measurement. LHV decided not to use any of the temporary regulatory measures allowing not changing customer risk treatment for the customers to whom payment holidays were given within the framework of a public payment moratorium. Which means that most of these customers were classified as forborne or default (distressed restructuring) exposures and which had significant impact on the increase in the share of IFRS 9 stage 2. Despite of the fact that almost all customers have returned to scheduled repayments without having any difficulties to servicing their obligations, then as the minimum probation period of forborne exposures is 2 years after the end of payment holiday, then the earliest reclassification for these exposures can take place in 2022 and 2023 depending on the initial length of the payment holiday (3-12 months). This decision was based on the fact that LHV Group shares are listed and it would have made more difficult for investors to understand the actual financial results.

ESG risks in credit risk

There is increasing evidence that ESG factors can affect credit risk and therefore ESG considerations have become increasingly important in Group credit risk decision processes including risk appetite principles, policies, and procedures.

ESG risks are defined in the context of this chapter as risks of any negative financial impact on the group stemming from the current or prospective impacts of ESG factors on its counterparties or invested assets. Environmental risk drivers are categorised as physical risks and transition risks. Physical risks are direct negative impacts proceeding from climate change and environmental degradation, which could result in reduced production capacity, increased raw material costs, asset impairment, increased labour, and capital costs, etc. Transition risks refer to the uncertainty related to the timing and speed of the process of adjustment to an environmentally sustainable economy. This process may be affected by three drivers: policy, technology, and consumer preferences. The main changes in this field are happening in carbon-intensive sectors (e.g. climate-related policy actions may have impact on asset prices). Social risks involve social factors that may have a positive or negative impact on the financial performance or solvency of a counterparty such as the rights, well-being and interests of people and communities including (in)equality, health, inclusiveness, labour relations, workplace health and safety, human capital, and communities.

ESG risks can materialise in two ways, reflecting their potential double materiality. Financial institutions can be impacted by (outside-in perspective) ESG risks through their counterparties and invested assets, as these may be impacted by (outside-in perspective) or have an impact on (inside-out perspective) ESG factors. For example, a counterparty's environmentally harmful business activities (negative inside-out impact on environmental factors) might make it more vulnerable to the implementation of transition policies targeting environmental degradation (negative outside-in impact of environmental factors).

Considering the impact of its business activity, LHV has set a goal to promote an environmentally and socially sustainable and responsible economy and expedite progress toward solutions to key environmental and climate problems, by motivating customers to make more sustainable choices in their business activities and investment decisions.

Areas of activity that conflict with the principles of environmental and social responsibility, LHV will refrain from knowingly offering credit products to customers whose activities bear clear evidence of human rights violations and serious environmental harm. Based on the principles of sustainable and responsible activity, it is against credit policy to credit customers whose volume of credit products from LHV exceeds EUR 500 thousand and whose operating activity is related to any of the areas listed in Exclusion list in the table below.

Field of activity	Description
Forestry	Those engaged in illegal logging
Well-being of endangered plant and animal species, animals	• Those engaged in trading in endangered or Red List plant and animal; • Those engaged in illegal animal testing as defined by European Union legal acts; • Activities related to the forcible feeding of ducks and geese; • Keeping of animals for the purpose of fur production
Arms industry	Those whose area of activity is the production or distribution of weapons or weapons components prohibited under international law (cluster bombs, infantry mines, biological and chemical weapons, nuclear weapons, laser weapons designed to cause permanent blindness)
Energy industry	• Coal and oil shale mining and generation of electricity from them; • Activities in the preliminary phase of the oil production chain
Hazardous materials	• Asbestos mining and production, marketing and use of asbestos fibres and products and compounds containing these fibres; • Export of mercury and mercury compounds and the production, export and import of many mercury containing products
Tobacco	Distribution of tobacco products or e-cigarettes if it is the primary area of activity of the company (>50% of revenue)
Fishing	Practising ecologically unsustainable fishing methods, such as drifting nets, deep sea bottom trawls, use of explosives or cyanide
Transport	• Transport of oil or other hazardous materials on ships that do not meet the requirements of the International Maritime Organization; • Financing new diesel-powered passenger cars in 2030 or later

General ESG principles

- production and trading of all goods that are illegal under the laws and regulations of the Republic of Estonia or international conventions and agreements;
- use of forced labour or human rights violations;
- facilitation of prostitution or production of pornographic material;
- distribution of prohibited substances and trading without required export or import licences;
- activities that have a negative impact on UNESCO World Heritage sites;
- activities that have a negative impact on national parks and natural protection areas or wetlands covered by the Ramsar Convention;
- activities prohibited under the legal acts of the Republic of Estonia or international conventions related to protection of biological diversity resources or cultural heritage;
- illegal forced expulsion of persons, groups of communities.

In the lending process ESG risks are taken into consideration in loan reviews. A detailed ESG risks analysis is done for corporate loan applications over EUR 0.5 million. For other customers a basic assessment of ESG factors is made based on the nature and complexity of the loan product and customer's activity. In order to identify borrowers that are exposed, directly or indirectly, to increased risk associated with ESG factors, comprehensive heat map of ESG risks for individual economic (sub)sectors was developed in cooperation with environmental and social field experts. The heat map highlights environmental and social risks assessment for each individual economic sector taking into account corresponding risk classifications of rating agencies and international financial institutions as well as local and EU regulations and Estonian national dimension there relevant.

Overview of LHV credit portfolio by E&S risks classification of economic sectors is given in the table below.

Focus area	Risk level	2021
Environmental and climate change risk (E)	High	14.0%
	Medium	51.2%
	Low	34.7%
Social (S)	High	14.7%
	Medium	56.1%
	Low	29.2%

Development of the Bank's ESG analysis procedures and tools for corporate customers took place during the year and is expected to carry over into next year.

2.1 Credit risk measurement and distribution

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) loans to legal entities

d) loans to individuals

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.

If Estonian local 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 and as the Group holds only very liquid positions with the counterparties.

b) Debt securities and derivatives

The Credit Committee sets limits for taking credit risk associated with debt securities considering the issuer's rating.

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

c) Loans to legal entities

Loan portfolio of legal entities includes credit to companies, local governments, non-profit association (incl. apartment associations) etc, including the following products:

- corporate loans (corporate lending)
- leasing
- overdraft (corporate lending)
- trade finance (corporate lending)
- leveraged loans (investment financing)
- credit cards and hire-purchase (consumer financing)
- apartment association loans (corporate lending)
- credit letters (consumer financing)

Credits to legal entities (except apartment association loans) with total exposure to LHV more than EUR 500 thousand are evaluated on individual basis. Each customer is assigned a credit rating between 1 and 13, where 1 means the lowest probability of default (PD) 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, local government, 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 usually at least quarterly for each customer's financial position. At least annually all customer ratings are reviewed. Customers with significant increase in credit risks are listed in watchlist. The financial position, liquidity and collateral value of watchlist customers is thoroughly monitored more frequently.

Credits below EUR 500 thousand to legal entities and loans to apartment association irrespective of loan amount 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.

d) Loans to private individuals

Loan portfolio to private individuals includes secured, unsecured credit and leasing products to private individuals, including following products:

Product	Explanation
mortgage loans (private lending)	secured loan for acquiring an apartment, house (home loan)
private loans (private lending)	secured loan for free use (investment activity, renovation etc)
consumer loans (consumer financing)	unsecured consumer loan (issuer subsidiary LHV Finance AS)
hire-purchase (consumer financing)	unsecured instalment payment product offered by merchants (credit issuer subsidiary LHV Finance AS)
leasing	leasing for the purchase of vehicles
leveraged loans (investment financing)	loan against the collateral of publicly traded securities
credit card loans (consumer financing)	unsecured credit card loan
overdraft (private lending)	unsecured overdraft
study loan (private lending)	loan to students with state guarantee
real estate leasing (private lending)	mortgage loan (property is owned by LHV)

Credits to private individuals are also analysed with a cost-efficient scoring process (please see sub-chapter "Credit risk grading" for input of the private PD models). The scoring process is carried out at the time of loan application and it is one of the criteria for issuing the credit. Credit decisions are made by the Retail Banking Credit Committee or by lower decision level. The maximum loan amount of mortgage loans is in line with the regulations set by Central Bank of Estonia. Consumer financing products to private individuals are offered through its subsidiary LHV Finance in Estonia. 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.

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. For credit decisions in corporate segment (exposure to LHV > EURt 500) customer rating is used and in retail application scoring 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 thousand	Rating models	Model	Model
Retail	SME, incl. micro enterprises	Loans to companies with total exposure to LHV <= EUR 500 thousand, loans to apartment association irrespective of total exposure to LHV	Scoring models		
	Private mortgage	All mortgage loans to private individuals	Scoring models		
	Private non-mortgage	All consumer financing products and car leasing to private individuals	Scoring models		

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 or scoring models tailored to the various categories of counterparty. Different risk characteristics are used for different types of exposures to assess the borrower's credit risk:

1) obligor risk characteristics

- for corporate exposures: financial statements, industry type, support from parent company etc.
- for retail exposures: financial statements or personal income information, socio-demographic information, behavioural information etc.

2) transactional risk characteristics - type of product, type of collateral etc.

3) delinquency characteristics from internal and external sources.

In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each counterparty. 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**

In retail portfolio, risk assessment is done on credit facility level and final scoring is mapped to PD. 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.

- **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 at least 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 based on 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.

- **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.

Ratings are divided into three groups: investment grade, special monitoring, and default. Investment grade is allocated when the counterparty is not overdue as at balance sheet date. Special monitoring status is allocated when the rating of the counterparty is 10-13. Rating 13 (default status) is based on the definition of default principle.

Collateral

The Group employs a range of policies and practices to mitigate credit risk. 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 realization and liquidity.

Expert evaluations are used to evaluate immovables. 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 over the right of claim
- Guarantee of KredEx Fund, Rural Development Foundation or European Investment Fund
- Letter of credit
- Surety of private person or legal entity
- Vehicle, machinery, aircraft, equipment etc.

The preferred collateral is where there is no strong correlation between the customer'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.

Collaterals for leveraged loans are monitored on a daily basis and, if collateral value is falling, immediate measures are taken to avoid credit losses. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of customers payment behaviour. Leasing and mortgage loans are all over-collateralized. The Group monitors customers in arrears of leasing, hire purchase, mortgage loans and overdraft to private individuals on regular basis.

In relation to under-collateralized 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-collateralized 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.

2.2 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 point 2.2.1 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 section 2.2.2 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 ECLs that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on ECLs on a lifetime basis. Please refer to section 2.2.3 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. Section 2.2.4 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.

2.2.1 Significant increase in credit risk

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

Quantitative criteria

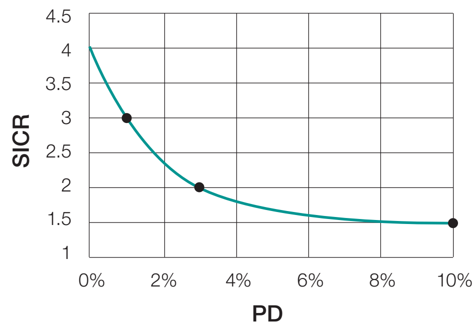
Quantitative criteria are applied to all credit contracts initiated since 2018 in the current portfolio and wholesale legacy portfolio, for which a rating-based Lifetime PD is used.

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

Current portfolio – contracts initiated from 1st January 2018

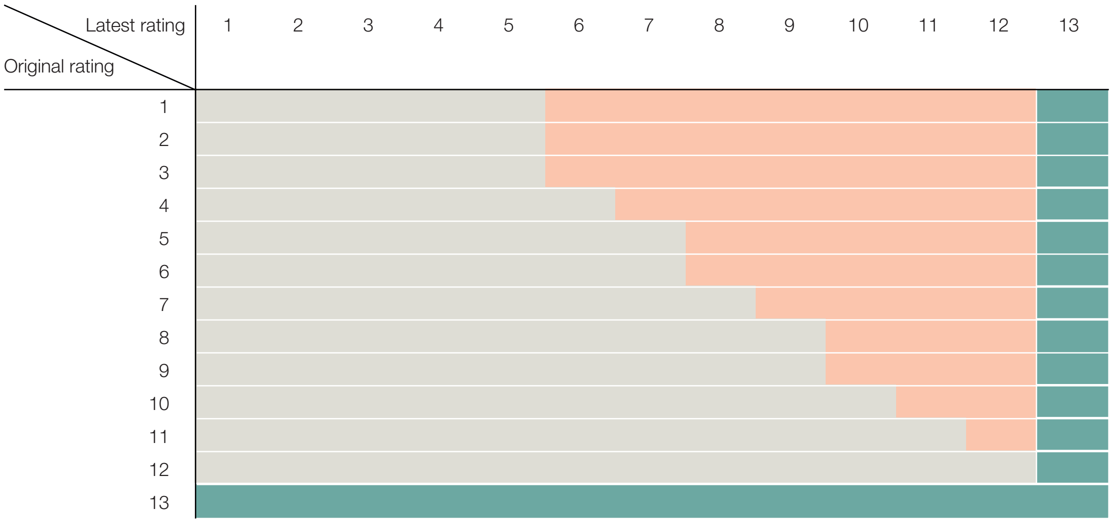
Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
X%	≥100 bps
And	Current PD_life/Initial PD_life > 1.4885+exp(0.9549-54.173*Initial PD_life)

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 shows the 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 SICR 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 SICR. The average maturity of the corporate portfolio is short, namely 2.5 years.

Qualitative criteria

Qualitative criteria are applied in SICR calculation to legacy retail portfolio that was initiated before 2018. For the current portfolio, the qualitative criteria are 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 01 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 SICR:

- 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 SICR:

- 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 over the last 12 months.

The assessment of SICR incorporates forward-looking information 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 SICR if the borrower is more than 30 days past due on its contractual payments.

Low credit risk exemption

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 2021 and 31 December 2020.

2.2.2 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 has breached materiality threshold in 90 consecutive days.

Qualitative criteria

The following circumstances are considered as indicators for the customer not to pay the debt in full:

- there are indications of unlikeliness to pay, which indicates the borrower is in significant financial difficulty;
- distressed restructuring has occurred;
- additional forbearance measures have been applied on probation period for existing forbearance measures;
- contract is terminated.

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 PD, EAD and 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 probation period should not be shorter than 3 months from the moment that the default criteria cease to be exist.

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;
- other end of grace period included in the restructuring arrangements.

2.2.3 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 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 PD for each period (the probability of a default between time periods t and t+1.

ECL calculations are based on four components:

- PD is an estimate of the likelihood of default over a given time horizon.
- 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.
- 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.

ECL	31.01.22	28.02.22	31.03.22	30.04.22	31.05.22	30.06.22	31.07.22	31.08.22	30.09.22
(1) Exposure (EAD)	4,000	3,500	3,000	2,500	2,000	1,500	1,000	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	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
(4) Potential loss amount [Max(0:1-3)]	2,000	1,500	1,000	500	0	0	0	0	0
(5) Expected marginal loss [2*4]	8.00	5.70	3.60	1.70	0.00	0.00	0.00	0.00	0.00
(6) Expected marginal loss, discounted	7.97	5.65	3.56	1.67	0.00	0.00	0.00	0.00	0.00
Lifetime ECL at 31/12/2021 [Sum (6)]	18.85								

Note. Discounting is done, assuming current reporting date 31.12.2021 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.

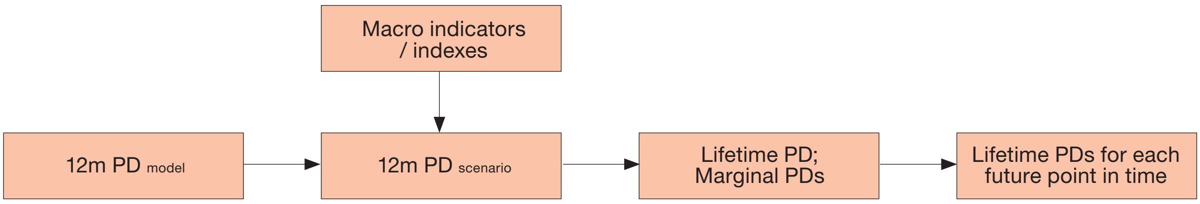
	IFRS 9 parameters
PD	• 12-month PD; lifetime PD broken down further into marginal probabilities for sub-periods • Forward looking PiT estimate, reflecting assessment of current and future economic conditions, and a range of possible future outcomes • No regulatory floors or margins of conservatism applied
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.

'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:



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

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.

'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.

'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.

2.2.4 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

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%
House price 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'.

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

Macroeconomic 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 macro analysts and experts from Risk Control, business and finance units.

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 2021 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 31.12.2021

	Base scenario		Downside scenario		Upside scenario	
General macro-financial indicators	**2022E**	**2023E**	**2022E**	**2023E**	**2022E**	**2023E**
Real GDP growth, %	**2.8%**	**3.9%**	**2.0%**	**3.0%**	**3.7%**	**4.1%**
Household consumption, %	4.0%	3.6%	3.5%	2.5%	6.0%	3.5%
Government consumption, %	-0.9%	-1.3%	0.0%	-0.4%	-1.2%	-0.8%
Gross fixed capital formation, %	-14.5%	6.9%	-15.0%	6.0%	-10.0%	8.0%
Exports of goods and services, %	4.9%	4.8%	3.0%	5.3%	6.5%	6.0%
Imports of goods and services, %	-0.9%	4.8%	-2.0%	5.3%	4.0%	4.2%
Nominal GDP, EURm	33,020	35,480	32,681	34,941	33,068	35,595
GDP deflator, % change	5.8%	3.4%	5.5%	3.8%	5.0%	3.4%
Consumer price growth, %	6.9%	3.0%	6.5%	3.5%	6.0%	3.0%
Unemployment rate, %	5.5%	5.3%	6.0%	5.8%	5.5%	5.0%
Change in employment, %	1.1%	0.6%	0.5%	0.8%	1.5%	0.2%
Net monthly wage growth, %	8.3%	8.0%	6.7%	6.0%	8.5%	8.0%
House price index growth, %	8.5%	8.0%	3.0%	5.0%	8.8%	8.2%
Euribor 6m	-0.5%	-0.2%	-0.5%	-0.5%	-0.5%	-0.2%
Bank lending margins on new loans (NFC)	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%

Nominal growth

	Base scenario		Downside scenario		Upside scenario	
Gross value added by sectors, y-o-y growth rates	**2022E**	**2023E**	**2022E**	**2023E**	**2022E**	**2023E**
Total - all NACE activities	**8.7%**	**7.5%**	**7.6%**	**6.9%**	**8.9%**	**7.6%**
Agriculture, forestry, and fishing	8.0%	0.1%	6.9%	-0.4%	8.2%	0.3%
Industry (except construction)	8.9%	7.5%	7.8%	6.9%	10.4%	6.4%
Industry, except construction and manufacturing (mostly energy related)	-0.1%	1.6%	-1.1%	1.1%	0.0%	1.8%
Manufacturing	11.8%	9.1%	10.6%	8.6%	13.6%	7.6%
Construction	5.4%	9.4%	4.3%	8.9%	5.5%	9.6%
Wholesale and retail trade, transport, accommodation, and food service activities	15.1%	7.5%	13.3%	7.5%	18.3%	4.9%
Information and communication	20.9%	10.0%	12.5%	11.0%	21.0%	12.8%
Financial and insurance activities	6.1%	7.5%	5.0%	6.9%	6.3%	7.6%
Real estate activities	10.0%	6.2%	8.9%	5.6%	10.2%	6.4%
Professional, scientific, and technical activities; administrative and support service activities	7.1%	7.5%	6.0%	6.9%	5.9%	9.0%
Public administration, defence, education, human health and social work activities	1.6%	7.5%	4.3%	3.0%	0.2%	9.3%
Arts, entertainment, and recreation; other service activities; activities of household and extra-territorial organizations and bodies	9.8%	7.5%	8.7%	6.9%	10.0%	7.6%

The weightings assigned to each economic scenario on 31 December 2021 were as follows:

Valid at 31.12.2021

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	60%	25%	15%

The weightings assigned to each economic scenario on 31 December 2020 were as follows:

Valid at 31.12.2020

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	60%	30%	10%

The most significant period-end assumptions used for the ECL estimate as at 31 December 2020 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 31.12.2020

	Base scenario		Downside scenario		Upside scenario	
General macro-financial indicators	**2021E**	**2022E**	**2021E**	**2022E**	**2021E**	**2022E**
Real GDP growth, %	**2.4%**	**4.5%**	**-1.1%**	**6.6%**	**4.5%**	**3.5%**
Household consumption, %	2.3%	4.1%	-1.1%	5.0%	4.5%	4.6%
Government consumption, %	-1.9%	0.6%	2.3%	0.8%	2.0%	1.5%
Gross fixed capital formation, %	3.2%	7.5%	-5.0%	9.0%	8.0%	4.5%
Exports of goods and services, %	3.5%	6.6%	-3.8%	9.3%	6.0%	3.5%
Imports of goods and services, %	4.2%	6.5%	-5.0%	9.0%	7.0%	4.5%
Nominal GDP, EURm	27,658	29,481	26,764	28,945	28,364	30,120
GDP deflator, % change	1.3%	2.1%	1.1%	1.7%	1.7%	2.6%
Consumer price growth, %	1.0%	1.9%	0.5%	1.5%	1.5%	2.3%
Unemployment rate, %	9.1%	8.2%	12.0%	10.0%	8.5%	7.5%
Change in employment, %	-1.1%	1.0%	-3.7%	2.2%	1.7%	1.0%
Net monthly wage growth, %	-0.6%	2.6%	-1.0%	1.6%	3.0%	4.2%
House price index growth, %	-5.0%	3.5%	-10.0%	2.1%	-3.0%	4.5%
Euribor 6m	-0.5%	-0.5%	-0.5%	-0.5%	-0.5%	-0.5%
Bank lending margins on new loans	3.1%	3.3%	3.3%	3.5%	3.0%	3.1%

Nominal growth

	Base scenario		Downside scenario		Upside scenario	
Gross value added by sectors, y-o-y growth rates	**2021E**	**2022E**	**2021E**	**2022E**	**2021E**	**2022E**
Total - all NACE activities	**2.6%**	**5.8%**	**-0.2%**	**6.8%**	**5.2%**	**5.4%**
Agriculture, forestry and fishing	4.1%	6.6%	0.3%	8.7%	6.8%	6.2%
Industry (except construction)	4.3%	7.3%	-0.3%	9.6%	7.6%	7.5%
Industry, except construction and manufacturing (mostly energy related)	0.8%	6.6%	-2.5%	8.1%	3.3%	6.2%
Manufacturing	5.3%	7.5%	0.3%	10.0%	8.8%	7.9%
Construction	-0.1%	8.0%	-3.3%	10.2%	2.5%	7.6%
Wholesale and retail trade, transport, accommodation, and food service activities	5.5%	8.3%	0.3%	10.7%	9.9%	7.3%
Information and communication	1.0%	3.8%	0.3%	6.8%	4.9%	3.5%
Financial and insurance activities	1.3%	1.6%	0.3%	5.7%	3.9%	1.3%
Real estate activities	2.8%	9.2%	-1.8%	9.5%	6.3%	8.8%
Professional, scientific, and technical activities; administrative and support service activities	-2.3%	2.7%	-5.5%	8.1%	0.2%	2.3%
Public administration, defence, education, human health and social work activities	0.0%	2.2%	1.6%	-2.6%	-3.0%	6.2%
Arts, entertainment, and recreation; other service activities; activities of household and extra-territorial organizations and bodies	8.0%	6.6%	-4.5%	18.4%	10.8%	6.2%

2.2.5 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 point 2.2.6).

Allowances based on individual assessments

Allowances based on individual assessments are formed, using discounted cash flow approach. The amount of the loan loss allowance is measured as the difference between the lending exposure’s carrying amount and the estimated future cash flows discounted at the effective interest rate. Individual loss allowance assessments are formed on a conservative basis to exposures of corporate customers which are classified as non-performing (default, rating 13) customers when the loan payments have not been collected by the due date and/or there is high uncertainty that expected cash flows from the realization of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments.

Minimum provisioning level for loans that become non-performing

All non-performing exposures where the expose was originated later than 26 April 2019 should have following minimum provisioning levels (percentage from exposure):

At the beginning of year	1	2	3	4	5	6	7	8	9	10
Unsecured exposure	0	0	35	100						
Secured (immovable property collateral)	0	0	0	25	35	55	70	80	85	100
Secured (other collateral)	0	0	0	25	35	55	80	100		
Export credit guarantee/insurance	0	0	0	0	0	0	0	100		

Where the terms and conditions of an exposure which was originated prior to 26 April 2019 are modified in a way that increases the exposure to the obligor, the exposure shall be considered as having been originated on the date when the modification applies.

In case non-performing exposure is only partly secured, then the unsecured part of non-performing exposure is considered as unsecured exposure and the provision level of unsecured exposure should is used for this part of non-performing exposure.

2.2.6 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 recognized as income.

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

Credit cards, consumer loan and hire purchase

- There has been no significant contribution in 12 months since the customer's insolvency (default) and the court proceedings relating to arrears have terminated to the Group's detriment or the customer fails to comply with the court decision;
- A bankruptcy has been announced to the customer or the customer has been declared insolvent;

- The court confirms the debt restructuring plan (the claim recognized 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 customer forwarded to the bailiff has a foreign address or none at all.

Leasing, private and business loans

- The customer does not voluntarily reimburse the Group's claim risen from the difference of original claim and the realization of the collateral.

2.2.7 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.

2.3 Credit risk exposure

The following tables contain an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group’s maximum exposure to credit risk on these assets. Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in Risk management section point 2.2 „Expected credit loss measurement“.

2.3.1 Risk concentration

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

31.12.2021

(in thousands of euros)	Note	Estonia	Germany	Other EU	USA	UK	Other	Total
Due from banks and investment companies	7	3,611,388	0	76,010	29,900	269,593	42	**3,986,933**
Financial assets at fair value	8	47,814	6	79,709	30	2	159	**127,720**
Loans and advances to customers	9	2,652,960	781	17,292	903	849	4,375	**2,677,160**
Receivables from customers	10	2,970	0	0	0	0	0	**2,970**
Other financial assets	11	117	0	0	2,119	0	0	**2,236**
Total financial assets		**6,315,249**	**787**	**173,011**	**32,952**	**270,444**	**4,576**	**6,797,019**
Amounts owed to central banks (TLTRO)	13	197,461	0	0	0	0	0	**197,461**
Deposits from customers	13	3,488,788	113,798	1,484,106	62,541	631,356	66,013	**5,846,602**
Loans received and debt securities in issue	13	349,063	0	0	0	0	0	**349,063**
Subordinated debt	16	88,989	0	0	0	0	0	**88,989**
Accounts payable and other financial liabilities	14	41,155	0	0	0	0	0	**41,155**
Financial liabilities at fair value	8	157	0	0	0	0	0	**157**
Total financial liabilities		**4,165,613**	**113,798**	**1,484,106**	**62,541**	**631,356**	**66,013**	**6,523,427**

31.12.2020

(in thousands of euros)	Note	Estonia	Germany	Other EU	USA	UK	Other	Total
Due from banks and investment companies	7	2,175,007	0	84,264	17,566	116,222	199	**2,393,258**
Financial assets at fair value	8	312,703	2	10,219	5	0	1	**322,930**
Loans and advances to customers	9	2,180,999	823	14,577	360	7,954	4,110	**2,208,823**
Receivables from customers	10	2,454	0	0	0	0	0	**2,454**
Other financial assets	11	122	0	0	1,951	0	0	**2,073**
Total financial assets		**4,671,285**	**825**	**109,060**	**19,882**	**124,176**	**4,310**	**4,929,538**
Amounts owed to central banks (TLTRO)	13	200,000	0	0	0	0	0	**200,000**
Deposits from customers	13	2,819,726	216,261	685,447	1,633	375,657	42,707	**4,141,431**
Loans received	13	248,825	0	19,759	0	0	0	**268,584**
Subordinated debt	16	88,500	0	0	0	0	0	**88,500**
Accounts payable and other financial liabilities	14	21,398	0	0	0	0	0	**21,398**
Financial liabilities at fair value	8	221	0	0	0	0	0	**221**
Total financial liabilities		**3,378,670**	**216,261**	**705,206**	**1,633**	**375,657**	**42,707**	**4,720,134**

2.3.2 Distribution of loans granted by industry

Distribution of net loans granted by industry is presented in the table below.

Distribution of legal entity financing by internal ratings

(in thousands of euros)	31.12.2021	%	31.12.2020	%
Individuals	1,009,927	37.7%	856,124	38.8%
Agriculture	68,459	2.6%	2,841	0.1%
Mining and Quarrying	2,019	0.1%	67,306	3.0%
Manufacturing	151,638	5.7%	73,123	3.3%
Energy	58,504	2.2%	57,737	2.6%
Water and Utilities	23,505	0.9%	495,953	22.5%
Construction	83,011	3.1%	16,336	0.7%
Wholesale and retail	131,630	4.9%	72,099	3.3%
Transport and logistics	28,752	1.1%	2,478	0.1%
Hotels and Restaurants	28,680	1.1%	151,668	6.9%
Information and communication	10,878	0.4%	43,129	2.0%
Financial services	85,505	3.2%	45,012	2.0%
Real estate	654,325	24.4%	87,714	4.0%
Professional, scientific, and technical activities	44,669	1.7%	27,413	1.2%
Administrative activities	114,446	4.3%	14,095	0.6%
Public administration	97,622	3.6%	12,656	0.6%
Education	4,328	0.2%	41,153	1.9%
Health	13,139	0.5%	120,805	5.5%
Art and entertainment	48,832	1.8%	13,230	0.6%
Other servicing activities	17,291	0.6%	7,952	0.4%
Total (Note 13)	**2,677,160**	**100.0%**	**2,208,823**	**100.0%**

2.3.3 Loan portfolio by ratings

Distribution of legal entity financing by internal ratings

(in thousands of euros)	31.12.2021	31.12.2020	Grading
3 low credit risk	0	5,696	Investment Grade
4 low credit risk	49,031	54,338	
5 low credit risk	64,896	96,302	
6 low credit risk	277,748	122,918	
7 medium credit risk	369,284	241,813	
8 medium credit risk	479,112	445,858	
9 heightened credit risk	184,268	167,041	
10 high credit risk	32,516	61,029	Non-investment grade (incl. special monitoring)
11 high credit risk	48,780	14,534	
12 non-satisfactory rating	19,111	20,379	
13 insolvent	1,619	6,311	Default
Total Corporates	**1,526,365**	**1,236,219**	
Retail SMEs	135,361	143,017	
Total	**1,661,726**	**1,379,236**	

Unused portions of corporate loans and financial guarantee limits are presented in the following table.

Credit quality of off-balance sheet liabilities
(unused loan commitments for corporate loans and financial guarantees)

(in thousands of euros)	31.12.2021	31.12.2020
3 very low risk	100,000	100,000
4 low credit risk	32,091	0
5 low credit risk	8,425	2,735
6 low credit risk	80,577	35,402
7 medium credit risk	143,825	37,332
8 medium credit risk	192,424	176,195
9 heightened credit risk	80,244	16,628
10 high credit risk	4,491	4,039
11 high credit risk	6,833	1,003
12 payments are delayed	103	747
13 insolvent	214	0
Non-rated (retail clients)	96,387	10,204
Total	**745,614**	**384,285**

2.4 Quality of credit portfolio

2.4.1 Distribution of loans by economic sectors and stages

The following tables present a breakdown of total loan portfolio by economic sectors and stages.

31.12.2021

(in thousands of euros)	Stage 1	Stage 2	Stage 3	Provision	Total
Individuals	886,127	114,863	11,328	-2,392	1,009,926
Agriculture	63,843	4,809	21	-214	68,459
Mining and Quarrying	923	1,114	0	-18	2,019
Manufacturing	125,985	26,328	255	-930	151,638
Energy	57,403	1,729	0	-627	58,505
Water and Utilities	23,172	573	0	-240	23,505
Construction	80,323	3,990	477	-1,778	83,012
Wholesale and retail	126,082	5,186	848	-486	131,630
Transport and logistics	25,730	3,057	101	-136	28,752
Hotels and Restaurants	5,526	25,036	159	-2,041	28,680
Information and communication	10,600	294	8	-24	10,878
Financial services	85,481	327	0	-303	85,505
Real estate	569,902	85,688	1,995	-3,260	654,325
Professional, scientific, and technical activities	39,062	5,344	482	-219	44,669
Administrative activities	113,860	3,698	155	-3,268	114,445
Public adminsitration	97,307	315	0	0	97,622
Education	4,035	275	31	-14	4,327
Health	9,766	3,441	3	-71	13,139
Art and entertainment	24,155	27,576	64	-2,963	48,832
Other servicing activities	16,463	856	38	-65	17,292
Total	**2,365,745**	**314,499**	**15,965**	**-19,049**	
Provision	-9,472	-7,444	-2,133		
Total loan portfolio	**2,356,273**	**307,055**	**13,832**		**2,677,160**

31.12.2020 *(in thousands of euros)*	Stage 1	Stage 2	Stage 3	Provision	Total
Individuals	761,422	92,491	4,228	-2,018	856,123
Agriculture	65,985	6,339	74	-299	72,099
Mining and Quarrying	2,082	420	0	-25	2,477
Manufacturing	116,695	36,075	198	-1,300	151,668
Energy	43,367	284	0	-522	43,129
Water and Utilites	2,014	824	9	-6	2,841
Construction	41,909	3,366	39	-303	45,011
Wholesale and retail	73,652	14,280	711	-928	87,715
Transport and logistics	24,844	2,679	11	-122	27,412
Hotels and Restaurants	5,554	10,918	0	-2,377	14,095
Information and communication	12,174	514	17	-49	12,656
Financial services	61,919	7,775	0	-2,388	67,306
Real estate	380,660	114,224	4,042	-2,974	495,952
Professional, scientific, and technical activities	30,025	11,205	448	-525	41,153
Administrative activities	57,513	14,155	2,799	-1,343	73,124
Public adminsitration	120,805	0	0	0	120,805
Education	16,072	332	0	-67	16,337
Health	7,037	6,298	1	-105	13,231
Art and entertainment	18,637	40,480	67	-1,447	57,737
Other servicing activities	7,535	450	27	-60	7,952
Total	**1,849,901**	**363,109**	**12,671**	**-16,858**	
Provision	-4,830	-10,011	-2,017		
Total loan portfolio	**1,845,071**	**353,098**	**10,654**		**2,208,823**

2.4.2 Distribution of loans by loan types and stages

The following tables explain the changes in the loss allowances as well as changes in stages by loan types between the beginning and the end of the annual period due to factors described in Risk management section point 2.2.

Total net loan portfolio by loan types and stages *(in thousands of euros)*	Stage 1	Stage 2	Stage 3	Purchased or Initiated Credit Impaired	Provision	Total
Corporate Lending	1,382,162	182,476	2,377	0	-15,288	1,551,727
Private Lending	777,868	107,810	9,949	0	-1,062	894,565
Leasing	120,117	18,848	2,162	0	-1,250	139,877
Consumer Financing	71,408	5,367	1,353	0	-1,320	76,808
Investment Financing	14,189	0	123	0	-129	14,183
Total as at 31.12.2021	**2,365,744**	**314,501**	**15,964**	**0**	**-19,049**	**2,677,160**
Corporate Lending	1,005,632	245,475	8,067	0	-13,447	1,245,727
Private Lending	665,989	80,705	3,674	1,124	-822	750,670
Leasing	101,187	27,269	395	0	-1,385	127,466
Consumer Financing	64,051	9,661	535	0	-1,179	73,068
Investment Financing	11,917	0	0	0	-25	11,892
Total as at 31.12.2020	**1,848,776**	**363,110**	**12,671**	**1,124**	**-16,858**	**2,208,823**

Stage 1

(in thousands of euros)	Initial	New	Unwind	Migration	Provision	Total
Corporate Lending	1,005,632	565,264	-216,800	28,066	-8,594	1,373,568
Private Lending	667,113	184,799	-66,357	-7,687	-221	777,647
Leasing	101,187	57,750	-37,613	-1,204	-281	119,839
Consumer Financing	64,051	39,037	-31,922	242	-364	71,044
Investment Financing	11,917	5,026	-2,754	0	-11	14,178
Total	**1,849,900**	**851,876**	**-355,446**	**19,417**	**-9,471**	**2,356,276**

Stage 2

(in thousands of euros)	Initial	New	Unwind	Migration	Provision	Total
Corporate Lending	245,475	10,721	-44,402	-29,318	-6,387	176,089
Private Lending	80,705	37,239	-10,719	585	-506	107,304
Leasing	27,269	4,512	-12,045	-888	-286	18,562
Consumer Financing	9,661	1,539	-4,549	-1,284	-266	5,101
Investment Financing	0	0	0	0	0	0
Total	**363,110**	**54,011**	**-71,715**	**-30,905**	**-7,445**	**307,056**

Stage 3

(in thousands of euros)	Initial	New	Unwind	Migration	Provision	Total
Corporate Lending	8,067	88	-7,030	1,252	-307	2,070
Private Lending	3,674	97	-924	7,102	-335	9,614
Leasing	395	14	-342	2,092	-683	1,476
Consumer Financing	535	111	-335	1,042	-690	663
Investment Financing	0	123	0	0	-118	5
Total	**12,671**	**433**	**-8,631**	**11,488**	**-2,133**	**13,828**

2.4.3 Transfers between stages

The following table explains the changes in the loan stages between the beginning and the end of the annual period due to factors described in Risk management section point 2.2.

Inter-stage transfers

(in thousands of euros)	1 > 2	1 > 3	2 > 1	2 > 3	3 > 1	3 > 2
Corporate Lending	34,149	144	62,359	1,108	0	0
Leasing	27,293	503	19,997	7,474	112	763
Private Lending	4,353	1	3,150	2,091	0	0
Consumer Financing	1,421	243	1,900	822	6	17
Investment Financing	0	0	0	0	0	0
Total	**67,216**	**891**	**87,406**	**11,495**	**118**	**780**

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2.4.4 Loans against collateral

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 31.12.2021 *(in thousands of euros)*	Corporate Lending	Consumer Financing	Investment financing	Leasing	Private Lending	Total
Listed securities	0	0	14,312	0	0	**14,312**
Unlisted equity securities	22,593	0	0	0	2,003	**24,596**
Mortgages, real estate	839,363	0	0	0	872,835	**1,712,198**
Guarantee of KredEx and Rural Development Foundation	42,578	0	0	0	9,812	**52,390**
Pledges of rights of claim	91,421	0	0	0	0	**91,421**
Deposits	3,176	0	0	0	2,000	**5,176**
Leased assets	0	0	0	77,857	0	**77,857**
Others	76,983	0	0	0	1,178	**78,161**
Unsecured loans	490,900	78,128	0	63,271	7,799	**640,098**
Total	**1,567,014**	**78,128**	**14,312**	**141,128**	**895,627**	**2,696,209**

Loans against collateral as at 31.12.2020 *(in thousands of euros)*	Corporate Lending	Consumer Financing	Investment financing	Leasing	Private Lending	Total
Listed Securities	0	0	11,917	0	0	**11,917**
Unlisted equity securities	14,888	0	0	0	1,024	**15,912**
Mortgages, real estate	670,484	0	0	0	735,067	**1,405,551**
Guarantee of KredEx and Rural Development Foundation	38,232	0	0	0	9,537	**47,769**
Pledges of rights of claim	63,810	0	0	0	0	**63,810**
Deposits	3,469	0	0	0	2,000	**5,469**
Leased assets	0	0	0	88,309	0	**88,309**
Others	78,018	0	0	0	0	**78,018**
Unsecured loans	390,272	74,247	0	40,543	3,864	**508,926**
Total	**1,259,173**	**74,247**	**11,917**	**128,852**	**751,492**	**2,225,681**

(in thousands of euros)	Over-collateralised loans Carrying value	Over-collateralised loans Fair value of collateral	Under-collateralised loans Carrying value	Under-collateralised loans Fair value of collateral	Total Carrying value	Total Fair value of collateral
As at 31.12.2021	**1,273,470**	**2,445,616**	**1,422,740**	**782,907**	**2,696,210**	**3,228,523**
Corporate Lending	472,856	880,020	1,094,160	603,640	1,567,016	1,483,660
Consumer Financing	0	0	78,128	0	78,128	0
Investment Financing	14,189	150,842	123	0	14,312	150,842
Leasing	17,607	31,903	123,521	60,251	141,128	92,154
Private Lending	768,818	1,382,851	126,808	119,016	895,626	1,501,867
As at 31.12.2020	**964,450**	**351,235**	**1,261,231**	**448,867**	**2,225,681**	**800,102**
Corporate Lending	371,650	794,170	887,523	328,285	1,259,173	1,122,455
Consumer Financing	0	0	74,247	0	74,247	0
Investment Financing	11,917	233,811	0	0	11,917	233,811
Leasing	16,625	26,134	112,226	59,575	128,851	85,709
Private Lending	564,257	1,254,497	187,235	61,007	751,492	1,315,504

As at 31.12.2021 (in thousands of euros)	Over-collateralised loans Carrying value	Over-collateralised loans Fair value of collateral	Under-collateralised loans Carrying value	Under-collateralised loans Fair value of collateral	Total Carrying value	Total Fair value of collateral
Stage 1	**1,106,892**	**2,175,002**	**1,258,854**	**675,832**	**2,365,746**	**2,850,834**
Corporate Lending	410,800	782,179	971,362	521,248	1,382,162	1,303,427
Consumer Financing	0	0	71,408	0	71,408	0
Investment Financing	14,189	150,842	0	0	14,189	150,842
Leasing	14,069	25,801	106,049	51,226	120,118	77,027
Private Lending	667,834	1,216,180	110,035	103,358	777,869	1,319,538
Stage 2	**154,808**	**246,017**	**159,693**	**105,495**	**314,501**	**351,512**
Corporate Lending	60,502	94,752	121,974	81,813	182,476	176,565
Consumer Financing	0	0	5,367	0	5,367	0
Investment Financing	0	0	0	0	0	0
Leasing	3,229	5,522	15,619	8,029	18,848	13,551
Private Lending	91,077	145,743	16,733	15,653	107,810	161,396
Stage 3	**11,771**	**24,597**	**4,193**	**1,580**	**15,964**	**26,177**
Corporate Lending	1,554	3,089	823	579	2,377	3,668
Consumer Financing	0	0	1,353	0	1,353	0
Investment Financing	0	0	123	0	123	0
Leasing	309	579	1,853	996	2,162	1,575
Private Lending	9,908	20,929	41	5	9,949	20,934

2.4.5 ECL sensitivity analysis

The following tables show the impact on the 31 December 2021 and 31 December 2020 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognised.

Loan portfolio 2021

(in thousands of euros)	Effect on impairment
+10% Change in SICR	-158
-10% Change in SICR	482
SICR with 0.5% threshold	1
SICR with 1.5% threshold	-1

Loan portfolio 2020

(in thousands of euros)	Effect on impairment
+10% Change in SICR	155
-10% Change in SICR	127
SICR with 0.5% threshold	0
SICR with 1.5% threshold	-1

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.

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 purpose of the sensitivity tests is to show the effect of changing the weights of positive and negative scenarios. Thus, in the sensitivity tests, the weight of the baseline scenario is retained and two tests have been carried out, where the weights of the positive and negative scenarios have been changed by +/- 5% respectively. The table below illustrates the impact of changing scenario weights of positive and negative scenarios to the portfolio as it was at 31 December 2021 and 31 December 2020.

31.12.2021 *(in thousands of euros)*	**60-10-30** (base/up/down)	**60-20-20** (base/up/down)
Change in scenario weights	671	-724

31.12.2020 *(in thousands of euros)*	**65-5-30** (base/up/down)	**65-15-20** (base/up/down)
Change in scenario weights	1,048	-1,127

Set out below are the changes to the ECL as at 31 December 2020 and 31 December 2021 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):

31.12.2021 *(in thousands of euros)*	Impact of increase	Impact of decrease
Unemployment rate +/-1%	115	-84
Wage growth +/- 5%	-112	111
Euribor +/-0.5%	26	-15
Bank lending margins +/-0.5%	165	-136
Consumer price growth +/-1%	-12	32
House price index +/- 2%	-5	3
Gross value added by sectors, yoy growth rates +/- 5%	-109	139

31.12.2020 *(in thousands of euros)*	Impact of increase	Impact of decrease
Unemployment rate +/-1%	51	-66
Wage growth +/- 5%	-99	38
Euribor +/-0.5%	9	-15
Bank lending margins +/-0.5%	39	-129
Consumer price growth +/-1%	-41	24
House price index +/- 2%	-3	2
Gross value added by sectors, yoy growth rates +/- 5%	-52	48

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.

2021 *(in thousands of euros)*	Impact on loss allowances
LGD negative 0.85	603
LGD negative 0.95	-686
Average PiT PD -0.5%	-3,042
Average PiT PD +0.5%	3,321

2020 *(in thousands of euros)*	Impact on loss allowances
LGD negative 0.9	812
LGD negative 1.0	-756
Average PiT PD -0.5%	-2,267
Average PiT PD +0.5%	2,719

3. Market risk

Market risk is the risk of losses caused by adverse movements in market prices, including market prices of foreign currencies, interest rates, and securities. Market risk arises from both on and off-balance sheet positions and can arise from positions from both the banking and trading book. The purpose of market risk management in the Bank is to correctly identify and quantify market risk and ensure risk conscious decisions are taken on market risk.

Among others, market risk must be managed as originating from the following sources:

- Currency risk from the Bank's positions in foreign currencies;
- Price risk from all the Bank's positions in securities and derivatives, including those taken for the purposes of investment, risk management and brokerage;
- Interest rate risk from the Bank's interest revenues, interest expenses, and sensitivity of the Bank's positions to the change in interest rates.

The Bank's market risk management is governed by the Market Risk Management Policy of LHV Group, the Market Risk Management Rules of LHV Pank and other internal rules, which set out the Bank's risk appetite for foreign currency risk, price risk and interest rate risk in the banking book. Based on the Market Risk Management Policy, the Group's appetite for market risk is low.

The Treasury unit, the Assets and Liabilities Management Committee (ALCO) have key roles in managing market risk as the first line of defence. The Risk Control Unit and the Internal Audit Unit are responsible for the second line of defence and third line of defence functions, respectively.

3.1 Foreign currency risk

Foreign currency risk arises from the mismatch of the Bank's foreign currency assets and liabilities. The majority of the Bank's balance sheet is euro denominated but a mismatch could result from the foreign currency transactions of the Bank's customers.

Foreign currency risk is measured by estimating the potential loss to the Bank from its net open foreign currency position in a stress scenario. The total loss from foreign currency risk should not exceed a prescribed level of the Bank's net own funds.

The Bank's ALCO has implemented additional risk limits for various types of market risks in the bank for daily operations. Foreign currency risk limits in the Bank are fixed as maximum nominal open net position limits in euro equivalent for each currency. If the open currency position exceeds the limits set by the ALCO, measures must be implemented to close or reduce such positions.

A sensitivity analysis has been performed to show the effect of movements in foreign currency exchange rates on the statement of profit or loss, with the assumption of other conditions remaining constant. The sensitivity has been measured against a potential exchange rate movement of +/- 7% which is in line with the stress scenario used by the Group for measuring foreign currency risk of its net open positions. It can be seen that the Bank's foreign currency risk exposure is very low.

Impact on statement of profit or loss

(in thousands of euros)	2021	2020
USD exchange rate +/- 7%	+/- 204	+/- 8
SEK exchange rate +/- 7%	+/-6	+/5
GBP exchange rate +/- 7%	+/-17	+/-10
CHF exchange rate +/- 7%	+/-0	+/-0

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. Foreign exchange forwards are shown in the table at their full contractual cash flow amounts as off-balance sheet assets and liabilities. The table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk, or equity.

It can be seen based on the table that as mentioned above, the majority of the Bank's business in conducted in euro currency.

31.12.2021
(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	7	3,686,878	1,367	277,043	1,075	18,433	2,137	**3,986,933**
Investments in debt and equity securities	8	127,677	0	1	0	37	4	**127,720**
Loans and advances to customers	9	2,669,321	18	463	396	6,616	346	**2,677,160**
Receivables from customers	10	1,036	0	491	226	167	1,050	**2,970**
Other financial assets	11	117	0	0	0	2,119	0	**2,236**
Total assets bearing currency risk		**6,485,029**	**1,385**	**277,998**	**1,697**	**27,372**	**3,538**	**6,797,019**
Liabilities bearing currency risk								
Amounts owed to central banks (TLTRO)	13	197,461	0	0	0	0	0	**197,461**
Deposits from customers	13	5,448,088	5,037	271,784	7,837	101,149	12,708	**5,846,602**
Loans received and debt securities in issue	13	349,063	0	0	0	0	0	**349,063**
Financial liabilities at fair value	8	0	0	0	16	123	18	**157**
Accounts payable and other financial liabilities	14	28,269	218	6,456	217	5,676	319	**41,155**
Subordinated debt	16	88,989	0	0	0	0	0	**88,989**
Total liabilities bearing currency risk		**6,111,870**	**5,254**	**278,240**	**8,070**	**106,948**	**13,045**	**6,523,427**
Open gross position derivative assets at contractual value		0	3,872	0	6,454	82,496	9,026	**101,848**
Open gross position derivative liabilities at contractual value		101,848	0	0	0	0	0	**101,848**
Open foreign currency position		**271,311**	**3**	**-242**	**81**	**2,920**	**-481**	**273,592**

31.12.2020
(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	7	2,251,277	1,163	119,368	1,943	12,295	7,212	**2,393,258**
Investments in debt and equity securities	8	322,834	7	0	9	52	28	**322,930**
Loans and advances to customers	9	2,195,133	24	7,016	484	5,997	169	**2,208,823**
Receivables from customers	10	841	0	350	11	464	788	**2,454**
Other financial assets	11	117	0	0	0	1,956	0	**2,073**
Total assets bearing currency risk		**4,770,202**	**1,194**	**126,734**	**2,447**	**20,764**	**8,197**	**4,929,538**
Liabilities bearing currency risk								
Amounts owed to central banks (TLTRO)	13	200,000	0	0	0	0	0	**200,000**
Deposits from customers	13	3,907,709	3,950	125,267	7,292	85,616	11,597	**4,141,431**
Loans received	13	268,584	0	0	0	0	0	**268,584**
Financial liabilities at fair value	8	221	0	0	0	0	0	**221**
Accounts payable and other financial liabilities	14	13,126	21	1,610	661	4,343	1,637	**21,398**
Subordinated debt	16	88,500	0	0	0	0	0	**88,500**
Total liabilities bearing currency risk		**4,478,140**	**3,971**	**126,877**	**7,953**	**89,959**	**13,234**	**4,720,134**
Open gross position derivative assets at contractual value		0	2,778	0	5,581	69,080	4,350	**81,789**
Open gross position derivative liabilities at contractual value		81,789	0	0	0	0	0	**81,789**
Open foreign currency position		**210,273**	**1**	**-143**	**75**	**-115**	**-687**	**209,404**

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3.2 Price risk

Price risk arises from securities held by the Bank in the liquidity portfolio, trading portfolio and investment portfolios (Note 11, 12).

Price risk is measured by estimating the potential loss that can be incurred by the Bank in a stress scenario. The loss from price risk in the stress scenario should not exceed a prescribed percentage of the Bank's net own funds. The ALCO has set additional limits on 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 Bank.

A sensitivity analysis has been performed to show the effect of movements in securities prices on the net result of the Bank. The potential securities price movements used in the sensitivity analysis are in line with the stress scenarios used by the Bank for measuring price risk and have been derived from actual historical volatility of the instruments included in the relevant portfolios.

Impact on statement of profit or loss (profit after tax)

(in thousands of euros)	2021	2020
Equity securities and fund units +/-25%	+/-92	+/-36
Debt securities (FVTPL) +/-2.0% (+/-2.0%)	+/-2,547	+/-6,454

It can be seen that the majority of the Bank's price risk results from the debt securities held in the Bank's liquidity portfolio. The Bank does not hold significant amounts of equity securities (see Note 8), accordingly the sensitivity to change in the market price of these positions is marginal.

3.3 Interest rate risk

Interest rate risk arises from the mismatch of the term structure of interest rate sensitive assets and liabilities (gap risk), mismatch of base rates (basis risk), the optionality inherent in the interest rate sensitive instruments (option risk) and the change in credit spreads (credit spread risk). Interest rate risk can arise both from balance sheet and off-balance sheet items. In the context of the Group, interest rate risk is relevant for the banking portfolio of LHV Pank.

Interest rate risk in the banking book is measured by estimating the change of net interest income (NII) and the economic value of equity (EVE) in a number of stress scenarios compared to the base scenario. The Group's risk appetite prescribes that the negative impact on NII or EVE in stress scenarios should not exceed a certain level of the Bank's net own funds.

The Bank's ALCO has approved the stress scenarios and other inputs and methodologies for calculating the change in NII and change in EVE. Market inferred interest rate curve is used as the base scenario. Six stress scenarios are used:

- parallel shock up;
- parallel shock down;
- steepener shock (short rates down and long rates up);
- flattener shock (short rates up and long rates down);
- short rates shock up; and
- short rates shock down.

Interest rate floors are applied for deeply negative rates where applicable based on regulatory guidance.

The analysis of the change in the economic value of equity (change in EVE) aims to assess the change in the economic value of the assets, liabilities, and equity in different interest rate scenarios. The measure of interest rate risk is the change in EVE in interest rate shock scenario compared to the base scenario. In order to calculate the change in EVE, the net present value of the cash flows arising from the assets, liabilities and off-balance sheet items of the banking book are found under each scenario. The cash flows are calculated based on the assumptions detailed below, using a run-off balance sheet. All cash flows from the assets, liabilities and off-balance sheet items are discounted using the same interest rate curve (swap curve depending on the scenario).

The analysis of the change in net interest income (change in NII) assesses the impact of interest rate changes on net interest income in the next 12-month period. In order to calculate the change in NII, all interest-bearing assets, liabilities and off-balance-sheet items are split into different time buckets according to their repricing date. Following repricing dates, interest sensitive assets and liabilities are assumed to reprice at new interest rates specific to the scenario and change in NII in different scenarios can be determined. The NII analysis is performed on a constant balance sheet.

The main assumptions for the calculation of the change in EVE and change in NII are as follows:

- The repricing term of demand deposits of households and non-financial corporations vary between 1 day and 5 years, depending on their interest rate sensitivity.
- For deposits of financial institution, immediate repricing is assumed.
- A 0% interest rate floor is applied to deposits of households.
- For loans as well as term deposits, contractual maturities are used.
- For loans, contract-specific interest rate floors are used.

- In the case of off-balance sheet items (e.g. loan commitments and credit limits), the credit conversion factor is included in the model and it is assumed that the use of the limit will increase linearly until the expiry date.
- Non-performing exposures are taken into account after the deductions of provisions. The maturity of such items are 2 years from the date of default.

The following table presents the of the changes in EVE and next 12 months NII that have been estimated in the six stress scenarios compared to base scenario.

31.12.2021

(in thousands of euros)	Change in the economic value of equity	Change in the next 12 months net interest income
Parallel shock up	85,367	33,935
Parallel shock down	23,806	-1,522
Steepener shock	-14,461	-1,519
Flattener shock	57,061	17,489
Short rates shock up	66,572	28,568
Short rates shock down	4,338	-1,523

31.12.2020

(in thousands of euros)	Change in the economic value of equity	Change in the next 12 months net interest income
Parallel shock up	102,454	35,587
Parallel shock down	-7,228	-4,094
Steepener shock	9,443	-4,103
Flattener shock	19,664	19,951
Short rates shock up	47,077	31,430
Short rates shock down	-8,039	-4,095

The table below shows the structure of the interest-bearing assets and interest-bearing liabilities of LHV Bank grouped by the recalculation dates of interest rates at the principal amounts of receivables and liabilities.

31.12.2021 *(in thousands of euros)*	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair-ments	Total
Financial assets									
Due from banks and investment companies	7	3,986,933	0	0	0	3,986,933	0	0	3,986,933
Financial assets at fair value (debt securities)	8	46,000	3,350	77,218	0	126,568	781	0	127,349
Loans and advances to customers	9	1,214,410	1,375,207	85,595	15,869	2,691,081	5,128	-19,049	2,677,160
Total		**5,247,343**	**1,378,557**	**162,813**	**15,869**	**6,804,582**	**5,909**	**-19,049**	**6,791,442**
Financial liabilities									
Amounts owed to central banks (TLTRO)	13	0	0	200,000	0	200,000	-2,539	0	197,461
Deposits from customers	13	2,288,647	101,744	3,457,466	0	5,847,857	-1,255	0	5,846,602
Loans received and debt securities in issue	13	0	0	350,000	0	350,000	-937	0	349,063
Subordinated debt	16	0	0	0	88,500	88,500	489	0	88,989
Total		**2,288,647**	**101,744**	**4,007,466**	**88,500**	**6,486,357**	**-4,242**	**0**	**6,482,115**
Net interest sensitivity gap		**2,958,696**	**1,276,813**	**-3,844,653**	**-72,631**	**318,225**			

31.12.2020 *(in thousands of euros)*	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair-ments	Total
Financial assets									
Due from banks and investment companies	7	2,393,258	0	0	0	2,393,258	0	0	2,393,258
Financial assets at fair value (debt securities)	8	200,045	117,300	4,280	0	321,625	1,074	0	322,699
Loans and advances to customers	9	993,697	1,113,053	103,141	10,616	2,220,507	5,174	-16,858	2,208,823
Total		**3,587,000**	**1,230,353**	**107,421**	**10,616**	**4,935,390**	**6,248**	**-16,858**	**4,924,780**
Financial liabilities									
Amounts owed to central banks (TLTRO)	13	0	0	200,000	0	200,000	0	0	200,000
Deposits from customers	13	974,235	378,926	2,785,625	28	4,138,814	2,617	0	4,141,431
Loans received	13	0	19,757	250,000	0	269,757	-1,173	0	268,584
Subordinated debt	16	0	0	0	88,500	88,500	489	0	88,989
Total		**974,235**	**398,683**	**3,235,625**	**88,528**	**4,697,071**	**1,933**	**0**	**4,699,004**
Net interest sensitivity gap		**2,612,765**	**831,670**	**-3,128,204**	**-77,912**	**238,319**			

3.4 Credit valuation adjustment risk

Credit valuation adjustment (CVA) risk can be defined as the risk of losses arising from changing CVA values in response to movements in counterparty credit spreads and market risk factors that drive prices of derivative transactions. The Bank applies the standardised approach to calculate the capital charge for CVA risk. The Bank's capital requirement for CVA risk as of 31.12.2021 amounted to EUR 97 thousand (2020: EUR 7 thousand).

4. Liquidity risk

Liquidity risk is the risk that the Bank is unable to fund increases in the Bank's assets or pay its liabilities in a timely manner and full amount, without incurring material losses or disrupting its normal business operations. Liquidity risk arises from both on and off-balance sheet positions. The purpose of the Bank's liquidity risk management is to correctly identify, measure, control and monitor liquidity risk, to ensure timely decisions can be taken so that sufficient liquidity with adequate margin can be maintained at all times.

According to the risk management policy of LHV Group, the Bank assesses liquidity risk from the following separate perspectives:

- Funding risk is the risk that the Bank is unable to attract funding in a timely way, in necessary amount and at acceptable cost without a negative impact to its daily activities or financial position. Funding risk also encompasses the risk related to liquidity outflows from withdrawal of deposits or redemption of wholesale funding. Intraday liquidity risk is also evaluated in this perspective.
- Market liquidity risk is the risk that it is not possible to execute a transaction such as selling of a security or pledging of an asset in a timely manner without incurring unacceptable losses, due to low trading activity, market disruption or limitations set by other market participants.
- Asset encumbrance risk is the risk that due to an excessive share of assets being encumbered as collateral the Group harms its ability to attract further unsecured or secured funding, due to unsecured creditors becoming effectively subordinated or due to the shortage of assets available to be pledged as collateral.

Liquidity risk is highly relevant for LHV Pank as the largest share of the Bank's funding is raised through collecting deposits that are used for funding long term loans which generally have a longer term than the deposits.

The Bank manages its liquidity risk in accordance with the Group's Liquidity Risk Management Policy, Group Funding Policy, Liquidity Risk Management Rules and other internal rules, which set out the Group's and the Bank's funding strategy and liquidity risk appetite, early warning indicators and various internal procedures such as reporting routines and contingency plans. The Treasury unit and the Assets and Liabilities Management Committee (ALCO) have key roles in managing liquidity risk as the first line of defence. Risk Control Unit and the Internal Audit Unit are responsible for the second line of defence and third line of defence functions, respectively.

The key quantitative metrics which are used for limiting the Bank's liquidity risk appetite include:

- minimum survival period in a stress scenario,
- Liquidity Coverage Ratio (LCR),
- Net Stable Funding Ratio (NSFR),
- metric for assessing the concentration of large depositors,
- encumbrance ratio.

Limits have been set for each of the above risk appetite metrics with buffers over regulatory requirements (if applicable). These metrics are calculated and reported on a monthly basis.

The regulatory LCR and the minimum survival period in stress scenario both assess the risk of liquidity outflows in a relatively short-term time horizon. In order to survive such possible stress scenario and expected deposit outflows, the Bank keeps a counterbalancing buffer of liquid high-quality assets that can be used in either a market wide or idiosyncratic stress scenario. The liquidity buffer of the Bank consists of cash and deposits with the central bank and liquid securities, which can be readily sold or used as collateral in funding operations. For calculating the survival horizon, behavioural assumptions are used for modelling liquidity outflows and inflows.

The regulatory NSFR and depositor concentration metric are used for assessing the longer-term structural funding risk. The Bank should have an appropriate funding structure where long term assets are matched with sufficient stable and well diversified funding sources. Encumbrance ratio is observed to ensure that the Bank is not exposed to excessive asset encumbrance that could limit its access to funding markets.

The following table presents the values of the LCR and NSFR ratios in comparison to regulatory thresholds. It can be seen that both ratios exceeded regulatory requirement with a healthy buffer characterising the Group's conservative approach to managing liquidity risk.

	Regulatory requirement	31.12.2021	31.12.2020
LCR	Minimum 100%	140.6%	146.5%
NSFR	Minimum 100%	164.2%	153.9%

As set out in the Group's Funding Policy, diversification of the funding profile is an important element of the Bank's liquidity risk management framework. The Bank's most stable funding source is retail deposits from its Estonian customers. Other deposits and wholesale unsecured and secured funding are used as additional sources of funding. The Bank has issued covered bonds to raise targeted funding for its residential mortgage loans portfolio. The Bank has also used the TLTRO facility offered by the European Central Bank in order to take advantage of the current attractive cost of this source of funding.

In order to manage longer term funding risk, Treasury drafts funding plans as part of the financial planning cycle. The funding plan presents a longer-term view of the funding required to support the business along with key liquidity metrics.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows. 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 Risk management section point 5.

31.12.2021 *(in thousands of euros)*	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates								
Amounts owed to central banks (TLTRO)	13	0	0	0	197,000	0	**197,000**	**197,461**
Deposits from customers	13	5,687,287	55,271	101,784	2,288	0	**5,846,630**	**5,846,602**
Loans received and debt securities in issue	13	0	0	1,140	352,538	0	**353,678**	**349,063**
Subordinated debt	16	0	1,748	10,208	95,810	0	**107,766**	**88,989**
Accounts payable and other financial liabilities	14	0	41,155	0	0	0	**41,155**	**41,155**
Unused loan commitments	19	0	679,579	0	0	0	**679,579**	**0**
Financial guarantees by contractual amounts	19	0	49,409	0	0	0	**49,409**	**0**
Foreign exchange derivatives (gross settled)		0	101,848	0	0	0	**101,848**	**0**
Financial liabilities at fair value	8	0	157	0	0	0	**157**	**157**
Total liabilities		**5,687,287**	**929,167**	**113,132**	**647,636**	**0**	**7,377,222**	**6,523,427**
Assets held for managing liquidity risk by contractual maturity dates								
Due from banks and investment companies	7	3,986,933	0	0	0	0	**3,986,933**	**3,986,933**
Financial assets at fair value (debt securities)	8	0	46,047	3,387	77,915	0	**127,349**	**127,720**
Loans and advances to customers	9	0	173,534	431,582	1,661,341	924,419	**3,190,876**	**2,677,160**
Receivables from customers	10	0	2,970	0	0	0	**2,970**	**2,970**
Other financial assets	11	2,236	0	0	0	0	**2,236**	**2,236**
Foreign exchange derivatives (gross settled)		0	101,848	0	0	0	**101,848**	**0**
Total assets held for managing liquidity risk		**3,989,169**	**324,399**	**434,969**	**1,739,256**	**924,419**	**7,412,212**	**6,797,019**
Maturity gap from assets and liabilities		**-1,698,118**	**-604,768**	**321,837**	**1,091,620**	**924,419**	**34,990**	

31.12.2020 *(in thousands of euros)*	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates								
Amounts owed to central banks (TLTRO)	13	0	0	0	197,000	0	**197,000**	**200,000**
Deposits from customers	13	3,657,063	99,647	380,442	4,993	28	**4,142,173**	**4,141,431**
Loans received and debt securities in issue	13	0	0	6,212	263,783	1,445	**271,440**	**268,584**
Subordinated debt	16	0	1,736	5,207	27,770	98,564	**133,277**	**88,500**
Accounts payable and other financial liabilities	14	0	21,398	0	0	0	**21,398**	**21,398**
Unused loan commitments	19	0	413,818	0	0	0	**413,818**	**0**
Financial guarantees by contractual amounts	19	0	36,492	0	0	0	**36,492**	**0**
Foreign exchange derivatives (gross settled)		0	81,180	0	609	0	**81,789**	**0**
Financial liabilities at fair value	8	0	221	0	0	0	**221**	**221**
Total liabilities		**3,657,063**	**654,492**	**391,861**	**494,155**	**100,037**	**5,297,608**	**4,720,134**
Assets held for managing liquidity risk by contractual maturity dates								
Due from banks and investment companies	7	2,393,258	0	0	0	0	**2,393,258**	**2,393,258**
Financial assets at fair value (debt securities)	8	0	200,448	117,716	4,534	0	**322,698**	**322,698**
Loans and advances to customers	9	0	146,192	329,310	1,375,417	741,393	**2,592,312**	**2,208,823**
Receivables from customers	10	0	2,454	0	0	0	**2,454**	**2,454**
Other financial assets	11	2,073	0	0	0	0	**2,073**	**2,073**
Foreign exchange derivatives (gross settled)		0	81,789	0	0	0	**81,789**	**0**
Total assets held for managing liquidity risk		**2,395,331**	**430,883**	**447,026**	**1,379,951**	**741,393**	**5,394,584**	**4,929,306**
Maturity gap from assets and liabilities		**-1,261,732**	**-223,609**	**55,165**	**885,796**	**641,356**	**96,976**	

The following table presents the distribution of assets and liabilities by classification of current and non-current.

(in thousands of euros)	Note	31.12.2021	31.12.2020
Current assets			
Due from central bank	7	3,874,284	2,213,211
Due from credit institutions	7	106,461	170,062
Due from investment companies	7	6,188	9,985
Financial assets at fair value through profit or loss	8	127,720	322,930
Loans and advances to customers	9	455,929	395,341
Receivables from customers	10	2,970	2,454
Other assets	11	2,446	1,943
Total current assets		**4,575,998**	**3,115,926**
Non-current assets			
Loans and advances to customers	9	2,221,231	1,813,482
Other financial assets	11	2,236	2,073
Tangible assets	12	8,139	6,571
Intangible assets	12	1,243	807
Total non-current assets		**2,232,849**	**1,822,933**
Total assets	**5**	**6,808,847**	**4,938,859**
Liabilities			
Current liabilities			
Deposits from customers	13	5,844,321	4,123,007
Loans received	13	0	19,759
Financial liabilities at fair value through profit or loss	8	157	221
Accounts payable and other liabilities	14	47,105	25,441
Total current liabilities		**5,891,583**	**4,168,428**
Non-current liabilities			
Amounts owed to central banks (TLTRO)	13	197,461	200,000
Deposits from customers	13	2,281	18,424
Loans received and debt securities in issue	13	349,063	248,825
Subordinated debt	16	88,500	88,500
Total non-current liabilities		**637,305**	**555,749**
Total liabilities	**5**	**6,528,888**	**4,724,177**

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5. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk and ICT risk but excludes strategic and reputational risk. Operational risk is inherent in all products, activities, processes and systems.

Each manager in LHV is responsible to manage operational risk within its responsibility area. Risk Division is acting as the second line of defence and providing both proper trainings and guidance to implement the Operational Risk Framework, as well as an oversight to ensure the risk profile is within the desired level as described in Risk Appetite statements.

Operational Risk Framework is described in Operational Risk Policy, Operational Resilience Policy, ICT and Information Security Policy and in other relevant operational risk management documents. Main processes and tools to manage, i.e. to identify, assess, mitigate and monitor operational risks are as follows.

Risk and control self-assessment

There is a unified process and method across LHV to assess operational risks within all products and processes. The regularity of the self-assessment depends on the criticality level of the product and the process and shall ensure all managers are aware of the risks they are responsible of and are applying relevant mitigating and monitoring tools to keep the risk profile within the desired risk level.

New Product Approval process (NPAP) in case of new or significant changes in products, IT systems, processes, organization, partners (incl. outsourcing) or in case of exceptional transactions

NPAP is designed to ensure all significant changes in products, IT systems, processes, organization, partners (incl. outsourcing) or significant exceptional transactions are managed with due care and no change is approved before all risk considerations are taken into account. For this objective pre-described risk management rules shall be implemented accompanied with independent opinions both from Risk and Compliance Divisions.

Operational risk event and business continuity management

The objective of the operational risk event management is to ensure all events are managed in proper manner, as well as to learn from the events and use the lessons to prevent similar cases happen in the future.

Event management activities depend on the event type and severity level. For the critical processes Business Continuity Plans are in place and shall be activated in the case there is a disruption in the critical process. Critical IT systems have Recovery Plans in place for the same reasons. If needed, crisis management shall be applied steered by the crisis committee.

Business Continuity Plans are being regularly reviewed and tested to ensure they are up-to-date and applicable for critical process disruption purposes.

All events shall be reported centrally and kept in a central database for further analysis purposes conducted by the Risk Division. Event data shall also be used for capital calculation purposes within ICAAP.

Key risk indicators

Key risk indicators (KRI) are the main tools to monitor if the risks are in a desired level and controls are working effectively. KRI's are used to monitor risks in different levels, i.e. across LHV as well as in concrete unit's level. Action plan shall follow if KRI reflects not-desired changes in risk level, as well as deficiencies in existing controls.

Capital calculation

Operational risk capital requirements are calculated based on the basic indicator approach and constitutes as of 31 December 2021 EUR 9,024 thousand.

ICT and information security risk management

One of our main goals is to be trustworthy banking partner to our customers with the focus on providing customer-friendly, secure and resilient digital banking services. Secure and resilient IT systems are the key for this objective.

We have defined our ICT and information security related risk appetite as:

- low for risks with high potential (financial or reputational) impact which are most cybersecurity risks (e.g., cyber-attacks or data loss): unnecessary security-related risks are not accepted and shall be mitigate promptly.
- medium for such technology-related risks where potential impact can be effectively controlled, which allows us to use new and innovative technology or agile development approach to be more efficient and secure.

In addition to general Operational Risk Framework, dedicated ICT and information security risk management tools and methods are being applied to protect the information and customers' assets and ensure the IT systems are available, for example:

- Reasonable conservatism is being applied when implementing new configurations to the production services.
- Regular security monitoring.
- Vulnerability management process.
- Security controls in the Software Development Lifecycle.
- Training and awareness to our personnel to prevent actions that may cause security incidents on IT systems and services.

- Up-to-date information about the developments in the security scene to understand potential weaknesses the trends might bring to us.

We take seriously and reach to all malicious attempts both towards our own infrastructure and customer data under our possession, as well as towards attempts against customers themselves.

In 2021 an increase of different social engineering attacks towards customers, incl. Phishing, Smishing and Vhishing, was identified. Such attacks take advantage of customers trust by using LHV brand. These campaigns were mainly investment fraud or impersonated a bank employee to manipulate their targets to disclose their authentication information (e.g. username and social security number) and enter their PIN-code to the 2FA device in to confirm a malicious transaction.

Even though the liability lies on the customers side and such transactions are considered as strong authentication, we address such social engineering campaigns promptly, cooperate actively with law-enforcement agencies and educate our customers to fight such campaigns targeting our customers or miss-using our brand.

6. Compliance risk

Considering the complexity and volume of regulations, the constant amendments thereto, the heightened attention of supervisory authorities towards meeting requirements and the compliance control function, society's quickly changing value judgements and expectations in different fields, including the prevention of money laundering, fraud prevention and ensuring sustainability, and the role of financial institutions in performing these tasks, the compliance risk is significant in today's environment.

The consequences of realisation of compliance risk are also felt more strongly, whether through the actual implementation of sanctions, the planned increase of sanction rates, establishment of the simplified sanction implementation procedure, or the effect of disclosure of breaches on the share price, contractual relations, employee recruitment and retention or the validity of the activity licence. Based on the previous period, it can clearly be seen that the Financial Supervision Authority increasingly applies enforcement measures, incl. making the breaches public, making precepts for the remediation of these, and requiring the development, presentation, and performance of detailed action plans.

The purpose of compliance control is the management of compliance risk, including identifying amendments to legislation and standards, assessing the effect thereof, consultation regarding measures that need to be applied to ensure compliance with new and existing legislation and standards, assessing the significant changes of new and existing products and processes and conducting risk-based compliance audits, performing internal monitoring activities, and reporting to management bodies.

In addition, compliance control turns additional attention to compliance risk related to money laundering and terrorist financing prevention and the implementation of international sanctions. For more efficient risk management, LHV has decided to separate this field from the compliance function and create it as a distinct internal control function.

In addition to practical daily activities, compliance control is also the cultural leader and moral compass of the organisation. Creating a culture that supports the meeting of all requirements is one of the most efficient ways of managing compliance risk. Every organisation is distinct, but the number of employees must be sufficient to ensure compliance in all fields, considering the complexity of business, including the structure of the organisation and the services provided. This means the capability to manage risks related to the provision of services, but also to operating as a credit institution. As a result, Compliance Control has increased the number of employees and constantly takes this need into account.

In the upcoming period, developing the principles of and cooperation in compliance risk management across the Group will remain important, including with the compliance control function of money laundering prevention created as an independent function of internal control. Applying for the licence of an individual bank in the United Kingdom and developing the functions of compliance, as well as fighting against financial crime, demand increased attention.

The compliance control function continues to have an important role in ensuring that operations meet the current legislation. The role and expectations of the compliance control function are also reflected by the performed and planned changes on the legislative level regarding the mandatory nature of the function, its tasks, the suitability of the one performing the function, as well as reporting requirements.

Although ensuring compliance starts with the top management and all employees must contribute to it, expectations of the compliance control function and its performer have also grown. While the whole organisation is liable for non-compliance, compliance control and its performer are expected to implement effective measures in managing the risk. For the efficient management of compliance risk, compliance control will continue with its current activities, to make decisions that consider the interests of the customer, the supervisory authority, the society in the wider sense, and LHV.

7. Anti-money laundering

7.1 AML/CTF Governance

The internal governance of LHV is based on the Three Lines of Defence model. In 2021 Bank`s AML internal governance was updated and demarcation lines between first and second line defence were introduced. AML department was reorganized to AML Compliance Department reporting directly to CEO. Previously AML Department was part of Risk Management reporting to CRO. KYC and EDD functions (e.g. screening) which were previously carried out by AML Department are now located within business units relevant AML departments.

AML Compliance is the second line of defence which is established to ensure the first line of defence (i.e. operational management) is properly designed, in place, and operating as intended. As management functions, they provide framework and guidance for developing and modifying risk management and internal controls.

All lines of defence follow a risk-based approach in assessing products, services, customers, and countries. Proper risk mitigating measures (incl. CDD and EDD) are applied on the basis of the risk-based screening and monitoring activities and defined risk levels. A high level of awareness and commitment towards risk management and AML issues is the foundation of a strong AML culture which is further supported by continuous activities of awareness raising, information and dissemination, networking and exchange of best practices, training and reporting.

The Management Board and the Supervisory Board of LHV Group and LHV Pank have a strong commitment towards implementing, maintaining and developing AML/ KYC regime all over the group entities. AML/ CTF policies and procedures are updated yearly. In 2021 the development of new risk assessment methodology was initiated in co-operation with Ernst & Young Baltics.

Analytical and technical capabilities of the group entities are the key elements of building a solid AML/KYC system. In 2021 previous vendors providing AML screening and monitoring software were replaced by new tool by OÜ Salv Technology. New technology provides better capabilities and flexibility of screening and monitoring systems.

In addition to the investments in IT systems, the number of employees directly and indirectly involved in AML has significantly raised. New positions were created both in the AML Compliance department and business unit AML functions. Strong focus is in improving of analytical competence.

7.2 AML Governance structure

Supervisory Board
- Adopts AML Policy
- Supervisory role

Management Board
- Adopts AML procedures and Risk Assessment
- Sets Risk Appetite
- Accepts high risk customers

High Risk Customer Acceptance Committee
- Acceptance of high risk customers

Financial Intermediaries Assessment Committee
- Assessment of Financial Intermediaries prior Management Board

AML Committee
- Provides information to Management Board
- Advises on risk assessment and appetite

First Line of Defence		Second Line of Defence		Third Line of Defence
Customer relations	**High Risk Customer Department**	**AML Department**	**Compliance**	**Internal Audit**
• Implementation of KYC	• On-boarding higher risk clients • Liaison to AML department • EDD measures and data quality	• Coordinates AML procedures and processes • Risk assessment of higher risk factors • AML monitoring and screening • Coordinating EDD measures • Reports to the board and FIU	• Advises management bodies on AML compliance • Performas AML inspections and compliance audits • Reports to governing bodies	• Carries out independent assessment of AML measures • Reports to Supervisory Board and Audit Committee

7.3 AML/KYC measures

Main AML/CTF measures (incl. KYC) in LHV are as follows:

- comprehensive risk assessment and risk segmentation;
- strong on-boarding CDD supported by the Customers Acceptance Principles;
- regular CDD and EDD;
- robust risk-based monitoring;
- screening customers and transactions against international financial sanctions lists and other similar lists (incl. UN and EU lists, but also US OFAC list and UK HM Treasury list);
- strong commitment of the senior and middle managers;
- regular training of employees;
- ongoing communication and cooperation with FIU and other relevant stakeholders;
- active participation in setting up industry best practices.

LHV has implemented a four-level decision making process for customer acceptance at the on-boarding stage. Depending on the risk indicators of the customer, the decision for a customer acceptance is made at the following level:

- The Customer Relationship Manager
- The Customer Relationship Manager together with a senior manager (so called 4-eyes principle)
- Risk Customer Acceptance Committee
- The Management Board

In addition to the conservative and risk-based approach and procedures followed at the on-boarding stage, risk-based monitoring and screening activities are implemented and regular KYC updates are carried out.

7.4 Banking Services

LHV is providing services to FinTech companies that provide financial services to their customers. Compared to servicing regular customers, different risks are involved in servicing the FinTech companies. Therefore, LHV has paid special attention to and applied additional measures to mitigating the risks related to the FinTech companies. LHV has dedicated Customer Relationship Managers with vast FinTech sector competence. Specific first line and second line units are monitoring industry trends, developments and threats related to the FinTech sector and update AML/KYC measures accordingly. LHV applies the same AML/KYC measures to all customers from the FinTech sector as to the correspondent service provider. LHV expects FinTech customers have same level of AML/KYC measures in place as banks do. During the on-boarding process and continuous KYC of the FinTech companies, LHV assesses their business model, ownership structure, team and managers, AML/KYC measures, technical capabilities for screening and monitoring, customer focus, customer risk segmentation, limit policy, source of funds, etc. LHV carries out regular on-site visits to ensure that the appropriate policies, processes, and procedures are in place and are working as intended. LHV pays special and continuous attention to the financial activities of the FinTech companies through robust monitoring. If there are doubts that customer does not comply to AML/KYC regulations and best practice, remediation actions are taken. If those customers do not increase their capacity, then off-boarding of those customer follows. Same applies in case where customers are not within risk appetite of the Bank.

7.5 Estonian AML system and perspectives

New National Risk Assessment was introduced by state. World Bank methodology updated by PWC was basis for NRA. Main identified risks are related to the Virtual Asset Service Providers sector, mainly related to domestic companies having VASP licence by FIU. In 2021 started Estonian assessment towards FATF recommendations carried out by FATF reginal body Moneyval (established in European Council). On-site visit and report are expected in 2022. The banking sector has heavily invested in human capital both in quantitative terms and from the competence perspective. All market participants are continuously improving the usage of modern information technology in relation to AML in order to improve their technical and analytical capabilities. From a regulatory point of view, many legislative initiatives are ongoing and aimed at improving the Estonian AML system and cooperation between all stakeholders.

7.6 Regulatory proceedings

FSA concluded several on- and off-site controls in various areas throughout the period. This is a common regulatory practice. During the period among others the onsite control concerning banking services business line and application of international financial sanctions was examined. To eliminate identified shortcomings LHV introduced and carried out a detailed action plan results of which were reported back to FSA.

As a good practice LHV has also requested external audits to be performed in the area of AML. Latest audit performed by FSCom to assess AML/KYC compliance framework and practice did not reveal significant shortcomings. However, recommendations to enhance processes were issued.

8. Other risks

8.1 Underwriting risk

Underwriting risk is one of the most important risks for the insurance subsidiary reflecting the core business of insurance, i.e. taking and managing insurance risk. The most important aspect of underwriting risk is the insurance premium and reserve risk deriving from the possible inadequacy of the pricing of insurance contracts and the assumptions used in the assessment of contractual liabilities.

Underwriting risk includes catastrophe accumulation risk deriving from extreme or extraordinary events (e.g. hurricanes, floods, damage attributable to human causes) during which the materialization of risks insured under individual insurance contracts accumulate extraordinarily.

Above all, underwriting risk involves risks associated with pricing, technical provisions and adequacy of the reinsurance cover.

Underwriting risk is managed and controlled via the following processes:

- Establishment of insurance subsidiary's risk strategy in accordance with the business strategy;
- Using actuarial analysis and sound assumptions in pricing of insurance contracts;
- Calculation of technical provisions and Solvency Capital Requirement (SCR) by using Solvency II standard formula and holding the necessary liquid assets accordingly;
- Assessment of loss reserving assumptions, performing liability adequacy tests and monitoring of the profitability of the insurance portfolio;
- Conduct regular/irregular own risk and solvency assessment (ORSA);
- Use of the reinsurance program for reinsuring major risks.

8.2 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.

8.3 Risk on reputation

Risk on reputation is defined as a risk, which arises from a loss of reputation for customers, business partners, owners, investors or supervisors. Risk on reputation is usually a result from realization 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.

8.4 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 conducting business activities in the United Kingdom.

Consolidated statement of profit or loss and other comprehensive income

(in thousands of euros)	Note	2021	2020
Interest income		124,637	88,374
incl interest income based on EIR		118,990	84,480
Interest expense		-26,973	-19,327
Net interest income	**4**	**97,664**	**69,047**
Fee and commission income		48,711	31,152
Fee and commission expense		-17,538	-12,769
Net fee and commission income	**5**	**31,173**	**18,383**
Net gains from financial assets measured at fair value	8	-1,515	834
Foreign exchange rate gains/losses		-26	43
Net gains from financial assets		**-1,541**	**877**
Other income		599	208
Staff costs	6	-26,721	-21,115
Administrative and other operating expenses	6	-22,619	-15,150
Profit before credit losses		**78,555**	**52,250**
Impairment losses on loans and advances	9	-3,948	-10,898
Profit before income tax		**74,607**	**41,352**
Income tax expense	24	-10,557	-6,749
Net profit for the year		**64,050**	**34,603**
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Net gains on investments in equity instruments designated at FVOCI		0	-212
Total profit and other comprehensive income for the year		**64,050**	**34,391**
Total profit attributable to:			
Owners of the parent		61,759	32,514
Non-controlling interest		2,291	2,089
Total profit for the year		**64,050**	**34,603**
Total profit and other comprehensive income attributable to:			
Owners of the parent		61,759	32,302
Non-controlling interest		2,291	2,089
Total profit and other comprehensive income for the year		**64,050**	**34,391**

Notes on pages 99 to 120 are an integral part of the consolidated financial statements.

Consolidated statement of financial position

(in thousands of euros)	Note	31.12.2021	31.12.2020
Assets			
Due from central bank	7	3,874,284	2,213,211
Due from credit institutions	7	106,461	170,062
Due from investment companies	7	6,188	9,985
Financial assets at fair value through profit or loss	8	127,720	322,930
Loans and advances to customers	9	2,677,160	2,208,823
Receivables from customers	10	2,970	2,454
Other financial assets	11	2,236	2,073
Other assets	11	2,446	1,943
Tangible assets	12	4,182	2,766
Right-of-use assets	12	3,957	3,805
Intangible assets	12	1243	807
Total assets		**6,808,847**	**4,938,859**
Liabilities			
Loans received from central banks (TRTLO)	13	197,461	200,000
Deposits from customers and loans received	13	5,846,602	4,141,431
Loans received and debt securities in issue	13	349,063	268,584
Financial liabilities at fair value through profit or loss	8	157	221
Accounts payable and other liabilities	14	46,616	24,952
Subordinated debt	16	88,989	88,989
Total liabilities		**6,528,888**	**4,724,177**
Equity			
Share capital	17	111,500	106,500
Statutory reserve capital	17	5,648	4,022
Retained earnings		156,745	98,285
Total equity attributable to owners of the parent		**273,893**	**208,807**
Non-controlling interest		6,066	5,875
Total equity		**279,959**	**214,682**
Total liabilities and equity		**6,808,847**	**4,938,859**

Notes on pages 99 to 120 are an integral part of the consolidated financial statements.

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28. 02. 2022
Signature / allkiri
KPMG, Tallinn

Consolidated statement of cash flows

(in thousands of euros)	Note	2021	2020
Cash flows from operating activities			
Interest received		124,688	87,145
Interest paid		-29,539	-20,733
Fees and commissions received	5	48,711	31,152
Fees and commissions paid	5	-17,538	-12,769
Other income received		599	-4
Staff costs paid		-24,181	-19,079
Administrative and other operating expenses paid		-19,186	-11,455
Income tax paid		-9,556	-4,158
Cash flows from operating activities before change in operating assets and liabilities		**73,998**	**50,099**
Net increase/(decrease) in operating assets:			
Net increase/(decrease) in financial assets at fair value through profit or loss		-140	-64
Loans and advances to customers		-475,118	-531,929
Mandatory reserve at central bank	7	-16,045	-14,827
Security deposits	11	-164	173
Other assets		2,586	730
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers	13	2,031,748	1,455,310
Term deposits of customers	13	-324,019	-25,248
Loans received	13	0	448,685
Repayments of loans received	13	-21,764	-5,886
Debt securities issued		99,633	0
Financial liabilities held for trading at fair value through profit or loss		-64	212
Other liabilities		20,097	-1,420
Net cash from/ (used in) operating activities		**1,390,748**	**1,375,835**
Cash flows from investing activities			
Purchase of tangible and intangible assets	12	-4,673	-2,430
Proceeds from disposal and redemption of investment securities at fair value through other comprehensive income	8	0	432
Net changes of investment securities at fair value through profit or loss	8	193,835	-289,533
Net cash from/ (used in) investing activities		**189,162**	**-291,531**
Cash flows from financing activities			
Paid in share capital	17	5,000	11,000
Proceeds from subordinated debt	16	0	25,000
Subordinated loans redeemed		0	-7,000
Dividends paid		-6,000	-4,091
Repayment of principal of lease liabilities		-1,254	-1,278
Net cash from (used in) financing activities		**-2,254**	**23,631**
Effect of exchange rate changes on cash and cash equivalents		**-26**	**43**
Net increase/(decrease) in cash and cash equivalents		**1,577,630**	**1,107,978**
Cash and cash equivalents at the beginning of the year	7	**2,352,005**	**1,244,027**
Cash and cash equivalents at the end of the year	7	**3,929,635**	**2,352,005**

Notes on pages 99 to 120 are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(in thousands of euros)	Share capital	Statutory reserve capital	Other reserves	Retained earnings	Total	Non-controlling interest	Total equity
Balance as at 01.01.2020	**95,500**	**3,025**	**212**	**67,793**	**166,530**	**5,218**	**171,748**
Transfer to statutory legal reserve (Note 19)	0	997	0	-997	**0**	0	**0**
Paid in share capital (Note 17)	11,000	0	0	0	**11,000**	0	**11,000**
Dividends paid	0	0	0	-2,658	**-2,658**	-1,432	**-4,090**
Share options (Note 17)	0	0	0	1,633	**1,633**	0	**1,633**
Profit for the year	0	0	0	32,514	**32,514**	2,089	**34,603**
Other comprehensive income	0	0	-212	0	**-212**	0	**-212**
Total profit and other comprehensive income for 2020	0	0	-212	32,514	**32,302**	2,089	**34,391**
Balance as at 31.12.2020	**106,500**	**4,022**	**0**	**98,285**	**208,807**	**5,875**	**214,682**
Balance as at 01.01.2021	**106,500**	**4,022**	**0**	**98,285**	**208,807**	**5,875**	**214,682**
Transfer to statutory legal reserve (Note 19)	0	1,626	0	-1,626	0	0	**0**
Paid in share capital (Note 17)	5,000	0	0	0	**5,000**	0	**5,000**
Dividends paid	0	0	0	-3,900	**-3,900**	-2,100	**-6,000**
Share options (Note 17)	0	0	0	2,227	**2,227**	0	**2,227**
Profit for the year	0	0	0	61,759	**61,759**	2,291	**64,050**
Other comprehensive income	0	0	0	0	**0**	0	**0**
Total profit and other comprehensive income for 2021	0	0	0	61,759	**61,759**	2,291	**64,050**
Balance as at 31.12.2021	**111,500**	**5,648**	**0**	**156,745**	**273,893**	**6,066**	**279,959**

Additional information on equity is provided in Note 17.

Notes on pages 99 to 120 are an integral part of the consolidated financial statements.

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28. 02. 2022
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KPMG, Tallinn

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.

1. Basis of preparation

The consolidated financial statements of the Group for the financial year 2021 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 2.

The financial year started at 1 January 2021 and ended at 31 December 2021. 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 2021. The overview of these standards and the potential impact of applying the new standards and interpretations are stated below.

1.1 Summary of significant accounting policies

A number of new standards are effective for annual periods beginning on or after 1 January 2021, but do not have a material impact on the Group's financial statements.

The following new standards, interpretations and amendments are not yet effective for the annual reporting period ended 31 December 2021 and have not been applied in preparing these consolidated financial statements. The Group plans to adopt these pronouncements when they become effective.

Amendments to IAS 1 Presentation of Financial Statements (effective for annual periods beginning on or after 1 January 2023; to be applied retrospectively. Early application is permitted) These amendments are not yet endorsed by the EU.

The amendments clarify that the classification of liabilities as current or non-current is based solely on the entity's right to defer settlement at the end of the reporting period. The company's right to defer settlement for at least 12 months from the reporting date need not be unconditional but must have substance. The classification is not affected by management's intentions or expectations about whether and when the entity will exercise its right. The amendments also clarify the situations that are considered settlement of a liability.

The Group does not expect the amendments to have a material impact on its financial statements when initially applied.

Annual improvements to IFRS standards 2018-2020 (Effective for annual periods beginning on or after 1 January 2022. Early application is permitted). These amendments are not yet endorsed by the EU.

Improvements to IFRS (2018-2020) include three amendments to the standards:

- the amendments to IFRS 9 Financial instruments clarify that, when assessing whether an exchange of debt instruments between an existing borrower and lender is on terms that are substantially different, the fees to include together with the discounted present value of the cash flows under the new terms include only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf;
- the amendments IFRS 16 Leases remove illustrative example 13 accompanying IFRS 16, which in practice creates confusion in accounting for leasehold improvements for both lessee and lessor. The purpose of the amendment is to remove the illustrative example that creates confusion;
- the amendments to IAS 41 Agriculture remove the requirement to use pre-tax cash flows to measure fair value of agriculture assets. Previously, IAS 41 had required an entity to use pre-tax cash flows when measuring fair value but did not require the use of a pre-tax discount rate to discount those cash flows.

The Group does not expect the amendments to have a material impact on its financial statements when initially applied.

IFRS 17, Insurance Contracts (effective for annual periods beginning on or after 1 January 2023; to be applied prospectively. Early application is permitted.)

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 its financial statements.

Amendment to IFRS 16 COVID-19-Related Rent Concessions beyond 30 June 2021 (effective for annual periods beginning on or after 1 April 2021)

The pronouncement amended IFRS16 Leased to provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification.

2. Consolidation

The 2021 consolidated financial statements include the financial statements of AS LHV Pank (parent company) and its subsidiary LHV Finance. AS LHV Pank holds 65% interest in LHV Finance.

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 recognized 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 24), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

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.

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 31.12.2021 and 31.12.2020.

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognized 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. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized 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.

4. Foreign currency translation

4.1 Functional and presentation currency

The functional and presentation currency of entities in the Group is euro except the LHV UK Ltd in UK which has pound as functional currency As the LHV UK Ltd had limited activities and transactions in 2021, the effect to Group financial statements is immaterial.

4.2 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".

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.

6. Financial assets

6.1 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.

6.2 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.

6.3 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.

6.4 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.

6.5 Derivatives

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

6.6 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.

6.7 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.

6.8 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 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 recognized 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)		31.12.2021	31.12.2020
Financial assets	Amortised cost	Due from banks and investment companies		3,986,933	2,393,258
		Loans and advances to customers	Loans to legal entities	1,667,234	1,352,700
			Loans to individuals	1,009,926	856,123
		Receivables from customers		2,970	2,454
		Other financial assets		2,236	2,073
	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	Shares and fund units	367	142
			Listed bonds	127,349	322,699
			Derivatives	4	89
	Equity instruments at fair value through other comprehensive income	Investment securities	Unlisted shares	0	0

7. Impairment of financial assets carried at amortised cost

7.1 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 assessments 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.

7.2 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.

7.3 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:

1) 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.

2) 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 have 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.

7.4 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.

7.5 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.

7.6 Individual assessments 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 assessments may be applied to significant exposures at a counterparty level. These assessments 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.

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 amortization 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.

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 customer agreements (see below). The annual amortisation rate for purchased licenses is 33%.

Sales costs for the acquisition of new customers are capitalised. The amortisation method for customer agreements is the diminishing balance method. The annual amortisation rate for purchased customer agreements is 12% of the residual value of those assets. At the end of each reporting period, the appropriateness of amortization 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.

10. Impairment of assets

Assets that have indefinite useful lives (including goodwill) are not subject to amortization, 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 recognized 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 recognized 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 amortization or depreciation) had no impairment loss been recognised for the asset in prior years. Reversals of impairment losses are recognized in the statement of profit or loss as a reduction of the impairment loss.

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.

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.

LHV entered into one new type of funding transaction in 2021:

- preferred bonds;

These instruments are accounted as other loans received using effective interest rates, similarly as year 2020 new fundings TLTRO III and covered bonds. Covered bonds are secured by mortgage book and issues are rated by Moody's and listed in Dublin stock exchange. TLTRO III is secured by mortgage bonds and loans given to local municipalities.

TLTRO III has conditional interest rate, where interest rate depends based on the fulfilment of conditions. LHV has taken conservative approach and calculates the effective interest without taking positive potential uplift of interest into account. In case the conditions will be fulfilled, then LHV will recalculate interest income and book difference into running period without restating the previous accounting periods.

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

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.

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.

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).

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 Risk management section point 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 Risk Management section point 4).

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.

17.1 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.

17.2 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.

17.3 Dividend income

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

18. Asset management services

The Group is engaged in providing asset management services (Note 21). 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.

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 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 recognized 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 guarantees in the end of the contract.

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 the reporting date 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.

See also Note 12, 14 and 15 for more details.

20. Taxation and deferred income tax

20.1 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 22). 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.

20.2 Corporate income tax in other countries

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

Corporate income tax rates	2021	2020
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 17 to the financial statements.

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 recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. More detailed information in Risk management section.

22. Statutory legal reserve

Statutory legal reserve 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 legal reserve, until the reserve reaches one-tenth of share capital. Statutory legal reserve may be used to cover a loss, or to increase share capital. Payments to shareholders from statutory legal reserve are not allowed.

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 2021 for AS LHV Pank (hereinafter the Bank) and its subsidiary AS LHV Finance (together hereinafter: the Group or LHV). AS LHV Pank holds 65% interest in AS LHV Finance.

AS LHV Pank (Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia and in UK. There are offices for client servicing in Tallinn, Tartu and also London branch was opened in 2018. LHV is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt. 2, Tallinn. As at 31.12.2021, the Group employed 611 people, including 40 non-active employees (31.12.2020: 497 people, 26 non-active employees). LHV Finance offers hire-purchase services to merchants and consumer loans.

The Management Board approved the consolidated annual report (incl. financial statements) on 16 February 2022. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 22.7% of the voting rights and Andres Viisemann, who owns 9.6% of the voting rights (see also Note 17), 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 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 (Risk management section 2, Notes, 8, 9 and 10).

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 2021.

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 Asset and Liability Management Committee.

NOTE 3 Offsetting assets and liabilities

The Bank has offset the following assets and liabilities.

				Related arrangements not set off in the statement of financial position		
31.12.2021	**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	157	0	157	0	0	0
31.12.2020						
ASSETS						
Derivatives	89	0	89	0	0	0
LIABILITIES						
Derivatives	221	0	221	0	0	0

NOTE 4 Net interest income

Interest income *(in thousands of euros)*	Note	2021	2020
Interest income using effective interest calculation			
Corporate loans		62,213	46,834
incl. loans to related parties	20	54	31
incl. stage 3 interests*		303	129
Hire purchase		3,409	3,708
Consumer loans		8,156	8,314
Leveraged loans and lending of securities		1,742	753
Credit card loans		834	849
From balances with credit institutions and investment companies		281	33
Mortgage loans		21,441	18,170
incl. loans to related parties	20	41	34
Private loans		2,299	2,109
incl. loans to related parties	20	6	7
From balances with central bank		2,283	0
Other loans		16,332	3,710
Subtotal		**118,990**	**84,480**
Other similar interest income			
Leasing		6,000	4,329
incl. loans to related parties	20	9	4
From debt securities		-353	-435
incl. debt securities at FVOCI		0	0
incl. debt securities at fair value through profit or loss	8	-353	-435
Subtotal		**5,647**	**3,894**
Total		**124,637**	**88,374**
Interest expense			
Deposits from customers and loans received		-5,245	-7,569
From balances with central bank		-14,171	-5,966
Subordinated debt	16, 20	-7,557	-5,792
Total		**-26,973**	**-19,327**
Net interest income		**97,664**	**69,047**

Interest income of loans by customer location
(interests from bank balances and debt securities not included):

Estonia	121,461	87,421
Other	965	1,355
Total	**122,426**	**88,776**

*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 5 Net fee and commission income

Fee and commission income	Note	2021	2020
Security brokerage and commission fees		6,159	4,825
Asset management and related fees		5,354	3,662
Currency exchange fees		8,617	3,418
Fees from cards and settlements		23,635	15,226
Other fee and commission income		4,946	4,021
Total	**23**	**48,711**	**31,152**

Fee and commission expense	Note	2021	2020
Security brokerage and commission fees paid		-1,856	-1,062
Expenses related to cards		-5,904	-4,722
Expenses related to acquiring		-7,104	-4,498
Fees related to consumer loans and hire-purchase paid		-667	-635
Other fee expense		-2,007	-1,852
Total	**23**	**-17,538**	**-12,769**

Net fee and commission income	**23**	**31,173**	**18,383**

Fee and commission income by customer location:	2021	2020
Estonia	41,414	27,557
Other	7,297	3,595
Total	**48,711**	**31,152**

NOTE 6 Operating expenses

(in thousands of euros)	Note	2021	2020
Wages, salaries and bonuses		20,356	16,159
Social security and other taxes*		6,365	4,956
Total staff costs		**26,721**	**21,115**
IT expenses		3,890	2,986
Information services and banking services		1,288	961
Marketing expenses		1,936	1,434
Office expenses		815	638
Transportation and communication costs		292	266
Training and travelling expenses of employees		407	299
Other outsourced services		3,452	2,528
Other administrative expenses		6,749	3,263
Depreciation and amortisation		2,668	2,417
Rental payments		526	41
Other operating expenses		596	317
Total other operating expenses		**22,619**	**15,150**
Total operating expenses		**49,340**	**36,265**

* lump-sum payment of social, health and other contributions

The average number of employees working for the Group in 2021 was 573 (2020: 465).

NOTE 7 Due from central bank, credit institutions and investment companies

(in thousands of euros)	31.12.2021	31.12.2020
Demand and term deposits with maturity of less than 3 months*	112,649	180,047
Statutory reserve capital at central bank	57,298	41,253
Demand deposit from central bank*	3,816,986	2,171,958
Total	**3,986,933**	**2,393,258**
*cash and cash equivalents in the statement of cash flows	3,929,635	2,352,005

Mandatory banking reserve as at 31.12.2021 was 1% (2020: 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 8 Investments in debt and equity securities

Mandatory measurement as fair value through profit or loss	**31.12.2021**
Shares and fund units	367
Debt securities	127,349
Foreign exchange forwards	4
Total financial assets	**127,720**
Interest rate swaps and foreign exchange forwards	157
Total financial liabilities	**157**

Mandatory measurement as fair value through profit or loss	**31.12.2020**
Shares and fund units	142
Debt securities	322,699
Foreign exchange forwards	89
Total financial assets	**322,930**
Interest rate swaps and foreign exchange forwards	221
Total financial liabilities	**221**

Financial assets at fair value through profit or loss 31.12.2019	**32,499**
Net changes of investment securities at fair value through profit or loss	289,533
Negative interest income (Note 5)	-435
Revaluation	1,333
Financial assets at fair value through profit or loss 31.12.2020	**322,930**
Net changes of investment securities at fair value through profit or loss	-193,852
Negative interest income (Note 5)	-353
Revaluation	-1,005
Financial assets at fair value through profit or loss 31.12.2021	**127,720**

Bid price is the fair value of investments in the case of publicly listed securities. In 2021, a loss of EUR 1,142 thousand (2020: EUR 865 thousand gain) was recognised on the revaluation of bonds. No profit or loss arose on the revaluation of interest rate swaps in 2021 and in 2020. Interest income from bonds is recognised in interest income.

NOTE 9 Loans and advances to customers

(in thousands of euros)	31.12.2021	31.12.2020
Loans to legal entities	**1,683,891**	**1,367,540**
incl. corporate loans	1,469,216	1,192,803
incl. leasing	111,001	102,297
incl. overdraft	32,327	30,338
incl. trade finance	37,162	20,497
incl. leveraged loans	5,304	5,551
incl. credit cards and hire-purchase	570	519
incl. apartment association loans	10,929	7,135
incl. factoring	17,382	8,400
Loans to individuals	**1,012,318**	**858,141**
incl. hire-purchase	13,081	14,294
incl. mortgage loans	840,736	695,204
incl. consumer loans	56,936	52,202
incl. private loans	49,683	50,264
incl. leasing	30,127	26,554
incl. leveraged loans	9,008	6,366
incl. credit card loans	7,540	7,232
incl. overdraft	19	23
incl. study loan	1,213	974
incl. real estate leasing	3,975	5,028
Total	**2,696,209**	**2,225,681**
incl. related parties (Note 20)	6,047	4,096
Impairment provisions	-19,049	-16,858
Total	**2,677,160**	**2,208,823**

In 2020 LHV purchased from Danske Bank Estonia Branch corporate portfolio, increasing the portfolio by EUR 254 million.

In 2021, the average effective interest rate of new consumer loans issued to individuals was 12-15%. The average effective interest rate for hire-purchase was around 22.4%, credit cards 18% and leasing 3.41%. The contractual interest rate of leveraged loans issued to individuals is generally equal to their effective interest rate because no other significant fees have been received upon their issue.

Changes in impairments	Balance as at 1 January	Impairment provisions / reversals set up during the year	Written off during the reporting period	Balance as at 31 December
Corporate Lending	-13,449	-9,707	7,867	-15,289
Consumer Financing	-1,178	-1,318	1,177	-1,320
Investment Financing	-25	-130	25	-130
Leasing	-1,385	-1,226	1,361	-1,250
Private Lending	-821	-707	466	-1,061
Total 2021	**-16,858**	**-13,087**	**10,896**	**-19,049**
Corporate Lending	-3,819	-11,345	1,714	-13,449
Consumer Financing	-789	-923	534	-1,178
Investment Financing	-6	-21	2	-25
Leasing	-639	-981	235	-1,385
Private Lending	-851	-498	528	-821
Total 2020	**-6,104**	**-13,767**	**3,013**	**-16,858**

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.

For credit risk exposures and loan collateral, see Risk management section 2.4.4. Distribution of loans granted by currencies is disclosed in Risk management section 3.1.

Distribution of loans granted by maturity is disclosed in Risk management section 4

The geographical distribution of loans granted is disclosed in Risk management section 2.3.1.

For interest income on loans granted, see Note 4.

NOTE 10 Receivables from customers

(in thousands of euros)	31.12.2021	31.12.2020
Asset management fees from customers	738	1,203
Other fees for providing services to customers	981	1,242
Payments in transit	1,251	9
Total	**2,970**	**2,454**

All fees, other than receivables related to collection of receivables, are receivable within 12 months of the end of the reporting period and are considered as current asset.

NOTE 11 Other assets

(in thousands of euros)	31.12.2021	31.12.2020
Financial assets		
Guarantee deposits of Baltic stock exchanges	17	15
Guarantee deposits of VISA and MasterCard	2,219	2,058
Subtotal	**2,236**	**2,073**
Non-financial assets		
Prepayments to Financial Supervision Authority	829	592
Other prepayments*	1,617	1,351
Subtotal	2,446	1,943
Total	**4,682**	**4,016**

* 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 12 Tangible and intangible assets

(in thousands of euros)	Tangible assets	Right-of-use assets	Total tangible assets	Intangible assets	Total
Balance as at 31.12.2019					
Cost	5,055	5,676	10,731	3,806	14,537
Accumulated depreciation and amortisation	-3,152	-899	-4,051	-3,121	-7,172
Carrying amount 31.12.2019	**1,903**	**4,777**	**6,680**	**685**	**7,365**
Changes in 2020:					
Purchase of non-current assets	1,636	0	1,636	794	2,430
Write-off of non-current assets	0	-230	-230	0	-230
Depreciation/amortisation charge	-773	-972	-1,745	-672	-2,417
Balance as at 31.12.2020					
Cost	6,691	5,446	12,137	4,600	16,737
Accumulated depreciation and amortisation	-3,925	-1,641	-5,566	-3,793	-9,359
Carrying amount 31.12.2020	**2,766**	**3,805**	**6,571**	**807**	**7,378**
Purchase of non-current assets	2,251	992	3,243	1,496	4,739
Write-off of non-current assets	0	-67	-67	-807	-874
Depreciation/amortisation charge	-835	-773	-1,608	-1,060	-2,668
Balance as at 31.12.2021					
Cost	8,942	6,438	15,380	5,289	20,669
Accumulated depreciation and amortisation	-4,760	-2,481	-7,241	-4,046	-11,287
Carrying amount 31.12.2021	**4,182**	**3,957**	**8,139**	**1,243**	**9,382**

Tangible assets include computer technology and office equipment, furniture, capitalized costs of office renovation. Intangible assets include licenses, client contracts and development costs. In 2021 and 2020, there was no indication of impairment of tangible and intangible assets.

NOTE 13 Deposits from customers and loans received

31.12.2021
(in thousands of euros)

	Individuals	Financial entities	Non-financial entities	Public sector	Total
Demand deposits	1,005,757	2,512,958	2,008,349	161,510	5,688,574
Term deposits	39,209	15,679	81,808	22,587	159,283
Accrued interest liability	285	-1,537	-5	2	-1,255
Total	**1,045,251**	**2,527,100**	**2,090,152**	**184,099**	**5,846,602**
incl. related parties (Note 20)	2,349	0	28,290	0	30,639

31.12.2020
(in thousands of euros)

Demand deposits	745,304	1,235,203	1,284,186	392,134	3,656,827
Term deposits	256,764	38,895	172,406	15,237	483,302
Accrued interest liability	1,208	24	68	2	1,302
Total	**1,003,276**	**1,274,122**	**1,456,660**	**407,373**	**4,141,431**
incl. related parties (Note 20)	1,791	0	19,527	0	21,318

		31.12.2021		**31.12.2020**
(in thousands of euros)	Loan principal	Accrued interest	Loan principal	Accrued interest
Loan received from EIF and NIB	0	0	19,757	2
Debt securities in issue	99,633	310	0	0
Covered bonds	248,980	140	248,685	140
Total	**348,613**	**450**	**268,442**	**142**

		31.12.2021		**31.12.2020**
(in thousands of euros)	Loan principal	Accrued interest	Loan principal	Accrued interest
Received loan from central banks (TLTRO)	200,000	-2,539	200,000	0
Total	**200,000**	**-2,539**	**200,000**	**0**

AS LHV Pank had 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 31.12.2020, the Bank had used EUR 12 250 thousand of the loan amount and repaid the principal in the amount of EUR 3,604 thousand. The outstanding balance as at 31.12.2020 is EUR 8,646 thousand. As at 31 12 2020, the Bank has received EUR 20,000 thousand loan from Nordic Investment Bank (NIB) and repaid the principal in the amount of EUR 8,889 thousand. As at 31.12.2020 the balance of the loan received from NIB is EUR 11,111 thousand.

At the end of 2021 loans received from European Investment Fund and Nordic Investment Bank were fully repaid.

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 Risk management section point 3.1.

Distribution of deposits from customers and loans received by maturity is presented in Risk management section 4.

Distribution of deposits from customers and loans received by geography and risk concentration is presented in Risk management section 2.3.1.

NOTE 14 Accounts payable and other liabilities

(in thousands of euros)	31.12.2021	31.12.2020
Financial liabilities		
Trade payables	2,682	575
Other short-term financial liabilities	6,904	5,591
Lease liabilities	3,266	3,394
Payments in transit	27,202	10,952
Financial guarantee contracts issued	1,101	397
Subtotal	**41,155**	**20,909**
Non-financial liabilities		
Prepaid expenses	816	239
Performance guarantee contracts issued	543	299
Tax liabilities	1,908	1,624
Payables to employees	2,194	1,881
Subtotal	**5,461**	**4,043**
Total	**46,616**	**24,952**

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. Deferred income tax calculated on future dividends in the amount of EUR 1,603 (2020: 2,416) thousand is included in other short term financial liabilities.

NOTE 15 Right of use assets and lease liabilities

The Group leases office premises. 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. The Group's total assets in the statement of financial position as at 31.12.2021 is EUR 3,957 (31.12.2020: 3,805) thousand and the liability is EUR 3,266 (31.12.2020: 3,394) thousand. The increase in 2021 was related to the new lease properties and also due to prolonging the agreements. During the year 2020 EUR 315 thousand was deducted from 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 2021 is disclosed in the Note 10. The lease liability is disclosed in the Note 14. Interest expense on lease liabilities was EUR 101 (2020: 144) thousand and the depreciation of the right of use assets was EUR 840 (2020: 972) thousand (Note 12). The repayments of principal of lease liabilities in 2021 were EUR 963 (2020: 963) thousand.

NOTE 16 Subordinated debts

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.

Subordinated bonds issued in 2015 in the amount of EUR 7,000 thousand were redeemed in 2020.

In May 2016, subordinated bonds were issued totalling EUR 5,000 thousand carrying rate of interest at 6.50%. The due date of the bonds is 29 July 2026.

In 2017, no subordinated bonds were issued or redeemed.

In December 2018, subordinated bonds were issued totalling EUR 10 000 thousand carrying a rate of interest at 6.50%. The due date of the bonds is 20.12.2028.

In June 2019, subordinated bonds were issued totalling EUR 20,500 thousand (due date 29.06.2029) and in October 2019 totalling EUR 5,000 thousand (due date 29.10.2029), both carrying a rate of interest at 6.50%.

In September 2020, subordinated bonds were issued totalling EUR 10,000 thousand (due date 30.09.2030) carrying a rate of interest at 7.0%.

In 2019 Tier 1 subordinated loans were issued totalling EUR 23,000 thousand carrying a rate of interest at 9.50%.

In 2020 Tier 1 subordinated loans were issued totalling EUR 15,000 thousand carrying a rate of interest at 9.50%.

The balances of subordinated debt 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.

Subordinated debt
(in thousands of euros)

Subordinated debt as at 01.01.2020	**70,500**
Subordinated bonds issued	25,000
Subordinated bonds redeemed	-7,000
Subordinated debt as at 31.12.2020	**88,500**
Subordinated bonds issued	0
Subordinated bonds redeemed	0
Subordinated debt as at 31.12.2021	**88,500**

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 debt as at 01.01.2020	**429**
Interest calculated for 2020 (Note 5)	5,792
Paid out during 2020	-5,732
Accrued interest on subordinated debt as at 31.12.2020	**489**
Interest calculated for 2021 (Note 5)	6,942
Paid out during 2021	-6,942
Accrued interest on subordinated debt as at 31.12.2021	**489**

NOTE 17 Shareholders' equity in the public limited company

The sole shareholder of the Group is a company registered in Estonia, AS LHV Group. Rain Lõhmus who owns 22.7% of the voting rights and Andres Viisemann who owns 9.6% of the voting rights in AS LHV Group have significant influence over the company (31.12.2020: 23.4% and 9.7%, respectively). According to the Company's articles of association, the minimum share capital is EUR 25 million and the maximum share capital is EUR 100 million (at 31.12.2020: EUR 25 million and EUR 100 million, respectively). The share capital is paid in full through cash contributions. In 2021, the share capital of AS LHV Pank was increased by EUR 5 million and in 2020 by EUR 11 million through a cash contribution by the sole shareholder AS LHV Group. The Bank's share capital increased to EUR 111.5 million by the year-end 2021.

As at 31.12.2021, the adjusted unconsolidated retained earnings of the Group amounted to EUR 156,690 thousand (31.12.2020: EUR 98,249 thousand). Thus, as at 31.12.2021 it is possible to pay out dividends in amount EUR 125,556 thousand (2020: EUR 78,764 thousand) and the related income tax charge would be EUR 31,134 thousand (2020: EUR 19,485 thousand). If the dividends were to be paid, the Group's capital adequacy would remain compliant.

Transactions with share capital and share premium	31.12.2021	31.12.2020
Share capital	**111,500**	**106,500**
Number of shares	111,500,000	106,500,000
Par value of a share	1 EUR	1 EUR

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 equivalent employees and department managers and equivalent employees of group companies that are part of AS LHV Group. 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 and comprehensive. The share options were issued in 2020 and in 2021.

In 2021, share options were granted to six members of the Management Board of AS LHV Pank and one hundred nineteen employees in the total amount of EUR 2,764 thousand.

In 2020, share options were granted to seven members of the Management Board of AS LHV Pank and ninety employees in the total amount of EUR 2,119 thousand.

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 can be exercised after the expiry of a three-year period.

Share options issued in 2018 were exercised in 2021, when shares with nominal value of EUR 1 could be acquired for EUR 5.33 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 EUR 1 can be acquired for EUR 4.90 per share.

Share options issued in 2020 can be exercised between the period of 01.04.2023-30.04.2023 and shares with nominal value of EUR 1 can be acquired for EUR 5.96 per share.

Share options issued in 2021 can be exercised between the period of 01.04.2024-30.04.2024 and shares with nominal value of EUR 1 can be acquired for EUR 9.23 per share.

Statutory legal reserve in equity is composed of:

(in thousands of euros)

Statutory legal reserve as at 01.01.2020	**3,025**
Transferred from 2019 net profit	997
Statutory legal reserve as at 31.12.2020	**4,022**
Transferred from 2020 net profit	1,626
Statutory legal reserve as at 31.12.2021	**5,648**

NOTE 18 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)

31.12.2021	31.12.2020	
Cash balance of customers	3,806	7,938
Securities of customers	3,599,285	2,058,404
incl. parent company (Note 20)	206,700	202,300
incl. shareholders of the parent company and related entities (Note 20)	660,351	306,625
Total	**3,603,091**	**2,066,342**

Asset management fees for the management of these assets have been in the range of 0.01 – 0.02 % p.a. (for respective income, see Note 5).

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 19 Contingent assets and liabilities

Non-cancellable agreements	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2021	19,919	49,409	1,438	679,579	**750,345**
Liability in contractual amount 31.12.2020	15,217	36,492	8	413,818	**465,535**

Income tax from potential future dividends is disclosed in Note 17.

With the initial application of IFRS 9, financial guarantees and unused loan commitments are subject to ECL, see also note Risk management section point 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 2020-2021. The Group's management estimates that in 2022 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 is as follows:

Breakdown by economic sectors	31.12.2021	31.12.2020
Construction	11,404	9,302
Water and utilities	3,186	950
Manufacturing	2,758	1,879
Administrative activities	691	1,235
Professional, scientific and technical activities	651	523
Other areas at activities	1,229	1,328
Total	**19,919**	**15,217**

Breakdown by internal ratings		
5 low credit risk	1,141	1,878
6 low credit risk	898	4,228
7 medium credit risk	5,127	2,267
8 medium credit risk	7,648	1,630
9 heightened credit risk	1,309	1,220
10 high credit risk	671	414
11 high credit risk	0	218
12 non-satisfactory rating	0	0
13 non-satisfactory rating	214	0
Non-rated	2,911	3,362
Total	**19,919**	**15,217**

Performance guarantees are over-collateralised as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2021 nor in previous period.

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NOTE 20 Transactions with related parties

In preparing the consolidated financial statements of AS LHV Pank, 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	2021	2020
Interest income	**5**	**144**	**54**
incl. management		63	54
Interest expenses	**5**	**6,969**	**5,803**
incl. management		7	4
incl. parent company		6,942	5,786
incl. shareholders, their related entities and close relatives that have significant influence		20	13
Fee and commission income	**6**	**12**	**13**
incl. management		8	7
incl. shareholders, their related entities and close relatives that have significant influence		5	6

Balances	Note	31.12.2021	31.12.2020
Loans and receivables as at the year-end	**11**	**6,047**	**4,096**
incl. management		2,887	2,462
incl. shareholders, their related entities and close relatives that have significant influence		3,160	1,634
Deposits and loans received as at the year-end		**30,639**	**21,318**
incl. management	15	788	626
incl. parent company	18	16,941	11,240
incl. shareholders, their related entities and close relatives that have significant influence	15	12,910	9,452

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.

As at 31.12.2021 and 31.12.2020, the management did not have term deposits and the interest rate on demand deposits corresponds to the terms applicable to customers.

The subordinated loans received in 2015 were redeemed during 2020. The subordinated debt received in 2016-2019 have the interest rate of 6.5%. The subordinated debt received in 2020 has the interest rate of 7.0%. Tier 1 subordinated debt received 2019 and 2020 have the interest rate of 9.5%.

The interest rate of all subordinated debts is the same as the parent company is paying on its own subordinated loan received from a third party and deposited the funds at the Bank.

In 2021, salaries and other compensations paid to the management of LHV totalled EUR 984 thousand (2020: EUR 1,057 thousand), including all taxes. The Management Board of the Bank had seven members in 2020.

Starting from the beginning of 2021 the Management Board of the Bank has 6 members. As at 31.12.2021, the remuneration for December and accrued holiday pay in the amount of EUR 51 thousand (as at 31.12.2020: EUR 60 thousand) is reported as a payable to management (Note 14). The Group did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2021 and 31.12.2020 (pension liabilities, termination benefits, etc.). In 2021 and 2020, no remuneration was paid to the members of the Supervisory Board.

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. Information on assets of related parties held as an account manager is presented in Note 18.

NOTE 21 Subsidiaries

As at 31.12.2021 and 31.12.2020, the Bank has one subsidiary that has been consolidated in these financial statements:

- AS LHV Finance (ownership interest 65%)

AS LHV Pank paid in 2013 EUR 325 thousand of monetary contribution for 65% ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand of monetary contribution for 35% ownership.

The contribution of the non-controlling interest has been reflected in the consolidated statement of financial position on the line „Non-controlling interest".

Set out below are the summarized financial information for each subsidiary that has non-controlling interests that are material to the Bank. The information disclosed is the amount before inter-company eliminations.

Summarized statement of financial position	**AS LHV Finance**	
(in thousands of euros)	31.12.2021	31.12.2020
Loans and advances to customers and other current assets	69,079	65,804
Non-current assets	10	45
Current liabilities	1,968	1,808
Non-current assets	48,449	45,970
Total net assets	**18,672**	**18,071**

Summarized statement of profit or loss and other comprehensive income	**AS LHV Finance**	
(in thousands of euros)	31.12.2021	31.12.2020
Net interest and fee and commission income	9,887	10,215
Profit before income tax	7,726	7,979
Income tax expense	-1,184	-826
Net profit	**6,542**	**7,153**
Total comprehensive income	6,542	7,153
Profit and other comprehensive income allocated to non-controlling interests	2,291	2,089

Summarized statement of cash flows	**AS LHV Finance**	
(in thousands of euros)	31.12.2021	31.12.2020
Cash flows from operating activities	6,494	9,411
Interest paid	-1,797	-1,899
Income tax paid	-1,184	-826
Net cash from/ (used in) operating activities	3,513	6,686
Net cash from/ (used in) investing activities	0	0
Net cash from/ (used in) financing activities	-3,515	-6,684
Net increase/(decrease) in cash and cash equivalents	**-2**	**2**
Cash and cash equivalents at the beginning of the year	2	0
Cash and cash equivalents at the end of the year	**0**	**2**

NOTE 22 Income tax expense

The Bank is calculating 14% advance income tax. Advance corporate income tax for the year 2021 was EUR 9,338 thousand (2020: EUR 4,740 thousand).

(in thousands of euros)	2021	2020
Advance corporate income tax	9,338	4,740
Corporate income tax	1,219	2,009
Total income tax expense	**10,557**	**6,749**

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NOTE 23 Operating segments

Bank divides its business activities by 4 main business segments: retail banking, corporate banking, hire purchase and financial intermediates. The business segments form LHV Pank, 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 are 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.

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.

Hire-purchase and consumer finance unit is separate legal entity covering small loan business to private individuals. These portfolios are relatively small, but due to customers' 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 activities include treasury activities through providing internal bank function to segments. Assets and liabilities are disclosed in a way how it is reported to the management of the Bank, i.e. the treasury function investments and funding are allocated to other segments, but some of the interest income and expense are allocated to treasury. This is, eliminated with intra-segment eliminations.

The management board of AS LHV Pank 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 4 and 5. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.

31.12.2021 *(in thousands of euros)*	Retail banking	Corporate banking	Hire-purchase and consumer finance	Financial intermediates	Other activities	Total
Interest income	36,226	59,564	11,577	5,107	12,163	124,637
Interest expense	-1,066	-10,172	-1,791	0	-13,944	-26,973
Net interest income	**35,160**	**49,392**	**9,786**	**5,107**	**-1,781**	**97,664**
Fee and commission income	10,003	2,515	768	34,647	778	48,711
Fee and commission expense	-1,831	-354	-667	-14,946	260	-17,538
Net fee and commission income	**8,172**	**2,161**	**101**	**19,701**	**1,038**	**31,173**
Net gains from financial assets	**-97**	**0**	**0**	**-436**	**-1,008**	**-1,541**
Net other income	**15**	**397**	**0**	**96**	**91**	**599**
Net income	**43,250**	**51,950**	**9,887**	**24,468**	**-1,660**	**127,895**
Administrative and other operating expenses, staff costs	-15,788	-9,853	-1,868	-14,732	-7,099	-49,340
Operating profit	**27,462**	**42,097**	**8,019**	**9,736**	**-8,759**	**78,555**
Impairment losses on loans and advances	-475	-3,110	-293	-43	-27	-3,948
Income tax	-3,120	-4,544	-1,184	-1,670	-39	-10,557
Net profit for the reporting period	**23,867**	**34,443**	**6,542**	**8,023**	**-8,825**	**64,050**
Total assets as at 31.12.2021	**2,885,760**	**3,905,861**	**69,089**	**0**	**-51,863**	**6,808,847**
Total liabilities as at 31.12.2021	**3,297,057**	**711,642**	**50,417**	**2,520,127**	**-50,355**	**6,528,888**

31.12.2020 *(in thousands of euros)*	Retail banking	Corporate banking	Hire-purchase and consumer finance	Financial intermediates	Other activities	Total
Interest income	28,867	44,659	12,022	941	1,885	88,374
Interest expense	-2,072	-6,246	-1,880	0	-9,129	-19,327
Net interest income	**26,795**	**38,413**	**10,142**	**941**	**-7,244**	**69,047**
Fee and commission income	8,284	1,000	708	21,160	0	31,152
Fee and commission expense	-1,042	-44	-635	-11,032	-16	-12,769
Net fee and commission income	**7,242**	**956**	**73**	**10,128**	**-16**	**18,383**
Net gains from financial assets	**-50**	**-1**	**0**	**17**	**911**	**877**
Net income	**33,987**	**39,368**	**10,215**	**11,086**	**-6,349**	**88,307**
Administrative and other operating expenses, staff costs	-13,213	-7,691	-1,703	-9,588	-3,862	-36,057
Operating profit	**20,774**	**31,677**	**8,512**	**1,498**	**-10,211**	**52,250**
Impairment losses on loans and advances	-976	-9,363	-533	-26	0	-10,898
Income tax	-1,825	-2,394	-826	-521	-1,183	-6,749
Net profit	**17,973**	**19,920**	**7,153**	**951**	**-11,394**	**34,603**
Total assets as at 31.12.2020	**1,722,042**	**3,050,474**	**65,851**	**147,604**	**-47,112**	**4,938,859**
Total liabilities as at 31.12.2020	**2,172,121**	**1,274,941**	**47,778**	**1,274,941**	**-45,604**	**4,724,177**

NOTE 24 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 consolidated financial statements.

Statement of profit or loss and other comprehensive income of the parent

(in thousands of euros)	2021	2020
Interest income	114,851	78,232
Interest expense	-26,973	-19,327
Net interest income	**87,878**	**58,905**
Fee and commission income	47,943	30,444
Fee and commission expense	-16,871	-12,134
Net fee and commission income	**31,072**	**18,310**
Net gains from financial assets measured at fair value	2,385	3,493
Foreign exchange rate gains/losses	-26	43
Net gains/losses from financial assets	**2,359**	**3,536**
Other income	2,893	1,048
Administrative and other operating expenses	-49,766	-35,402
Operating profit	**74,436**	**46,397**
Impairment losses on loans and advances	-3,655	-10,365
Profit before income tax	**70,781**	**36,032**
Income tax expense	-9,372	-4,740
Net profit for the year	**61,409**	**31,292**
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	-212
Items that will not be reclassified to profit or loss:		
Net gains on investments in equity instruments designated at FVOCI	0	0
Total profit and other comprehensive income for the year	**61,409**	**31,080**

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Statement of financial position of the parent

(in thousands of euros)	Note	31.12.2021	31.12.2020
Assets			
Due from central bank		3,874,284	2,213,211
Due from credit institutions		106,461	170,060
Due from investment companies		6,188	9,985
Financial assets at fair value through profit or loss		127,720	322,930
Loans and advances to customers		2,656,811	2,189,287
Receivables from customers and other financial assets		8,036	5,082
Other assets		2,423	1,907
Subsidiaries	21	325	325
Tangible fixed assets		4,097	2,766
Right-of-use assets		4,042	3,805
Intangible assets		1,233	762
Total assets		**6,791,620**	**4,920,120**
Liabilities			
Amounts owed to central banks (TLTRO)		197,461	200,000
Deposits from customers		5,846,602	4,141,431
Loans received		349,063	268,584
Financial liabilities at fair value through profit or loss		157	221
Accounts payable and other liabilities		43,287	19,384
Lease liability		3,266	3,394
Subordinated debt		88,989	88,989
Total liabilities		**6,528,825**	**4,722,003**
Equity			
Share capital	17	111,500	106,500
Statutory legal reserve		5,648	4,022
Retained earnings		145,647	87,595
Total equity		**262,795**	**198,117**
Total liabilities and equity		**6,791,620**	**4,920,120**

Statement of cash flows of the parent

(in thousands of euros)	2021	2020
Cash flows from operating activities		
Interest received	114,871	76,980
Interest paid	-29,533	-20,714
Fees and commissions received	47,943	30,444
Fees and commissions paid	-16,871	-12,134
Other income received	2,893	836
Staff costs paid	-24,599	-18,349
Administrative and other operating expenses paid	-19,300	-11,428
Income tax paid	-8,372	-3,332
Cash flows from operating activities before change in operating assets and liabilities	**67,032**	**42,303**
Net increase/(decrease) in operating assets:		
Net acquisition/disposal of trading portfolio	-140	-64
Loans and advances to customers	-473,990	-528,397
Mandatory reserve at central bank	-16,045	-14,827
Security deposits	-164	173
Other assets	-515	-80
Net increase/(decrease) in operating liabilities:		
Demand deposits of customers	2,031,748	1,455,310
Term deposits of customers	-324,019	-25,248
Net loans received (including loan repayments)	-21,691	442,799
Subordinated loans received	99,633	0
Financial liabilities held for trading at fair value through profit or loss	-64	212
Other liabilities	22,965	-439
Net cash from/ (used in) operating activities	**1,384,750**	**1,371,742**
Cash flows from investing activities		
Purchase of tangible and intangible assets	-4,673	-2,430
Proceeds from disposal and redemption of investment securities	0	432
Net changes of investment securities at fair value through profit or loss	197,735	-286,875
Net cash from/ (used in) investing activities	**193,062**	**-288,873**
Cash flows from financing activities		
Paid in share capital	5,000	11,000
Proceeds from subordinated debt	0	25,000
Subordinated debt redeemed	0	-7,000
Dividends paid	-3,900	-2,658
Repayment of principal of lease liabilities	-1,254	-1,278
Net cash from financing activities	**-154**	**25,064**
Effect of exchange rate changes on cash and cash equivalents	**-26**	**43**
Net increase/ (decrease in cash and cash equivalents	**1,577,632**	**1,107,976**
Cash and cash equivalents at the beginning of the financial year	**2,352,003**	**1,244,027**
Cash and cash equivalents at the end of the financial year	**3,929,635**	**2,352,003**

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Statement of changes in shareholders' equity

(in thousands of euros)	Share capital	Statutory reserve capital	Other reserves	Retained earnings	Total
Balance as at 01.01.2020	**95,500**	**3,025**	**212**	**58,377**	**157,114**
Transferred into statutory legal reserve	0	997	0	-997	**0**
Paid in share capital	11,000	0	0	0	**11,000**
Dividends paid	0	0	0	-2,658	**-2,658**
Share options	0	0	0	1,581	**1,581**
Net profit for the year	0	0	0	31,292	**31,292**
Other comprehensive income	0	0	-212	0	**-212**
Net profit and other comprehensive income for 2020	0	0	-212	31,292	**31,080**
Balance as at 31.12.2020	**106,500**	**4,022**	**0**	**87,595**	**198,117**
Carrying amount of holdings under control and significant influence	0	0	0	-325	**-325**
Value of holdings under control and significant influence under equity method	0	0	0	10,978	**10,978**
Adjusted unconsolidated equity as at 31.12.2020	**106,500**	**4,022**	**0**	**98,248**	**208,770**
Balance as at 01.01.2021	**106,500**	**4,022**	**0**	**87,595**	**198,117**
Transferred into statutory legal reserve	0	1,626	0	-1,626	**0**
Paid in share capital	5,000	0	0	0	**5,000**
Dividends paid	0	0	0	-3,900	**-3,900**
Share options	0	0	0	2,168	**2,168**
Net profit for the year	0	0	0	61,409	**61,409**
Other comprehensive income	0	0	0	0	**0**
Net profit and other comprehensive income for 2021	0	0	0	61,409	**61,409**
Balance as at 31.12.2021	**111,500**	**5,648**	**0**	**145,647**	**262,795**
Carrying amount of holdings under control and significant influence	0	0	0	-325	**-325**
Value of holdings under control and significant influence under equity method	0	0	0	11,368	**11,368**
Adjusted unconsolidated equity as at 31.12.2021	**111,500**	**5,648**	**0**	**156,690**	**273,838**

Adjusted unconsolidated equity is the maximum amount that can be distributed to shareholders' according to Estonian legislation.

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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 Pank for the financial year ended 31 December 2021. The consolidated financial statements present a true and fair view of the Bank's consolidated financial position, the consolidated results of operations and its consolidated cash flows.

01.03.2022

Kadri Kiisel
Chairman of the Management Board

Andres Kitter
Member of the Management Board

Indrek Nuume
Member of the Management Board

Jüri Heero
Member of the Management Board

Meelis Paakspuu
Member of the Management Board

Martti Singi
Member of the Management Board

Independent auditors' report

To the Shareholders of AS LHV Pank

(Translation of the Estonian original)

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of **AS LHV Pank** and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2021, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in the European Union.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (Estonia). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Code of Ethics for Professional Accountants (Estonia) (including International Independence Standards), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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. We have determined the matter described below to be the key audit matter to be communicated in our report.

Impairment of loans and advances to customers	
Refer to Risk Management section, Note 2 "Significant management estimates and assumptions", and Note 9 "Loans and advances to customers".	
The key audit matter	**How the matter was addressed in our audit**
As at 31 December 2021, loans and advances to customers amounted to EUR 2 677 million and related impairment loss for the financial year EUR 4 million. We have focused on this area because of overall financial significance and the matter that measurement of expected credit losses (ECL) on financial instruments involves significant judgement. ECL calculations are forward looking and probability weighted accounting estimates. The key areas where we identified greater level of management judgement and therefore increased level of audit focus in the Group's ECL related accounting estimates: — Judgmental modelling is used to estimate ECL which involves determining the Probability of Default (PD), Loss Given Default (LGD) and Exposure at Default (EAD). The PD models are the key drivers of complexity in the ECL and also impact the staging of relevant financial assets, and hence, are considered the most significant judgmental aspect of the Group's ECL modelling approach. — Economic scenarios – IFRS 9 requires the Group to measure ECL on an unbiased forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied in determining the economic scenarios used and the probability weights applied to them when considering the current uncertain economic environment. — For defaulted corporate loans, an individual impairment loss is calculated based on the exposure and realizable value of relevant collateral at the reporting date, and also requires significant accounting estimates.	In this area, we conducted, among others, the following audit procedures: We have assessed the Group's accounting policies and methodology applied for the calculation of impairment of loans and advances to customers in relation to the requirements of IFRS 9. We have performed end to end process walkthrough to identify key systems, applications and controls used in the ECL calculation process. We tested relevant manual, general IT and application controls over key systems used in ECL process. We have tested the design, implementation and operating effectiveness of the credit file periodic review, rating assessment and monitoring of collaterals for corporate loans. We have performed test of details over the following: • completeness and accuracy of data used in ECL calculation • compliance of key inputs used in ECL calculation with the IFRS 9 methodology • accuracy and compliance of 12-month and lifetime ECL calculations with IFRS 9 methodology • adequacy of discounting in the ECL model • accuracy and completeness of data used for staging loans • internal assignment of credit ratings to corporate exposures • adequacy of information about collaterals and their values • completeness of stage 3 exposures and related ECL calculations. We have assessed the reasonableness of key assumptions made by the management, which serve as critical inputs in the ECL model, such as weights of different scenarios, loan portfolio point in time PD estimates, criteria to determine significant increase in credit risk, key forecasts of macroeconomic information and multipliers used for different scenarios.

Other Information

Management is responsible for the other information. The other information includes management report but does not include the consolidated financial statements and our auditors' 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 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. In addition, our responsibility is to state whether the information presented in the management report has been prepared in accordance with the applicable legal and regulatory requirements.

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 and we state that the information presented in the management report is materially consistent with the consolidated financial statements and in accordance with the applicable legal and regulatory requirements.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted in the European Union, and for such internal control as management 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, management 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 management 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.

Auditors' 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 auditors' 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 International Standards on Auditing (Estonia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and 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 these consolidated financial statements.

As part of an audit in accordance with International Standards on Auditing (Estonia), we exercise professional judgement and maintain professional skepticism 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 management.
- Conclude on the appropriateness of management'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, then we are required to draw attention in our auditors' 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 auditors' 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 communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and where applicable, actions taken to eliminate threats or safeguards applied.

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 auditors' 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

Report on Compliance with the Requirements for iXBRL tagging of Consolidated Financial Statements included within the European Single Electronic Format Regulatory Technical Standard (ESEF RTS)

We have undertaken a reasonable assurance engagement on the iXBRL tagging of the consolidated financial statements included in the digital files 529900GJOSVHI055QR67-2021-12-31-en.zip prepared by **AS LHV Pank**.

Responsibilities of Management for the Digital Files Prepared in Compliance with the ESEF RTS

Management is responsible for preparing digital files that comply with the ESEF RTS. This responsibility includes:

- the selection and application of appropriate iXBRL tags using judgement where necessary;
- ensuring consistency between digitized information and the consolidated financial statements presented in human-readable format; and
- the design, implementation and maintenance of internal control relevant to the application of the ESEF RTS.

Auditors' Responsibilities

Our responsibility is to express an opinion on whether the electronic tagging of the consolidated financial statements complies in all material respects with the ESEF RTS based on the evidence we have obtained. We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* (ISAE 3000) issued by the International Auditing and Assurance Standards Board.

A reasonable assurance engagement in accordance with ISAE 3000 involves performing procedures to obtain evidence about compliance with the ESEF RTS. The nature, timing and extent of procedures selected depend on the practitioner's judgment, including the assessment of the risks of material departures from the requirements set out in the ESEF RTS, whether due to fraud or error. A reasonable assurance engagement includes:

- obtaining an understanding of the tagging and the ESEF RTS, including of internal control over the tagging process relevant to the engagement;
- reconciling the tagged data with the audited consolidated financial statements of the Group dated 31 December 2021;
- evaluating the completeness of the tagging of the consolidated financial statements;
- evaluating the appropriateness of the Group's use of iXBRL elements selected from the ESEF taxonomy and the creation of extension elements where no suitable element in the ESEF taxonomy has been identified;
- evaluating the use of anchoring in relation to the extension elements.

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

In our opinion, the consolidated financial statements included in the annual report of AS LHV Group identified as 529900GJOSVHI055QR67-2021-12-31-en.zip for the year ended 31 December 2021 are tagged, in all material respects, in compliance with the ESEF RTS.

Other Requirements of the Auditors' Report in Accordance with Regulation (EU) No 537/2014 of the European Parliament and of the Council

We were appointed by those charged with governance on 13 March 2019 to audit the consolidated financial statements of AS LHV Group for the year ended 31 December 2021. Our total uninterrupted period of engagement is two years, covering the periods ended 31 December 2020 to 31 December 2021.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Group;
- we have not provided to the Group the prohibited non-audit services (NASs) referred to in Article 5(1) of EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit.

Tallinn,

/digitally signed and dated/

Eero Kaup

Certified Public Accountant,
License No 459

KPMG Baltics OÜ
License no 17

KPMG Baltics OÜ

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Proposal for profit distribution

The Management Board of AS LHV Pank proposes to the General Meeting of shareholders to distribute the profit of the financial year 2021 as follows:

- transfer EUR 3,088 thousand to statutory reserve capital
- pay dividends EUR 3,900 thousand
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 54,771 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 consolidated financial statements, the independent auditor's report and the profit distribution proposal, and approved it for presentation at the General Meeting of shareholders.

01.03.2022

Madis Toomsalu
Chairman of the Supervisory Board

Rain Lõhmus
Member of the Supervisory Board

Andres Viisemann
Member of the Supervisory Board

Tiina Mõis
Member of the Supervisory Board

Raivo Hein
Member of the Supervisory Board

Heldur Meerits
Member of the Supervisory Board

Allocation of income according to EMTAK classificators

Consolidated:

EMTAK	Activity	2021	2020
66121	Security and commodity contracts brokerage	11,513	8,487
64191	Credit institutions (banks) (granting loans)	155,835	106,710
64911	Finance lease	6,000	4,329
	Total income	**173,348**	**119,526**