AS LHV Varahaldus
Annual Report 2019
(Translation of the Estonian original)

Annual report	**01.01.2019 - 31.12.2019**
Business name	AS LHV Varahaldus
Commercial Registry No.	10572453
Legal address	Tartu mnt. 2, Tallinn 10145
Phone	(372) 6800400
Fax	(372) 6800402
Main activities	Fund management
Management Board	Joel Kukemelk
	Vahur Vallistu (since 06.06.2019)
	Mihkel Oja (until 19.06.2019)
Supervisory Board	Madis Toomsalu
	Andres Viisemann
	Erki Kilu
Auditor	AS PricewaterhouseCoopers

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Management Report

AS LHV Varahaldus is a fund management company managing investment funds. LHV Varahaldus manages mandatory pension funds (II pillar) and voluntary pension funds (III pillar) and one eurofund.

LHV Varahaldus is the second largest fund management company in Estonia based on the volume of managed funds. LHV Varahaldus has 200 thousand clients.

Pension funds' results

In the last years, LHV's actively managed pension funds have invested in a manner in which the price risk associated with international securities markets is low. In 2018, when asset values fell sharply around the world, this strategy proved successful compared to the competitors. On the other hand, 2019 was one of the best in stock markets, with larger markets showing nearly 30% growth. Among the most popular indexes, for example, the S&P500 returned 31.4% in EUR terms, while MSCI World, a global stock index, returned 30.0%. As a result, index funds with a high equity ratio showed the best performance among Estonian pension funds; the value of LHV Pension Fund Index increased 25.7% over the year.

LHV's actively managed 2nd pillar pension funds ended the year with yields ranging from +1.3% to +5.8%, falling short of the performance of the competitive funds with high equity shares.

Of course, the achievement of good returns over a longer period is more important than annual results. The objective of LHV Varahaldus is to provide the best long-term yields in Estonia to its pension funds' customers and achieve that with an investment strategy that clearly differs from its competitors. The significant focus on alternative asset classes, including real estate, local corporate bonds, and private equity and real estate funds, creates the prerequisites for more stable higher returns over business cycles and has a positive impact on the local economy and capital market.

Pension funds' investments

In the last three years, LHV's funds have significantly increased investments in Estonia. In 2017, investment decisions related to Estonia (including commitments to invest in the future) were made in the amount of EUR 170 million, in 2018 in the amount of EUR 153 million and in 2019 in the amount of EUR 55 million.

In addition to Estonia, private equity funds with a strong operating history were also focused on non- listed investments.

New investments in the local market include the purchase of an office building known as the Skype House on Academy Road, as well as investment in Ekspress Group bonds. The 127-apartment Manufactory Rental House project in Tallinn was also completed. LHV Varahaldus believes that the home market will provide pension funds with attractive long-term investment opportunities and will continue to invest in Estonia in 2020 as well.

Pension fund fees decreased by 40%

Pension fund fees have decreased in recent years along with volume growth, due to competition, as well as regulatory changes. While in 2015 LHV's actively managed pension fund fees ranged from 0.9% to 2.0% then by 2018 they were down to 0.59% to 1.26%. In September 2019, a new regulation came into force, easing investment restrictions on pension funds, drastically lowering pension fund management fee rates, and providing a chance to earn performance fee (benchmark is set as increase in social security pension contributions from September 2019). LHV's actively managed pension fund fees decreased as a result of this regulation up to 40% and ranged since September 2019 from 0.58% to 0.72%. The average fee of the Estonian 2nd pillar market decreased in the end of 2019 to 0.6%.

LHV Varahaldus modified the documentation of actively managed Pillar II pension funds (except for pension funds with conservative investment strategy) that carry out more complex investments, so that a performance fee is applied alongside the base management fee. The amount of the performance fee is related to the result of the pension fund. The right to a performance fee arises when the return of the pension fund exceeds the benchmark, which is the growth of the I pillar (more specifically social security pension contributions growth rate).

Simultaneously with the changes in fees regulatory investment restrictions were reduced giving fund managers the possibility to invest pension funds assets more freely. Among other things, equity risk limit for pension funds (except for conservative strategies) was abolished. LHV Varahaldus changed terms and prospectuses three times in 2019 (January, May and September) to adopt changes to pension funds' documentation. As a result of these steps, from September 2019, the maximum admissible share of equity and equity funds in pension funds increased to 110% in LHV Pension Fund Estonia and XL (of which 10% can be a loan), and 100% in pension funds L and M. In addition to regulatory reasons, in May 2019, we amended the terms of LHV Pension Fund S so that this fund no longer qualifies as a conservative pension fund and may assume equity risk for up to 25% of the fund's assets. The only conservative fund remaining is LHV Pension Fund XS, where as a result of the changed regulation investment restrictions were also relaxed.

The year 2019 also included the closure of the SEF-LHV Persian Gulf Fund, the pension reform initiated by the new government to make Pillar II voluntary after the Riigikogu elections in spring, and notification of the decision to merge LHV Pension Fund Estonia with LHV Pension Fund L.

To help people get the most out of their retirement assets, in 2019 LHV launched an unique "My Pension" mobile app, where you can view the amount of your I, II and III pillar pension assets and view forecasted monthly pension payment in retirement age. The app can be used by both the customers of LHV and people, who collect their pension elsewhere. We believe that modern, smart and good tools will help people make the best decisions about the future of their retirement.

FInancial results

LHV Varahaldus posted a net profit of EUR 6.1 million in 2019, in 2018 the net profit was EUR 6.8 million.

The main reason for the decrease in profit was the regulatory reduction in the management fee that came into effect in September, which reduced the management fee rate of the largest actively managed funds of LHV by 40%. Fee income decreased from EUR 13.9 million in 2018 to EUR 12.5 million in 2019. The decrease in management fees was compensated by the increase in net financial income due to higher yield as well as the decrease in marketing expenses. Operating expenses were EUR 4.2 million (EUR 4.0 million in 2018). Costs related to fixed assets were added to the costs (incl. depreciation of customer contracts) in the amount of EUR 1.9 million (EUR 1.8 million in 2018). Income tax related to paid dividends decreased from EUR 1.1 million to EUR 1.0 million.

The total volume of funds grew by EUR 160 million during the year, amounting to EUR 1 374 million at the end of the year. The number of LHV’s mandatory pension funds’ active clients decreased by 1.3 thousand to 176.6 thousand over the year. In 2016 Danske Capital AS was acquired and merged with, which is the reason the number of customers increased exponentially. After this merger, the number of LHV Varahaldus’ customers has been broadly the same, as the numbers of new and outgoing customers have been similar.

In 2019, LHV Varahaldus’ II pillar market share, measured by the total volume of funds, decreased from 30.2% to 28.4%, as the yields of LHV funds were below those of its competitors and competition in fund marketing increased. According to the number of active customers, the market share decreased from 25.2% to 24.3%,

In 2019, LHV Varahaldus paid dividends in the amount of EUR 4.4 million (EUR 4.4 million in 2018) and decreased its share capital by EUR 1.5 million (EUR 1.2 million in 2018).

Organizational development and remuneration principles

LHV Varahaldus’ main business units are the investment unit, the risk management unit, the operations unit and sales and client services unit.

Andres Viisemann, Romet Enok and Kristo Oidemaa continue as fund managers of actively managed funds. Romet Enok joined LHV in 2006 and he is specializing in credit risk analysis and bond investments in managing pension funds. Kristo Oidermaa joined LHV in 2009 and specializes in equity markets, as well as real estate and private equity investments when investing for actively managed pension funds (except for LHV XS and LHV S). Andres Viisemann continues to be responsible for designing the investment strategy and diversifying between asset classes. Fund managers are supported by portfolio managers and analysts in making investments, in 2019 investment unit increased by recruiting a real estate investment manager.

Vahur Vallistu was elected as the new CEO and Chairman of the Management Board of LHV Varahaldus in June 2019, as long-term CEO and Chairman of the Management Board Mihkel Oja decided to leave the position. The previous employer of Vahur Vallistu was Swedbank AS, where he worked since 2011 and where he was mainly involved in financing the buyout transactions. The Management Board continued with 2 members. There were no changes in the 3-member Supervisory Board.

Members of the Management Board and employees of LHV Varahaldus are paid a monthly basic salary, all employees are employed under employment contract. In 2019, the contracts provided only for a fixed salary. No cash-based performance bonus was paid to employees in 2019. LHV Varahaldus has not implemented significant severance fees or non-cash compensations.

During the reporting year, LHV Varahaldus had 35 employees on average (including members of the Management Board) (2018: 36). In the reporting period, the total remuneration paid to employees (incl. taxes) was EUR 1 337 499 (2018: EUR 1 175 026). The amount of remuneration accounted for the management is provided in Note 16. Members of the Supervisory Board did not receive a fee for participation in the work of the board.

Share options

In 2014 the shareholders meeting of AS LHV Group approved the terms and conditions of issuing share options to the members of the Management Board and employees treated as such and heads of departments and employees treated as such in the AS LHV Group consolidation group companies. The goal for share options is to align management and employee interests with those of the shareholders and clients. Furthermore, it is important to offer a comprehensive remuneration package that is equal to employee benefits offered by competitors. Similarly to 2014, share options were issued in 2015, 2016, 2017, 2018 and 2019 and are planned to be issued at the beginning of 2020.

The granting and number of share options was dependent upon the successful achievement of operational targets of the overall company and individual targets of management board members and employees. In the beginning of 2020 share options were granted to two members of the management board of LHV Varahaldus and to 7 employees in the amount of 125 thousand euros. In the beginning of 2019 share options were granted to two members of the management board and to 6 employees in the amount of 279 thousand euros. In the beginning of 2018 share options were granted to two members of the management board and to 6 employees in the amount of 193 thousand euros. In the beginning of 2017 share options were granted to two members of the management board and to 6 employees in the amount of 289 thousand euros. In the beginning of 2016 share options were granted to two members of the management board and to 4 employees in the amount of 128 thousand euros.

The individual performance of staff responsible for funds' investment decisions was assessed based on the following criteria: funds' returns for the past 3 and 10 years, finding issuers for new securities; making financing offers; structuring of investments; compliance with investment restrictions and rules of procedures and other contributions to the development of the business. The heads of departments were assessed based on person's fulfilment of the organization's objectives (e.g. growth of business volumes, representing the interests of the company) and development (e.g. development of customer products), also performing ordinary tasks (e.g. supporting other units, updating processes and systems). The share option contracts with the members of the Management Board and employees are concluded for a three-year period. Share options issued in 2014 were exercised during the period of 01.07.2017-30.09.2017 and shares with nominal value of 1 euro were acquired for 2 euros per share. Share options issued in 2015 were exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of 1 euro were acquired for 2.4 euros per share. Share options issued in 2016 were exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of 1 euro were acquired for 3 euros per share. Share options issued in 2017 can be exercised between the period of 01.04.2020-30.04.2020 and shares with nominal value of 1 euro can be acquired for 4.65 euros per share. Share options issued in 2018 can be exercised between the period of 01.04.2021-30.04.2021 and shares with nominal value of 1 euro can be acquired for 5.33 euros per share. Share options issued in 2019 can be exercised between the period of 01.04.2022-30.04.2022 and shares with nominal value of 1 euro can be acquired for 4.9 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.

The members of the Management Board and employees do not have the possibility to take the specified amount in cash in lieu of the share options. Share options cannot be exchanged, sold, pledged or encumbered. Share options can be inherited. The contract for share options will expire upon premature termination of the employment contract on the employee's initiative, for which exceptions can be made by the Supervisory Board of AS LHV Group, and upon extraordinary termination of the employment contract by the employer due to reasons resulting from the employee. According to the Credit Institutions Act the Supervisory Board of AS LHV Group can reduce the number of share options issued or cancel the share options if the overall financial results of the Company have significantly deteriorated compared to the previous period, the member of the Management Board or employee no longer meets the performance criteria, the Company no longer meets the prudential regulations or the Company's business risks are not adequately covered by Company's own funds or the performance fee has been determined based on information, which proved to be substantially misstated or incorrect.

FINANCIAL STATEMENTS

Statement of financial position

(in euros)

Assets	Note	31.12.2019	31.12.2018
Due from credit institutions	5	5 654 646	5 017 481
Financial assets at fair value through profit or loss	6	336 442	352 696
Receivables from managed funds	16	834 841	1 226 783
Other assets		103 713	238 805
Units of managed mandatory pension funds at fair value through profit or loss	6	7 695 071	7 589 957
Tangible assets		6 433	12 720
Intangible assets	7, 8	14 019 846	14 184 344
Goodwill	7, 8	2 570 100	2 570 100
Total assets		**31 221 092**	**31 192 886**
Liabilities and equity			
Liabilities			
Supplier payables	9, 16	282 997	251 896
Other liabilities	10, 11	266 613	258 075
Subordinated debt	11	1 550 000	2 100 000
Total liabilities		**2 099 610**	**2 609 971**
Equity			
Share capital		1 500 000	1 500 000
Statutory reserve capital		683 000	683 000
Share options		527 811	337 615
Retained earnings		26 410 671	26 062 300
Total equity	12	**29 121 482**	**28 582 915**
Total liabilities and equity		**31 221 092**	**31 192 886**

The Notes presented on pages 11 – 33 are an integral part of the Financial Statements.

Statement of comprehensive income

(in euros)

	Note	2019	2018
Fee income	**13,16**	**12 868 618**	**13 942 364**
Net gains/losses from financial assets measured at fair value	6	465 626	-19 973
Foreign exchange rate gains/losses		-1 119	-5 145
Other financial income/expenses (Interest income/expense based on EIR)	5, 11, 16	-144 142	-167 680
Net gains from financial assets		**320 365**	**-192 798**
Other income/expenses		-19 137	-7 909
Staff costs	14	-1 775 335	-1 548 271
Administrative and other operating expenses	14, 16	-2 429 915	-2 459 625
Depreciation and impairment of intangible and tangible fixed assets	7	-1 872 132	-1 807 458
Profit before tax		**7 092 464**	**7 926 303**
Income tax expense		-972 093	-1 100 000
Net profit for the year		6 120 371	6 826 303
Total profit and other comprehensive income for the year		**6 120 371**	**6 826 303**

The Notes presented on pages 11 – 33 are an integral part of the Financial Statements.

Statement of cash flows

(in euros)

	Note	2019	2018
Cash flows from operating activities			
Profit before tax		7 092 464	7 926 303
Adjustments:			
Depreciation and impairment of tangible and intangible assets	7	1 872 132	1 807 458
Share option reserve		318 196	197 131
Net gains from financial assets measured at fair value	6	-465 626	19 973
Other financial income/expenses	5, 11, 16	144 142	167 680
Change in receivables and prepayments		527 034	-73 764
Change in payables	9,10	43 306	23 197
Interests paid	11	-148 322	-168 000
Income Tax	12	-972 093	-1 100 000
Total change in working capital		**1 318 769**	**873 675**
Total cash from/-used in operating activities		**8 411 233**	**8 799 978**
Cash flow from investing activities			
Purchase of tangible and intangible assets	7	-1 701 347	-2 054 778
Proceeds from disposal of financial assets measured at fair value	6	30 443	3 124
Purchase of units of managed pension funds	6	-133 295	-1 720 000
Proceeds from disposal of units of managed pension funds	6	457 251	344 765
Dividends and interest received		22 880	30 154
Total cash flow used in investing activities		**-1 324 068**	**-3 396 735**
Cash flow from financing activities			
Dividends paid	12	-4 400 000	-4 400 000
Cancellation of shares	12	-1 500 000	-1 200 000
Redemption of subordinated debt	11	-550 000	0
Total cash flow from financing		**-6 450 000**	**-5 600 000**
Total cash flow		**637 165**	**-196 757**
Cash and cash equivalents at the beginning of the period	5	5 017 481	5 214 238
Change in cash and cash equivalents		**637 165**	**-196 757**
Cash and cash equivalents at the end of the period	5	**5 654 646**	**5 017 481**

The Notes presented on pages 11 – 33 are an integral part of the Financial Statements.

Statement of changes in equity

(in euros)

	Share capital	Statutory reserve capital	Share option reserve	Retained earnings	Total equity
Balance as at 01.01.2018	**2 700 000**	**683 000**	**230 484**	**23 545 997**	**27 159 481**
Dividends paid	0	0	0	-4 400 000	-4 400 000
Cancellation of shares	-1 200 000	0	0	0	-1 200 000
Share options	0	0	107 131	90 000	197 131
Total transactions with owners	**-1 200 000**	**0**	**107 131**	**-4 310 000**	**-5 402 869**
Net profit for the year	*0*	*0*	*0*	*6 826 303*	*6 826 303*
Total profit and other comprehensive income for the year	**0**	**0**	**0**	**6 826 303**	**6 826 303**
Balance as at 31.12.2018	**1 500 000**	**683 000**	**337 615**	**26 062 300**	**28 582 915**
Balance as at 01.01.2019	**1 500 000**	**683 000**	**337 615**	**26 062 300**	**28 582 915**
Dividends paid	0	0	0	-4 400 000	-4 400 000
Fund issue	1 500 000	0	0	-1 500 000	0
Cancellation of shares	-1 500 000	0	0	0	-1 500 000
Share options	0	0	190 196	128 000	318 196
Total transactions with owners	**0**	**0**	**190 196**	**-5 772 000**	**-5 581 804**
Net profit for the year	*0*	*0*	*0*	*6 120 371*	*6 120 371*
Total profit and other comprehensive income for the year	**0**	**0**	**0**	**6 120 371**	**6 120 371**
Balance as at 31.12.2019	**1 500 000**	**683 000**	**527 811**	**26 410 671**	**29 121 482**

More detailed information on share capital is provided in Note 12.

The Notes presented on pages 11 – 33 are an integral part of the Financial Statements.

Notes to the Financial Statements

NOTE 1 General information

The financial statements of AS LHV Varahaldus (hereinafter the Company) have been prepared in accordance with International Financial Reporting Standards as adopted by European Union (IFRS).

AS LHV Varahaldus is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. AS LHV Varahaldus is the subsidiary of AS LHV Group, which is a holding company, sister company AS LHV Pank provides banking, financial advisory and securities brokerage services to customers.

The current annual report (including financial statement) has been approved by the Management board on 6 March, 2020.

The annual report approved by the Management board shall be authorised for approval by the Supervisory board and shareholder. The shareholder have the right not to approve the annual report while the Supervisory board does not have that right.

NOTE 2 Summary of significant accounting policies

2.1 Basis of preparation

The financial statements of AS LHV Varahaldus for the financial year 2019 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The principal accounting policies applied in the preparation of these financial statements are set out below.

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 at fair value through profit and loss“ and „Units of managed mandatory pension funds through profit and loss“.

The preparation of 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 judgment or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

The financial year started at 1 January 2019 and ended at 31 December 2019. The financial statements are presented in euros unless otherwise stated.

Certain new or revised International standards and interpretations have been issued by the time of compiling these financial statements that are mandatory for the annual periods beginning on or after 1 January 2019 or later. Overview of these standards and interpretations to the annual report are outlined below.

(a) Adoption of new or revised standards and interpretations

The following new or revised standards and interpretations became effective for AS LHV Varahaldus from 1 January 2019.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17 that is, the lessor continues to divide its leases into operating and capital leases and reflect these types of leases differently. The first-time adoption of the standard had no material impact on the Company's financial statements, see also note 2.15.

Annual Improvements to IFRSs 2015-2017 cycle (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU).
The narrow scope amendments impact four standards. IFRS 3 was clarified that an acquirer should remeasure its previously held interest in a joint operation when it obtains control of the business. Conversely, IFRS 11 now explicitly explains that the investor

should not remeasure its previously held interest when it obtains joint control of a joint operation, similarly to the existing requirements when an associate becomes a joint venture and vice versa. The amended IAS 12 explains that an entity recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, eg in profit or loss or in ohter comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits. The revised IAS 23 now includes explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowings costs eligible for capitalisation only until the specific asset is substantially complete. The company is currently assessing the impact of the new amendments.

There are no other new or revised standards or interpretations that were effective from 1 January 2019 that would be expected to have a material impact on the Company.

(b) New Standards, Interpretations and Amendments

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

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

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

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

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

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

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose

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

2.2 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of the Company is euro.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the balance sheet date. 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 as income or expenses for that peeriod. Translation differences on non-monetary assets denominated in foreign currencies and liabilities which are not measured at fair value, (such as prepayments, tangible and intangible assets) are not revaluated on balance sheet date, but accounted continuously at the European Central Bank rate as at the transaction date.

2.3 Cash and cash equivalents

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

2.4 Financial assets

Initial recognition and derecognition

Financial assets are recognised on the statement of financial position when LHV Varahaldus 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) LHV Varahaldus has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control.

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

Subsequent measurement

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

Debt instruments (loans and debt securities)

The classification is based on a combination of assessing the business model for managing the financial assets and whether the contractual cash flows consist of solely payments of principal and interest (‘SPPI’). The business model assessment is performed for homogenous portfolios/ products identified based on how the business is managed in the divisions of the Group. The assessment is based on reasonable scenarios taking into consideration how the portfolio is evaluated and reported to management; the risks affecting the performance of the portfolio and how these risks are managed; how managers are compensated; and the frequency, value and timing of sales including the reasons for the sales. In determining if the cash flows consist solely of principal and interest, the principal is defined as the fair value of the debt instrument at initial recognition, which can change over the life if there are repayments or capitalisation of interest. Interest cash flows are consistent with components per a basic lending arrangement including consideration for time value of money, credit risk, liquidity risk as well as administrative costs and profit margin. If there are contractual features introducing an exposure to other risks or volatility, it is not considered to consist of solely payments of principal and interest. Debt instruments are presented in the statement of financial position line items: Due from credit institutions and receivables from managed funds and include instruments in the following measurement categories.

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

Equity instruments

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

IFRS 9 category		Class (applied by LHV Varahaldus)		31.12.2019	31.12.2018
Financial assets	Amortised cost	Due from credit institutions		5 654 646	5 017 481
		Receivables from managed funds		834 841	1 226 783
	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	Funds units	336 442	352 696
		Mandatory measurement at fair value through profit or loss	Units of managed pension funds	7 695 071	7 589 957

2.5 Impairment of financial assets carried at amortised cost

The Company assesses on a forward-looking basis the expected credit losses ("ECL") associated with its debt instruments carried at amortised cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

The measurement of ECL reflects: (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions. Company expert based individual assesments for calculating ECLs.

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

At the end of each reporting period the company 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 whose contractual terms have been revised due to the customer's financial difficulties). 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 on probation period such that there is no longer a significant increase in credit risk since initial recognition, the financial asset moves back to Stage 1.

For trade receivables without a significant financing component the Company applies a simplified approach permitted by IFRS 9 and measures the allowance for impairment losses at expected lifetime credit losses from initial recognition of the receivables. The Company uses a provision matrix in which allowance for impairment losses is calculated for trade receivables falling into different ageing or overdue periods.

2.6 Tangible fixed assets

Tangible fixed assets are non-current assets used in the operating activities of the Company 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 AS LHV Varahaldus 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 each balance sheet date. AS LHV Varahaldus 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 periood.

2.7 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance which Company uses to provide services or for administrative purposes and intends to use for a longer period than one year. 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. The annual amortisation rate for intangible assets (except for positive goodwill and client contracts) is 33%.

Goodwill is not amortised, instead, an impairment test is performed annually.

In addition to the expenses which AS LHV Varahaldus makes in order to have new clients are capitalized, there are client agreements from business combination recorded as intangible assets, see also Note 7. The amortisation method for client contracts is the diminishing balance method. The annual amortisation rate for purchased client contracts is 12% of the residual value of those assets.

At each balance sheet date the appropriateness of amortization rates, methods and residual values is assessed. AS LHV Varahaldus reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use.

2.8 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 profit or loss.

At each following balance sheet date, 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 income statement as a reduction of the impairment loss.

2.9 Financial liabilities

All financial liabilities (supplier payables, accrued expenses and subordinated debts) are initially recorded at the acquisition cost that includes all transaction costs related to acquisition. After initial recognition, financial liabilities are 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 “Other financial income/expenses”.

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 or declaration of bankruptcy, are settled after the satisfaction of the justifiable claims of other creditors.

2.10 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 balance sheet date. 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. LHV Varahaldus has neither existing legal nor constructive obligations to make pension or similar payments supplementary to social security tax.

2.11 Provisions and contingent liabilities

Liabilities arising from an obligating event before the balance sheet date that have either a legal basis or that have arisen from AS LHV Varahaldus' 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 balance sheet date 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.

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

2.12 Share-based payments

Company's parent company 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 (retained earnings). 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 Company revises its estimates of the number of options that are expected to vest based on the vesting 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. According to the contractual conditions of the share options there are no social security tax charges when exercising the options after the 3-year period.

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

Assets from which resources are expected to flow to AS LHV Varahaldus within 12 months are recognised as current assets. The portion of assets with expected inflows later than 12 months after the balance sheet date is recognised as non-current assets (see Note 3.4).

Liabilities are classified as current when they are due within twelve months after the balance sheet date or if AS LHV Varahaldus does not have an unconditional right to defer the payment for later than 12 months after the balance sheet date.

Loans received with due date within 12 months after the balance sheet date which are refinanced as non-current after the balance sheet date 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 balance sheet date due to breaches of contractual terms are also classified as current.

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

2.14 Income 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 ohter 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 integraal part of the effective interest rate. However, expected credit losses are not taken into account.

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

Fee and commission income

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

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 Varahaldus expects to be entitled in exchange for the service. 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.

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.

Dividend income

Dividend income is recognised when the legal right to receive dividends is established

2.15 Leases - Company as the lessee

Accounting policy from 1 January 2019

LHV Varahaldus pays monthly lease for the rent of office premises, where the leasing contract was determined as short-term. Due to this, the company applied the exception of IFRS 16 and office leases are recognized as short-term leases. Therefore, the rental payments are recognised in the statement of profit or loss as expense in line item “Administrative and other operating expenses“.

Accounting policy until 31 December 2018

Leases of tangible fixed assets where the lessee acquires substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases. The Company has only operating leases.

Payments made under operating leases are charged to the statement of profit or loss on a straight-line basis over the lease term.

2.16 Taxation and deferred income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying amounts of assets and liabilities and no deferred tax assets or liabilities arise. Instead of the income tax payable on profits, the Estonian entities pay corporate income tax on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. The tax rate from 01.01.2015 is 20/80 on net dividends paid. The corporate income tax arising from the payment of dividends is recognised as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account.

A deferred income tax liability in respect of AS LHV Varahaldus’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 12 to the financial statements.

2.17 Statutory reserve capital

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

2.18 Business combinations

According to IFRS 3, business combination means merging different (ecomonic) entities or businesses to one reporting (economic) entity. Specifically, IFRS defines that business combinations are accounted for using the acquisition method. 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. According to the acquisition method, the identifiable assets, liabilities and contingent liabilites of the acquiree are recognized at their fair values at the acquisition date; also goodwill that is not amortised, but for which impariment tests are performed, is recognized.

The acquisition method addresses the business combination from the perspective of the acquiring (economic) entity. The acquirer purchases net assets and recognizes the assets acquired and liabilities and contingent liabilities assumed, including those not previously recognized by the acquiree. This transaction does not affect the measurement of acquirer's assets and liabilities, also no additional assets or liabilities of the acquirer are recognized as a result of the transaction, since these are not the subjects of the transaction.

NOTE 3 Risk management

Risk is defined as a potential negative deviation from expected financial results. AS LHV Varahaldus encounters several risks in its day-to-day operations. The objective of risk management at AS LHV Varahaldus is to recognise these risks, to measure them appropriately and to manage them. More broadly, the aim of risk management is to increase the value of AS LHV Varahaldus by minimising losses and reducing the volatility of results. Risk management at AS LHV Varahaldus is based on a strong risk culture and is built on the principle of three lines of defence where the first line of defence, the business units, are responsible for taking risk and for day-to-day management. The second line of defence, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of defence, the internal audit, conducts independent supervision. Risk management principles, requirements and areas of responsibility are described in policies and procedures. In accordance with the capital management principles that AS LHV Varahaldus has adopted, it must have adequate capital to cover risks.

3.1 Capital management

The goal of AS LHV Varahaldus's capital management is to:

- ✓ ensure continuity of AS LHV Varahaldus's business;
- ✓ maintain a strong capital base supporting the development of business;
- ✓ comply with capital requirements as established by supervision authorities.

The Company considers net own funds as capital. The amount of capital that LHV Varahaldus managed as of 31.12.2019 was 13 553 725 EUR (31.12.2018: 13 590 856 EUR).

The goals are set based on both the regulative requirements and additional internal buffer. AS LHV Varahaldus follows the general principles in its capital management:

- AS LHV Varahaldus must be adequately capitalized at all times, having necessary capital to ensure economic preservation;
- The main focus of the capital management is on tier 1 own funds, because only tier 1 own funds can absorb losses. All other capital layers in use are dependent of tier 1 own funds volume;
- Capital of AS LHV Varahaldus can be divided into: 1) regulated minimum capital and 2) capital buffer held by AS LHV Varahaldus;
- LHV Varahaldus' regulated minimum capital depends primarily on the volume of managed funds and due to that additional capital requirement. Fund manager's operational risks are an important additional input to determine internal buffer.

Own funds	31.12.2019	31.12.2018
Tier 1 own funds	**12 003 725**	**11 490 856**
Paid-in share capital	1 500 000	1 500 000
Statutory reserve capital	683 000	683 000
Accumulated profit	20 290 300	19 235 997
Net profit for accounting period	6 120 371	6 826 303
Intangible assets (subtracted)	-16 589 946	-16 754 444
Tier 2 own funds	**1 550 000**	**2 100 000**
Subordinated debt	1 550 000	2 100 000
Total net own funds	**13 553 725**	**13 590 856**

The amount of the own funds of LHV Varahaldus as the fund manager must be at least equal to each of the following indicators 1) the minimum amount of the initial capital of the pension fund manager (i.e. EUR 1 million), 2) 25 per cent of the fixed overheads of the pension fund manager, 3) the required amount of additional own funds of the pension fund manager. In consideration of the volume of funds managed by LHV Varahaldus, the requirement for additional own funds of the pension fund manager determines the minimum amount of own funds, which is 0.5 per cent of the market value of the assets of the pension funds managed by the fund manager in the part which does not exceed EUR 1 000 000 000 and 0.02 per cent of the market value of the assets of the pension funds managed by the fund manager in the part which exceeds EUR 1 000 000 000. Until January 9th 2017, the amount of the own funds of LHV Varahaldus had to be at least EUR 2.5 million and 1% of the market value of managed pension funds, which exceeds EUR 125 million.

3.2 Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet its obligations to AS LHV Varahaldus.

AS LHV Varahaldus has complied with all capital requirements during the financial year and in previous years.

Financial assets of LHV Varahaldus

Financial assets of LHV Varahaldus are:

a) Due from credit institutions
b) Financial assets at fair value through profit or loss
c) Receivables from managed funds
d) Units of managed mandatory pension funds at fair value through profit or loss

Financial liabilities of LHV Varahaldus are:

a) Supplier payables
b) Other financial liabilities
c) Subordinated debt

Due to the nature of financial assets, credit risk and market risk and Company wide liquidity and operational risk are assessed below.

Maximum exposure to credit risk	31.12.2019	31.12.2018
Due from credit institutions (Note 5)	5 654 646	5 017 481
Receivables from managed funds (Note 16)	834 841	1 226 783
Total maximum exposure to credit risk	**6 489 487**	**6 244 264**

a) Due from credit institutions

Credit risk arises from receivables from credit institutions (cash in bank accounts). AS LHV Varahaldus's money is deposited in fund depositories (AS SEB Pank – Standard & Poor's rating A+), Swedbank AS (Moody'se rating Aa3) and accounts opened at AS LHV Pank (Moody's rating Baa1). Management estimates that the credit risk exposure from cash and cash equivalents held at credit institutions has inherently low credit risk.

Ratings distribution Standard & Poor´s/ Moody´s	Total 31.12.2019	Total 31.12.2018
AA- to AA+/Aa3 to Aa1	1 487	13 783
A- to A+/A3 to A1	698 257	798 266
BBB- to BBB+/Baa1 to Baa3	4 954 902	4 205 432
Total (Note 5)	**5 654 646**	**5 017 481**

Management have estimated the expected credit loss for credit institutions and according to the strong rating, financial condition and positive outlook for macro environment the LHV Varahaldus does not need to make a discount its receivables from credit institutions. All recevivables from credit institutions are recorded in stage 1.

b) Receivables from managed funds and other financial assets

Receivables from managed funds and other financial assets have been received by the time of compiling these financial statements.

Due to the short-term payment term of these receivables, historical payment behavior (no debts), strong liquidity position of the funds at the balance sheet date and positive macro environment outlook, the management estimates that the expected credit loss is zero and no discounts were made at balance sheet date. There are no overdue receivables or financial assets as at the balance sheet date. All recevivables from managed funds and other financial assets are recorded in stage 1.

3.3 Market risk

Market risk is a potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates.

Most of the available assets of AS LHV Varahaldus are his own managed pension funds. The management of AS LHV Varahaldus is responsible for monitoring of the market risk.

3.3.1 Foreign currency risk

Foreign currency risk may arise from acquisition of securities mostly nominated in foreign currencies or foreign currency receivables and liabilities.

The currency of Company's available assets is mainly euro, there are no financial instruments in foreign currency as of the date of financial position, because of that Company's management estimates foreign currency risk as minimal.

3.3.2 Price risk

Pursuant to the Investment Funds Act, the minimal shares of LHV Varahaldus as the management company is 0,5% (as of the Investment Funds Act valid until January 9th 2017 1%) of the number of units in each of the mandatory pension fund managed by it.

To the extent in which the market value of the mandatory pension funds managed by the pension fund manager exceeds the amount of one billion euros, the pension fund manager must hold at least 0.02 per cent of the units. As an exception, the pension

fund manager must hold at least two per cent of the units of pension fund if it is established over past three years.

Based on historical performance and volatility of the pension fund unit NAV changes, the price changes should remain +/- 10% in the next 12 month period with the most likely change +/-5% and the impact to statement of profit or loss is presented in the next table.

LHV Varahaldus invests the remaining available assets in euros, to ensure liquidity and to not bear investment risk.

Impact on statement of profit or loss *(in thousands)*	**2019**	**2018**
Equity securities +/-10%	+/- 34	+/- 35
Mandatory pension fund units +/- 5%	+/- 333	+/- 379

3.3.3 Interest rate risk

Interest rate risk reflects the mismatch in the statement of financial position items and the off-balance sheet items when interest rate repricing periods, volumes or the underlying interest rate of assets, liabilities and derivatives do not correspond exactly. Company's interest rate risk management is based on risk policies, limits and internal procedures resulting in identification of all significant sources of interest rate risk and balanced risk taking. Interest rate risk is measured through various scenario analyses by calculating several net interest income scenarios and comparing the difference between these scenarios.

As at 31.12.2019 and 31.12.2018 there were no interest-bearing instruments among Company's assets, as according to management estimate, the receivables from credit institutions bear immaterial interest rates. Also, as at 31.12.2019 and 31.12.2018 LHV Varahaldus had no interest-bearing bonds.

Subordinated debts bear a fixed interest rate, more detailed information in Notes 3.4, 11 and 16.

3.4 Liquidity risk

Liquidity risk relates to the solvency of LHV Varahaldus to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. LHV Varahaldus' liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, LHV Varahaldus' liquidity management reflects a conservative approach towards liquidity risk.

31.12.2019	**On Demand**	**Up to 0-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**	**Carrying amount**
Liabilities by contractual maturity dates							
Supplier payables (Note 9, 16)	0	282 997	0	0	0	**282 997**	**282 887**
Other financial liabilities (Note 10, 11)	0	5 311	0	0	0	**5 311**	**5 311**
Subordinated debt (Note 11)	0	31 000	93 000	796 000	1 623 400	**2 543 400**	**1 550 000**
Total liabilities	**0**	**319 308**	**93 000**	**796 000**	**1 623 400**	**2 831 708**	**1 838 308**

Assets held for managing liquidity risk by contractual maturity dates							
Due from credit institutions (Note 5)	5 654 646	0	0	0	0	**5 654 646**	**5 654 646**
Financial assets at fair value (Note 6)	0	0	0	0	336 442	**336 442**	**336 442**
Receivables from managed funds (Note 16)	0	834 841	0	0	0	**834 841**	**834 841**
Total assets held for managing liquidity risk	**5 654 646**	**834 841**	**0**	**0**	**0**	**6 489 487**	**6 825 929**

Maturity gap from assets and liabilities	**5 654 646**	**1 154 149**	**93 000**	**796 000**	**1 623 400**	**9 321 195**	**8 664 237**

31.12.2018	On demand	Up to 0-3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates							
Supplier payables (Note 9, 16)	0	251 896	0	0	0	**251 896**	**251 896**
Other financial liabilities (Note 10, 11)	0	8 978	0	0	0	**8 978**	**8 978**
Subordinated debt (Note 11)	0	42 000	126 000	672 000	2 315 733	**3 155 733**	**2 100 000**
Total liabilities	**0**	**302 874**	**126 000**	**672 000**	**2 315 733**	**3 416 607**	**2 360 874**

Assets held for managing liquidity risk by contractual maturity dates							
Due from credit institutions (Note 5)	5 017 481	0	0	0	0	**5 017 481**	**5 017 481**
Financial assets at fair value (Note 6)	0	0	0	0	0	**0**	**352 696**
Receivables from managed funds (Note 16)	0	1 226 783	0	0	0	**1 226 783**	**1 226 783**
Total assets held for managing liquidity risk	**5 017 481**	**1 226 783**	**0**	**0**	**0**	**6 244 264**	**6 596 960**

Maturity gap from assets and liabilities	**5 017 481**	**1 529 657**	**126 000**	**672 000**	**2 315 733**	**9 660 871**	**8 957 834**

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

	31.12.2019	31.12.2018
Current assets		
Due from credit institutions (Note 5)	5 654 646	5 017 481
Financial assets at fair value through profit or loss (Note 6)	336 442	352 696
Receivables from managed funds (Note 16)	834 841	1 226 783
Other assets	103 713	238 805
Total current assets	**6 929 642**	**6 835 765**
Non-current assets		
Financial assets at fair value through profit or loss (Note 6)	7 695 071	7 589 957
Tangible assets	6 433	12 720
Intangible assets (Note 7, 8)	14 019 846	14 184 344
Goodwill (Note 7, 8)	2 570 100	2 570 100
Total non-current assets	**24 291 450**	**24 357 121**
Total assets	**31 221 092**	**31 192 886**
Liabilities		
Current liabilities		
Supplier payables (Note 9, 16)	282 997	251 896
Other liabilities (Note 10, 11)	266 613	258 075
Total current liabilities	**549 610**	**509 971**
Non-current liabilities		
Subordinated debt (Note 11)	1 550 000	2 100 000
Total non-current liabilities	**1 550 000**	**2 100 000**
Total liabilities	**2 099 610**	**2 609 971**

3.5 Operating risk

Operating risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the segregation of duties principle is used in LHV Varahaldus' working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of LHV Varahaldus and to evaluate capital requirements. The analysis of cases collected into the database enables to identify the flaws in rules of procedure, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk and compliance control manager of LHV Varahaldus is responsible for collecting information.

Compliance control and internal audit department have an important role in evaluating, monitoring and mitigating the operating risk. Pursuant to the Investment Funds Act and Securities Market Act, the main task of Compliance Officer is to define the risks of non-compliance of the activities of LHV Varahaldus with legislation, recommended guidelines of the Financial Supervision Authority and procedure rules of LHV Varahaldus, considering the nature, range and complexity of business and services rendered, and arrangement of mitigating or avoiding those risks. Internal audit is an independent and objective function, assuring and consulting activity that is targeted at improving LHV Varahaldus' performance and adding value. Internal audit helps achieving the goals of LHV Varahaldus, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.6 Fair value of financial assets and financial liabilities

Financial assets at fair value through profit or loss	Level 1	Level 2	Level 3	31.12.2019
Fund units (Note 6)	336 442	0	0	**336 442**
Units of managed pension funds (Note 6)	0	7 695 071	0	**7 695 071**
Total financial assets	**336 442**	**7 695 071**	**0**	**8 031 513**

Financial assets at fair value through profit or loss	Level 1	Level 2	Level 3	31.12.2018
Fund units (Note 6)	352 696	0	0	**352 696**
Units of managed pension funds (Note 6)	0	7 589 957	0	**7 589 957**
Total financial assets	**352 696**	**7 589 957**	**0**	**7 942 653**

LHV Varahaldus' investments into pension fund units have quoted prices from the market, however the market is inactive and therefore disclosed as level 2.

The management board of LHV Varahaldus has assessed the fair value of assets and liabilities carried at amortised cost in the statement of financial position. For estimating fair value, the future cash flows are discounted on the basis of the market interest yield curve.

Levels used in hierarchy:

1. Level 1 – quoted prices in active market
2. Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)
3. Level 3 – other valuation techniques (e.g. discounted cash flow method) with judgemental inputs

Receivables from pension funds are short-term, so their fair value is approximate to their carrying amount. Due from credit institutions are demand deposits, so there fair value is close to the carrying amount. Valutation for assets at amortised cost are at level 2. Accounts payable are short-term, so their fair value is approximate to their carrying amount and valuation corresponds to level 2 . Market interest rate for subordinated debt does not differ from management estimate, therefore their fair value is close to the carrying amount. Valuation corresponds to level 3.

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the balance sheet date, 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, including choosing the useful life of client contracts and amortization method (see notes 6 and 7).

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.

NOTE 5 Due from credit institutions

	31.12.2019	31.12.2018
Demand deposits, except related parties	699 744	812 049
Demand deposits in AS LHV Pank (Note 16)	4 954 902	4 205 432
Total due from credit institutions	**5 654 646**	**5 017 481**

In 2019, the interests earned on bank accounts totalled EUR 513 (2018: 320 EUR).

NOTE 6 Financial assets at fair value through profit or loss

Mandatory measurement at fair value through profit or loss:	**31.12.2019**
Fund units	336 442
Units of managed mandatory pension funds (Note 16)	**7 695 071**
Total financial investments at fair value through profit or loss	**8 031 513**

Mandatory measurement at fair value through profit or loss:	**31.12.2018**
Fund units	352 696
Units of managed mandatory pension funds (Note 16)	**7 589 957**
Total financial investments at fair value through profit or loss	**7 942 653**

Securities are accounted for on the basis of market prices quoted in an active market.

In 2019 and 2018 no fund units were acquired or sold.

In 2019 dividends from investments amounted to EUR 22 367 (2018: 29 834 EUR).

In 2019, the fair value gain from investments totaled EUR 443 259 (2018: a loss of EUR 49 807). Total net gain (loss) on financial assets at fair value of EUR 465 626 (2018: loss of EUR 19 973). In 2019, the units of pension funds under management were acquired in the total amount of EUR 133 295 (2018: 1 720 000 EUR) and were sold in the total amount of EUR 457 251 (2018: 344 765 EUR). The acquisition cost of the units of pension funds recognised at fair value in the balance sheet is EUR 6 910 589 (see also Note 16).

On 28th of February 2018, the fund manager merged voluntary pension funds LHV Pensionifond Intress Pluss (merging) with LHV Täiendav Pensionifond (receiving).

In March 2018, the fund manager AS LHV Varahaldus created new mandatory pension fund called LHV Pensionfond Eesti.

NOTE 7 Intangible assets

	Licenses, developments	Client contracts acquired through business combination	Costs for acquisition of client contracts	Total intangible assets	Goodwill
Balance as at 01.01.2018	**90 505**	**3 217 487**	**10 617 779**	**13 925 771**	**2 570 100**
Changes during 2018					
Assets acquired	236 543	0	0	236 543	0
Capitalised costs for acquisition of client contracts	0	0	1 818 236	1 818 236	0
Depreciation and amortisation	0	-365 554	-1 430 652	-1 796 206	0
Total 31.12.2018					

Total cost	383 092	4 029 900	12 436 015	16 849 007	2 570 100
Accumulated depreciation and amortisation	-56 044	- 1 177 967	-1 430 652	-2 664 663	0
Carrying amount 31.12.2018	**327 048**	**2 851 933**	**11 005 363**	**14 184 344**	**2 570 100**
Total 01.01.2019	**327 048**	**2 851 933**	**11 005 363**	**14 184 344**	**2 570 100**
Changes during 2019					
Assets acquired	117 029	0	0	117 029	0
Capitalised costs for acquisition of client contracts	0	0	1 584 318	1 584 318	0
Depreciation and amortisation	-81 695	-324 022	-1 460 128	-1 865 845	0
Total 31.12.2019					
Total cost	500 121	4 029 900	14 020 333	18 550 354	2 570 100
Accumulated depreciation and amortisation	-137 739	- 1 501 989	-2 890 780	-4 530 508	0
Carrying amount 31.12.2019	**362 382**	**2 527 911**	**11 129 553**	**14 019 846**	**2 570 100**

NOTE 8 Goodwill

On May 2, 2016 AS LHV Varahaldus acquired 100% shares of Danske Capital AS. This purchase enabled LHV Varahaldus to significantly increase its market share and also profitability. Immediately after conclusion of the share purchase and sale transaction on May 2, LHV Varahaldus started the merger of the two fund management companies. The merger took effect on July 28, 2016, with the balance sheet date on May 1.

AS LHV Varahaldus recognised the acquisition of Danske Capital AS in accordance with requirements of IFRS 3 by carrying out purchase price allocation. In the course of the purchase price allocation, the value of assets of Danske Capital AS was assessed and the assets were recognised in fair value on the transaction date (02.05.2016). Date of the financial information used for the purchase price allocation was 30.04.2016, which is the date closest to the transaction date with reliable financial information available. No significant transactions occurred between the financial information date and transaction date that had a significant impact on the value of net assets acquired. The total fair value of assets (cash, client agreements, pension fund units and other receivables) was 8 782 thousand euros. The total fair value of payables (payables to employees, tax payables and other payables) was 427 thousand euros

The acquisition and subsequent merger of Danske Capital AS resulted in goodwill in the balance sheet in the amount of EUR 2 570 100, see also Note 7.

Impairment test of goodwill was performed as at 31.12.2019. The cash generating unit of goodwill is AS LHV Varahaldus.

The calculation of the value in use is based on the following assumptions:

- Increase in the volume of assets under management 18% per annum (2018: 16%)
- Increase of fund managament company income -4% per annum on average (2018: .10%);
- Increase in indirect costs by 5% per annum (2018: 2%);
- The discount rate used is 15% (2018: 15%).

When using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations. Expectations are more conservative due to the changes in the market situation and legislation. Based on the results of the impairment test performed as at 31.12.2019, the recoverable amount of the cash generating unit is higher than its carrying amount, as a result of which no impairment losses have been recognized.

NOTE 9 Supplier payables

	31.12.2019	31.12.2018
Supplier payables, except related parties	248 245	238 073
Liabilities to related parties (Note 16)	34 752	13 823
Total supplier payables	**282 997**	**251 896**

NOTE 10 Other liabilities

	31.12.2019	31.12.2018
Financial liabilities		
Accrued interest on subordinated debt (Note 11)	5 311	8 978
Subtotal	**5 311**	**8 978**
Non-financial liabilities		
Payables to employees	155 462	155 626
Tax liabilities	105 840	93 471
incl. social security tax	58 363	52 075
incl. personal income tax withheld	32 773	29 198
incl. unemployment insurance premium	4 046	3 211
incl. contributions to mandatory pension	3 577	3 288
incl. corporate income tax	1 999	853
incl. value-added tax	5 082	4 846
Subtotal	**261 302**	**249 097**
Total	**266 613**	**258 075**

NOTE 11 Subordinated debt

According to the Company's business activity, only subordinate loans are recognized as a financing activity in the cash flow statement, as other loans received are part of the ordinary business activities. This appendix presents changes in subordinated liabilities, including monetary or non-monetary movements, and exchange rate effects, if they occurred during the reporting period or comparable periood.

AS LHV Varahaldus has issued subordinated bonds to comply with the standards imposed by law on the management company's own funds.

In 2014, bonds were issued to the parent company in the amount of EUR 550 thousand which were redeemed in June 2019.

In 2015, bonds were issued to the parent company in the amount of EUR 950 thousand. In 2016, new bonds were issued to the parent company in the amount of EUR 600 thousand. The bonds are issued at an interest rate of 8%

The underlying currency of the new bonds is the euro and the maturity date of bonds is ten years The right to prematurely redeem the new bonds issued applies after 5 years, by informing investors of it 30 days in advance. Early redemption takes place only if Financial Supervision Authority has given a permission previously for that.

Subordinated bonds	Interest rate	Amount
Balance as at 31.12.2017		**2 100 000**
Balance as at 31.12.2018		**2 100 000**
Redemption 2019		-550 000
Balance as at 31.12.2019		**1 550 000**

As at 31.12.2019 the subordinated liabilities with maturity above 5 years is EUR 1 550 000 (31.12.2018: 2 100 000). Interest expenses on subordinated bonds in the amount of EUR 144 655 are included within interest expense in the income statement (2018: 168 000 EUR). The current portion of non-current liabilities is disclosed in Note 10.

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	
Accrued interest on subordinated debts as at 31.12.2017	**8 978**
Interest calculated for 2018	168 000
Paid out during 2018	-168 000
Accrued interest on subordinated debts as at 31.12.2018	**8 978**
Interest calculated for 2019	144 656
Paid out during 2019	-148 322
Accrued interest on subordinated debts as at 31.12.2019	**5 311**

NOTE 12 Shareholders' equity in the public limited company

	31.12.2019	**31.12.2018**
Share capital (in euros)	1 500 000	1 500 000
Issued shares (pcs)	1 500 000	1 500 000
Nominal value of shares	1	1

According to AS LHV Varahaldus's articles of association, the minimum share capital is EUR 750 000 and maximum share capital is EUR 3 million. The share capital has been fully paid in cash.

In March 2019, the amount EUR 4 400 000 was paid for dividend to AS LHV Group (income tax in the amount EUR 972 093). In March 2018, the amount EUR 4 400 000 was paid for dividend to AS LHV Group (income tax in the amount EUR 1 100 000).

In April 2019, a fund issue was carried out in the amount of EUR 1 500 000 at the expense of retained earnings.

In May 2019, AS LHV Group cancelled the share of AS LHV Varahaldus in the amount of EUR 1 500 000. The repayment to the parent company occured in August 2019. In April 2018, AS LHV Group cancelled the shares of AS LHV Varahaldus in the amount of EUR 1 200 000. The repayment to the parent company occured in July 2018.

In July 2019, the options issued in 2016 were fully exercised in the amount of EUR 128 000. In July 2018, the options issued in 2015 were fully exercised in the amount of EUR 90 000. The vesting period for all share options in the option programm is 3 years. The right to subscribe will occur on the first day of the exercising period. The option strike price is calculated using Black-Scholes model based on LHV Group share price in Q4 2019 and volatility, risk free rate Latvian and Lithuanian government bonds used as proxy and dividend yield as inputs.

As at 31.12.2019 the retained earnings of AS LHV Varahaldus totalled EUR 26 410 671 (31.12.2018: profit EUR 26 062 300). If total profits would be distributed as dividends, the dividends would amount to EUR 21 304 537 (31.12.2018: 20 849 840). Part of the potential dividends (1/3 from dividends paid out in 2019 and 1/3 from dividends paid out in 2018) would be taxed at a preferential rate of 14/86 and the remaining part 20/80. The arising income tax expense would amount to EUR 5 106 134 (31.12.2018: 5 212 460).

NOTE 13 Fee income

	2019	2018
Pension fund management (Note 16)	12 748 053	13 671 609
Investment fund management (Note 16)	111 401	231 345
Fund issue and redemption fees	9 164	39 410
Total	**12 868 618**	**13 942 364**

In the financial year and in 2018, AS LHV Varahaldus's services were rendered only in Estonia.

NOTE 14 Administrative and other operating expenses

	2019	2018
Depository fees	745 102	678 065
Other purchased services	677 197	663 204
IT expenses	302 830	291 431
Advertising expenses	142 631	88 646
Marketing fees	102 171	305 361
Supervision and guarantee fees	115 386	99 376
Office expenses	114 194	116 885
Registry fees	88 861	79 812
Legal consultations and audit fees	70 754	74 483
Travel and training costs	33 818	27 489
Expenses related to funds	25 219	16 708
Communication costs	10 546	15 169
Other expenses	1 206	2 996
Total	**2 429 915**	**2 459 625**

In the calculation of minimum requirements of the pension fund manager´s own funds for covering the employee expenses, the general expenses, fixed general expenses also include the depreciation of non-current assets and other operating expenses that are reported in the income statement under a separate item.

Employee expenses	**2019**	**2018**
Salaries	1 439 429	1 236 415
Social tax	328 432	305 463
Unemployment insurance premium	7 474	6 393
Total employee expenses	**1 775 335**	**1 548 271**

In the reporting period, the wages and salaries (incl. taxes) of employees (not incl. management) totalled EUR 1 337 499 (2018: EUR 1 175 026). The amount of management remuneration is disclosed in Note 16. In the reporting year, the average number of employees (incl. members of the board) in AS LHV Varahaldus was 35 (2018: 36).

NOTE 15 Short-term leases

The company pays monthly lease for the rent of office premises, but the lease contract is on behalf of the sister company AS LHV Pank. Due to this, long-term non-cancellable lease period according to IFRS 16 “Leases” does not apply to LHV Varahaldus and office leases are recognized as short-term leases. In the reporting period, the rent for office space has been recognized under operating expenses in the total amount of EUR 81 344 (2018: EUR 79 750).

NOTE 16 Related party transactions

For the purpose of preparation of the annual report of AS LHV Varahaldus, the related parties include:

- owners (parent company and owners of the parent company);
- other subsidiaries and associates of the parent company;
- members of the Management Board, manager of the internal audit department and the entities under their control (together referred to as management);
- members of the Supervisory Board;
- close relatives of the persons mentioned above and the companies related to them;
- funds managed by LHV Varahaldus.

As at 31.12.2019, the owner of AS LHV Varahaldus was AS LHV Group with ownership interest 100%.

AS LHV Varahaldus conducted transactions with managed funds in the following amounts (see also Note 7):

Management fees	**Revenue 2019**	**Receivable as at 31.12.2019**	**Revenue 2018**	**Receivable as at 31.12.2018**
Pension funds (Note 13)	12 748 053	823 881	13 690 565	1 209 061
Investment funds (Note 13)	111 401	5 960	64 275	4 713
Total	**12 811 056**	**829 841**	**13 754 840**	**1 213 774**

In 2019, LHV pension and investment funds were repaid the management fees and commissions in the total amount of EUR 4 490 (2018: EUR 6 239).

In 2019, units of managed pension funds were purchased in the amount of EUR 133 295 (2018: EUR 1 720 000). The acquisition cost of the units of pension funds recognised at fair value in the balance sheet is EUR 6 910 589. In 2019, units of managed pension funds were sold in the amount of EUR 457 251 (2018: EUR 344 766), see also Note 6. See Note 6 for information about fair value of pension funds at balance sheet date.

In Feburary 2018, the fund managent company merged pension funds LHV Pensionifond Intress Pluss (merging) with LHV Täiendav Pensionifond (receiving).

In March 2018, the fund managent company AS LHV Varahaldus created new mandatory pension fund called LHV Pensionfond Eesti.

As at 31.12.2019, AS LHV Pank's (LHV's) accounts held demand deposits in the amount of EUR 4 954 902 (31.12.2018: EUR 4 205 432), see also Note 5.

In 2018, advertising and administrative services were purchased from LHV in the total amount of EUR 220 143 (2018: EUR 145 509). The expenses are included in the income statement under administrative and other operating expenses. As at 31.12.2019 the balance sheet includes a payable to LHV in the amount of EUR 34 752 (31.12.2018: EUR 13 823), see also Note 9. In 2019, administrative services were sold to LHV in the total amount of EUR 100 (2018: EUR 858).

As registrar, LHV intermediated until December 2018 to AS LHV Varahaldus redemption fees of LHV World Equities Fund. In 2018, redemption fees were paid in the amount of EUR 14 552.

2019, the sales fee from funds paid to LHV totalled to EUR 16 151 (2018: EUR 50 017).

The interest expenses of subordinated bonds in year 2019 amounted to EUR 144 655 (2018: 168 000) (see also Note 11).

In March 2019, dividends were paid to the parent company AS LHV Group in the amount of EUR 4 400 000 (income tax expense amounted to EUR 972 093).

In April 2019, a fund issue was carried out in the amount of EUR 1 500 000 at the expense of retained earnings.

In May 2019, AS LHV Group cancelled the share of AS LHV Varahaldus in the amount of EUR 1 500 000. The repayment to the parent company occured in August 2019

In July 2019, the options issued in 2016 were fully exercised in the amount of EUR 128 000.

In April 2018, AS LHV Group cancelled the shares of AS LHV Varahaldus in the amount of EUR 1 200 000. The repayment to the parent company occured in July 2018.

In March 2018, dividends were paid to the parent company AS LHV Group in the amount of EUR 4 400 000 (income tax expense amounted to EUR 1 100 000).

In July 2018, the options issued for the results of 2014 were fully exercised in the amount of EUR 90 000.

The Company 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.

In the reporting period, the members of the Management Board were paid total remuneration (incl. taxes) of EUR 437 836 (2018: EUR 373 246). No remuneration was paid to the members of the Supervisory Board. Members of the Supervisory Board with an employment contract were paid the total remuneration (incl. taxes) of EUR 131 217 (2018: EUR 104 400), which is accounted in the overall payroll expense, for more information see also Note 14. As at 31.12.2019, the payables to the members of the Management Board totalled EUR 10 402 (31.12.2018: EUR 13 163). As at 31.12.2019, payables to members of the Supervisory Board totalled EUR 9 317 (31.12.2018: EUR 8700). As part of the share option program the members of the Management Board and Supervisory Board have been issued share options in the amount of EUR 242 634 (2018: EUR 146 861).

In 2019 and 2018, no impairments were recorded with regard to receivables from the related parties.

NOTE 17 Contingent liabilities

Tax authorities have the right to review to 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 Company's management estimates that there are no circumstances which may lead tax authorities to impose additional taxes on the Company.

NOTE 18 Subsequent events

Estonian government wants to make the mandatory 2nd pillar pension scheme voluntary by giving people the opportunity to get access to all the money collected in the 2nd pillar pension (2% self-contributed and 4% added by the state social tax) before retirement, provided 20% income tax is paid. Thereupon, for the next 10 years, the 4% of the personal social tax contributions would move to the national 1st pillar. The Parliament of Estonia passed the corresponding pension reform decision on 29.01.2020, but the President did not proclaim it on 07.02.2020, citing possible violations with the Constitution of the Republic of Estonia. The pension reform returned by the President is likely to be resolved by the Parliament in March 2020. If the Parliament sends the law back to the President unamended, it is possible and likely that the President will challenge it in the Supreme Court. It is therefore difficult to assess the scale of the impact of a possible pension reform. If a significant part of LHV's mandatory pension fund contributors decide to leave the 2nd pillar as a result of the pension reform, then the fund volumes will decrease, which in turn may affect the Fund manager's financial performance.

In November 2019 the Fund manager informed the public of its intention to merge LHV Pension Fund Estonia with LHV Pension Fund L. The reason for the merger is the planned pension reform, after which it would no longer be possible to invest in LHV Pension Fund Estonia in the scale and strategy initially envisaged. The permission to merge funds was obtained from the Financial Supervision Authority in February 2020, the merger will take place on 02.09.2020.

NOTE 19 Report of mandatory pension funds' management

(in euros)	2019	2018
Fee income	**12 576 502**	**13 516 588**
Management fees	12 576 502	13 516 588
Fee expenses	**-1 095 006**	**-1 006 948**
Depositary fees	-745 102	-678 065
Registrar fees	-253 100	-226 325
Other fee expenses	-96 804	-102 557
incl. other fee expenses to related parties	-55 007	-54 885
Personnel and operating expenses	**-2 894 531**	**-2 721 512**
Wages and salaries	-1 597 802	-1 393 444
Supervisory fees	-113 079	-97 388
Guarantee Fund fees	-273 579	-314 943
Marketing and advertising fees	-224 862	-292 787
Other operating expenses	-685 209	-622 950
Other income and expenses	**-1 834 689**	**-1 771 309**
Operating profit/loss	**6 752 276**	**8 016 820**
Financial income and expenses	**311 065**	**-192 303**
Net profit/loss for the financial year	**7 063 341**	**7 824 517**
Income tax	**-952 651**	**-1 078 000**
Gross profit/loss for the financial year	**6 110 690**	**6 746 517**

Report of mandatory pension funds' management is composed according to accounting policies and procedures of AS LHV Varahaldus. The income and expenses related to mandatory pension funds' management are recognized in accordance with fund manager's income and expenses in the related income statement. Direct costs of mandatory pension funds' management are calculated using the direct method. Indirect costs are allocated proportionally according to the volume of assets. Costs not related to mandatory pension funds' management are eliminated.

Signatures of the Management Board to the 2019 Annual Report

The Management Board has prepared the management report and the financial statements of AS LHV Varahaldus for the financial year ended on 31 December 2019. The financial statements present a true and fair view of the financial position, the results of operations and the cash flows of the Company.

6.03.2020

/signed/
Vahur Vallistu ____________________
Chairman of the Management Board

/signed/
Joel Kukemelk ____________________
Member of the Management Board

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of AS LHV Varahaldus

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of AS LHV Varahaldus (the Company) as at 31 December 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

What we have audited

We audited the Company's financial statements that comprise:

- the statement of financial position as at 31 December 2019;
- the statement of comprehensive income for the year then ended;
- the statement of cash flows for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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

Independence

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

Other information

The Management Board is responsible for the other information. The other information comprises the Management report (but does not include the financial statements and our auditor's report thereon).

Our opinion on the 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 financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the financial statements

The Management Board is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as the Management Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Management Board is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to

events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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.

AS PricewaterhouseCoopers

/signed/

Verner Uibo
Auditor's certificate no.568

6 March 2020

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* *This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

Proposal for profit distribution

The Management Board of AS LHV Varahaldus proposes to the General Meeting of Shareholders to allocate the net profit for financial year ended 31 December 2019 as follows:

- Pay dividends EUR 4 400 000
- Transfer to retained earnings EUR 1 720 371

Signatures of the Supervisory Board to the Annual Report

The Supervisory Board has reviewed the annual report, which consists of management report and financial statements, independent auditor's report and profit allocation proposal for financial year and approved it for presentation at the General Meeting of Shareholders.

6.03.2020

/signed/

Madis Toomsalu ____________________
Chairman of the Supervisory Board

/signed/

Andres Viisemann ____________________
Member of the Supervisory Board

/signed/

Erki Kilu ____________________
Member of the Supervisory Board

The revenue of AS LHV Varahaldus according to EMTA classificator

EMTAK	Field of activity	2019	2018
66301	Fund management	12 868 618	13 942 364
	Total	**12 868 618**	**13 942 364**

Report of management company’s fixed overheads

(in euros)	**2019**	**2018**
Total costs	6 219 926	5 966 575
Bonuses, profit shares and other variable fees appointed to employees and management which do not result from contractual obligations	325 196	203 071
Shared commission fees and other fees for the period, which are directly related to commissions and other fees included in total revenue	15 490	100 587
Total fixed overheads	5 879 240	5 662 917

The calculation method of fixed overheads was changed regarding to the new Investment Funds Act that came into force on 10th January 2017 and the amount of the respective costs is determined by deducting certain cost items from the total costs.