AS LHV Pank
Consolidated Annual Report 2016

(translation of the Estonian original)

Consolidated Annual Report	**01.01.2016 – 31.12.2016**
Legal name	AS LHV Pank
Commercial Registry no.	10539549
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
Fax	(372) 6800410
E-mail	lhv@lhv.ee
Main activities	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	Erki Kilu (chairman)
	Andres Kitter
	Indrek Nuume
	Jüri Heero
	Meelis Paakspuu
	Martti Singi
Supervisory Board	Erkki Raasuke (until 04.12.2016), Madis Toomsalu (since 05.12.2016)
	Rain Lõhmus
	Andres Viisemann
	Tiina Mõis
	Heldur Meerits
	Raivo Hein
Auditor	AS PricewaterhouseCoopers

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Management report

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

LHV Pank (hereinafter the Bank) is the largest bank based on Estonian capital. The Bank concentrates on active and independent customers with an entrepreneurial mindset. For private individuals, the Bank mainly offers services of depositing and increasing monetary funds. For corporate clients, LHV offers flexible and suitable financing and managing of everyday financial operations. The products and services provided by the Bank are simple, transparent and appropriate. Client interaction is mainly conducted using modern electronic communication channels. Costs avoided will reach the clients of LHV through affordable cost of everyday service.

The branch offices of the Bank are located in Tallinn, Tartu and Vilnius (to be closed on 31.03.2017). The Bank employs over 250 people and more than 110 000 customers use the Bank's services. The Bank owns 65% of its subsidiary AS LHV Finance, that provides hire-purchase and consumer finance services (hereinafter the Group).

Business activities

In 2016, opening of new accounts and customer activity continued to grow at very good momentum. The number of customers increased by 30 000 and the customer base exceeded 110 000 customers. New records were set in customer activity in payments, card payments and card payment acceptance. In Estonia, the Bank rose fourth in the volume of personal and corporate deposits and in the number of card payments, and third in terms of the volume of securities held in accounts of the Estonian Central Depository of Securities and in the number of customers.

The volume of Bank deposits grew by 25% year-on-year, amounting to EUR 785 million (2015: EUR 629 million). During the year, the focus was on growing deposit volume and on reducing interest expense. The European Central Bank continued with base rate cuts, triggering the growth in the Bank's expenses of holding liquid funds. Due to the rapid growth of deposits and increase in the Bank's liquid funds, interest rates on term deposits were cut further. The liquidity account service was discontinued at the end of the year. The proportion of demand deposits continued to grow, reaching 81% of all deposits by the end of the year (71% a year ago). At the beginning of the year the Bank repaid a loan of EUR 13 million it had borrowed under the long-term refinancing operations (TLTRO) program to the European Central Bank.

The carrying amount of loans grew by 31% year-on-year to EUR 532 million (2015: EUR 405 million). Corporate loans, which also include retail loans granted to businesses, grew 31% year-on-year to EUR 377 million (2015: EUR 286 million) and loans granted to private individuals grew by 65% to EUR 86 million (2015: EUR 52 million). Majority of the loan portfolio consisted of corporate loans, followed by leasing, hire-purchase and consumer loans, mortgage loans. The Bank has issued a loan to UAB Mokilizingas, the other subsidiary of the parent company AS LHV Group, the amount of which was EUR 30.5 million at year end (2015: EUR 33 million).

The profit for the year was EUR 13.2 million (2015: EUR 9.9 million). During the year both the interest margin and credit quality was kept a very good levels. The profit was positively affected by a larger international business transaction in which a public company VISA Inc. acquired VISA Europe that had been owned by banks. For the acquisition, VISA Inc paid the banks both in cash, as well as in VISA shares. The Bank received a one-off income of approximately EUR 0.9 million from the sale of its equity share of VISA Europe.

Product development

In spring, the Bank in cooperation with the European Investment Fund launched micro-loan, which is a loan produced targeted to small and medium-sized enterprises. The collateral of micro loan is being financed by the European Union as a part of the employment and social innovation program.

In autumn, the Bank started offering mortgage loans. Customer interest towards mortgage loans was high from the start of launching the product. Approximately half of the Bank's mortgage loan customers are existing customers of the Bank and the other half are new customers.

New developments include mobile banking interface for businesses and additions to the mobile bank. The banking interface LHV Connect enables businesses to connect their bank account information directly to their accounting system. LHV Connect allows to send payments, receive notifications of payment receipt and receive account statements. LHV Connect can be used by large, small and medium-sized companies. In mobile banking, an overview of securities and password login were added, which are especially important for children and young people.

In the autumn, swipe payment cards, swipe card payment terminals and swipe ATMs were launched. The Bank's new re-designed website with new functionality was also launched. Leasing, hire purchase agreements and small loan contracts became available in the Internet Bank.

The Bank decided to join a pilot project of EBA Clearing Instant Payments. EBA Clearing is implementing a system of real-time euro payments between member banks. EBA Clearing plans to make the system available to customers in 2017.

At the end of the year, a new business unit - Trade Finance Division - was created under the Corporate Banking department. Trade Finance Division will be offering letters of credit, foreign guarantees, trade loans and factoring. These products will be launched gradually during 2017.

Organisation

The organizational structure of the Bank is divided into three major business areas: Retail Banking, Private Banking and Corporate Banking, and three major support services: Information Technology, Finance and Operations, and Risk Management. Marketing and communication, and Human resource department are across the Bank.

During the year, corporate loan portfolio was divided into two. Customers whose credit balance was lower than EUR 250 000 were transferred from Business Banking to Retail Banking Department, and customers whose credit balance was more than EUR 250 000 remained in Corporate Banking. Transfer of smaller loans to Retail Banking was important as it enabled to keep the focus of Corporate Banking and Credit Analyses on larger and more individual approach requiring credit clients. Business loans smaller than EUR 250 000 will undergo a more cost-effective scoring process.

At the end of the first quarter, the Latvian branch office was closed. The Bank's operations in Latvia were small-scale. In its business pursuits, the Bank has been governed, above all, by the business interests of its customers and endeavours to keep pace with the customers. Today, Estonian companies need services and support mainly in the West European direction, and it is appropriate to take it into account also in developing the bank's operations and services

At the end of the year, a new office was opened in Tartu. In the second half of the year a staff satisfaction survey was carried out. The survey attracted a record number of respondents and was given the highest rating of all times.

The number of employees of the group increased by 22 people in a year to 270 employees (including passive and part-time), including 20 people employed at LHV Finance. The number of active full-time equivalent employees was 248 in total.

During the year, the Bank was recognised with several significant awards. Nasdaq named the Bank the Member of the Year of the Baltic stock exchange market. The Bank was ranked first in the level of customer service in the banking sector by market survey company Dive. In the annual survey of most valued employers, CV-Keskus ranked LHV Pank eighth overall, behind only Estonia's largest companies. Among the banks LHV was in a strong second position.

Sponsorship

The Bank takes social responsibility seriously. Within the limits of our available resources, we support enterprises and initiatives that contribute to the development of the Estonian society. When it comes to sponsorship projects, we prefer a long-term, substantial partnership. We stand ready to contribute to the community and the pursuit of innovative ideas which help to advance Estonian life.

The Bank's long-term partners are the Estonian Football Association, the Estonian Optimist Class Association, the Estonian Cyclists Union, the Estonian Entrepreneur of the Year contest, the Gazelle Movement, the Tallinn Restaurant Week, Enn Soosaar Foundation and the Estonian Music Days.

Financial results

The net profit of LHV in 2016 amounted to 13.2 million euros, up 33% compared to the previous year (2015: 9.9 million euros). Net interest income grew by 36% and net fee and commission income increased by 18%. Financial income was higher by 711% compared to the previous year. Significant increase in financial income was due to one-off income from the sale of VISA Europe equity share.

The large increase in net interest income is attributable to a growth in lending and deposit volumes.

Among fee and commission income, the greatest contribution continues to come from security brokerage income. Income on cards and settlements are also showing a growth trend.

Operating expenses grew by 15% year-on-year, which was expected given the current phase of high growth and new business development.

Loan losses were 164% higher compared to the previous year.

The total volume of the Bank's loan portfolios at the end of December amounted to 532 million euros (31.12.2015: 405 million euros). The portfolio volume grew by 31% year-on-year. The majority of the loan portfolio is made up of loans to businesses, which grew by 31% year-on-year to 377 million euros (31.12.2015: 286 million euros). The retail loan portfolio grew by 65% year-on-year to 86 million euros (31.12.2015: 52 million euros). LHV Pank has issued a loan to the other subsidiary of AS LHV Group, UAB Mokilizingas, the amount of which at the year-end was 31 million euros (31.12.2015: 33 million euros).

The volume of deposits of the Bank grew by 25% year-on-year and reached 785 million euros by year-end (31.12.2015: 629 million euros). The increase mainly resulted from the growth of deposits in retail banking, which is why the bank decided to end providing liquidity accounts to customers as of 1st of January 2017. As a result of the overall low interest rate environment, a change has occurred in the deposit structure. The proportion of demand deposits has increased significantly, accounting for 81% of all deposits as at the end of December (71% one year ago).

Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Bank, calculated according to the definitions of the Basel Committee, was 221% at the end of December (31.12.2015: 272%). The Bank includes cash and bond portfolios, accounting for 40% of the balance sheet total, among its liquidity buffer (31.12.2015: 45%). The Bank's loan-to-deposit ratio at the end of 2016 was 68% (31.12.2015: 63%).

The debt security portfolio decreased by 37% during 2016 due to low interest rates. Low interest rate levels do not support holding the Bank’s liquidity buffer in debt securities, and it is held in European Central Bank instead.

The Bank repaid a loan in a total amount of 13 million euros which was emitted regarding targeted longer-term refinancing operations (TLTRO) by European Central Bank.

Through a shares and subordinated bonds issue by the Bank's parent entity, AS LHV Group, the Bank's share capital was increased by 5 million euros at the end of the year and the amount of subordinated bonds by 5 million euros.

The Bank's level of own funds at 31.12.2016 was 96.5 (31.12.2015: 75.1) million euros. The bank is well-capitalised as at the end of the reporting period with a capital adequacy level of 18.7% (31.12.2015: 19.2%).

AS LHV Pank and its subsidiary AS LHV Finance are included in the calculation of capital adequacy. The Group uses the standard method for the calculation of credit risk and market risk capital requirements and the basic indicator approach for the calculation of operational risk capital requirements. The Bank has complied with all capital requirements during the financial year and in previous year.

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

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2016 was 8.2% (31.12.2015: 6.5%). Leverage ratio is calculated as bank’s total Tier 1 own funds divided by its total risk exposure measure (incl risk position on assets and off the balance sheet liabilities). As at the end of the reporting period, the leverage ratio is arithmetic mean of the monthly leverage ratios over the last quarter.

Statement of profit or loss, EUR million	**2016**	**2015**	**change**
net interest income	25.55	18.76	36%
net fee and commission income	5.72	4.85	18%
other financial income	1.00	0.12	711%
total net operating revenues	32.27	23.73	36%
other income	0.39	0.09	333%
operating expenses	-17.64	-15.38	15%
loan losses	-1.77	-0.67	164%
discontinued operations	0.00	2.18	-100%
net income	13.25	9.94	33%

Volumes, EUR million	**31.12.2016**	**31.12.2015**	**change**
loan portfolio	531.8	405.4	31%
bond portfolio	64.9	103.0	-37%
deposits	785.0	629.0	25%
equity	80.2	61.4	31%
number of customers holding assets in bank	112 998	83 081	36%

Key figures, EUR million	2016	2015	change
net profit	13.2	9.9	33%
net profit attributable to owners of the parent	12.1	9.4	29%
average equity	70.8	52.8	34%
return on equity (ROE) % *	17.1	17.8	-0.7
average assets	821	640	28%
return on assets (ROA) %	1.5	1.5	0.0
net interest income	25.6	18.8	36%
average assets exposed to interest risk	817	631	30%
net interest margin (NIM) %	3.13	2.97	0.15
spread %	3.10	2.90	0.2
cost/income ratio %	54%	65%	-11

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

Explanations

average equity (attributable to owners of the parent) = (equity of current year end + equity of previous year end) / 2

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

average assets = (assets of current year end + assets of previous year end) / 2

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

net interest margin (NIM) = net interest income/average assets exposed to interest risk * 100

spread = yield on assets exposed to interest risk – cost of interest bearing liabilities

yield on assets exposed to interest risk = interest income / average assets exposed to interest risk * 100

cost of interest bearing liabilities = interest expenses/average liabilities exposed to interest risk * 100

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

Risk Management

The purpose of risk management is to identify, assess, manage and control all risks related to the activities of the Group. The principles of identification, measuring, reporting and control of risks at the Group are set out in the policies and procedures approved by the supervisory board and daily risk management is organised by Risk management unit. The purpose of the risk management is to identify, assess, monitor and manage all risks related with LHV Group in order to ensure the LHV Group's reliability, stability and profitability. In the Group, risk management is based on three lines of defence. Business units as the first line of defence are responsible for taking and managing risks. The second line of defence – which includes the risk management unit – is responsible for developing and maintenance of the risk management framework. The third line of defence, internal audit function, carries out independent control over processes, operations and control functions in the entire Group. The rules and procedures of risk management are regularly reviewed at least once a year and updated in case of a need.

Detailed overview of the risks taken by the Group is presented in Note 3 of the annual report.

Capital base *(in EUR thousands)*	**31.12.2016**	**31.12.2015**
Paid-in share capital	56 500	51 500
Statutory reserves paid in from net profit	848	396
Accumulated profit/deficit	7 838	-1 099
Intangible assets (subtracted)	-772	-626
Net profit for accounting period	12 096	9 407
Non-controlling interests	0	535
Total Tier 1 capital	**76 510**	**60 113**
Subordinated debt	20 000	15 000
Total Tier 2 capital	**20 000**	**15 000**
Net own funds for capital adequacy calculation	**96 510**	**75 113**
Capital requirements		
Central governments and central banks under standard method	1 498	0
Credit institutions and investment companies under standard method	6 190	5 292
Companies under standard method	364 895	265 870
Retail claims under standard method	87 549	81 109
Public sector under standard method	216	0
Housing real estate under standard method	7 079	0
Overdue claims under standard method	1 869	3 918
Other assets under standard method	4 654	3 933
Total capital requirements for covering the credit risk and counterparty credit risk	**473 950**	**360 122**
Capital requirement against foreign currency risk	225	182
Capital requirement against interest position risk	1 709	1 947
Capital requirement against equity portfolio risks	601	87
Capital requirement against credit valuation adjustment risks under standard method	24	0
Capital requirement for operational risk under base method	39 664	28 734
Total capital requirements for adequacy calculation	**516 173**	**391 072**
Capital adequacy (%)	**18.70**	**19.21**
Tier 1 Capital Ratio (%)	**14.82**	**15.38**

Management and compensation policy

LHV Pank is a public limited company and its governing bodies are the general meeting of shareholders, the supervisory board and the management board.

General meeting

The general meeting of shareholders is the highest governing body of LHV Pank where shareholders invoke their rights.

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

General meetings of shareholders are called by the management board. The annual general meeting of shareholders held for approval of the annual report is held at least once per annum.

The sole shareholder of LHV Pank is AS LHV Group. Shareholders with significant ownership interest in AS LHV Group are Rain Lõhmus and persons related to him with 25.9% and Andres Viisemann and persons related to him with 9.81%.

Supervisory board

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

The supervisory board of LHV Pank has six members. The supervisory board is comprised of Madis Toomsalu (since 05.12.2016), Rain Lõhmus, Andres Viisemann, Tiina Mõis, Heldur Meerits, Raivo Hein and Erki Raasuke (until 04.12.2016).

Management board

The management board is a governing body of LHV Pank that represents and manages LHV Pank. The management board has three to seven members. The term of the management board member's powers is five years, unless otherwise decided by the supervisory board. The chairman of the management board organises the work of the management board. The company may be represented by two management board members jointly in each transaction.

The management board of LHV Pank has six members. The Management board is comprised of Erki Kilu, Andres Kitter, Indrek Nuume, Jüri Heero, Meelis Paakspuu and Martti Singi.

Committees

The supervisory board of AS LHV Group, the sole shareholder of LHV Pank, has formed two committees on the AS LHV Group level, the aim of which is to advise the supervisory board of AS LHV Group in matters pertaining to audit and compensation as described below concerning all of the group companies that are part of AS LHV Group.

Audit committee

The audit committee is above all an advisory body to the supervisory board of AS LHV Group in the fields of accounting, audit, risk management, internal control and internal audit, supervision and budgeting and the legality of the activities. The audit committee must comprise at least two members.

The duties of the audit committee are to monitor and analyse the processing of financial information to the extent necessary for preparing quarterly and annual financial statements, effectiveness of risk management and internal control, the audit process of financial statements or consolidated financial statements and the independence of the auditor and independent auditor who represents it on the basis of law and compliance of its activities with provisions of the Auditors Activities Act.

The audit committee is responsible for making proposals to the supervisory board of AS LHV Group and provide recommendations for the appointment or removal of the auditor, appointment or removal of the internal auditor, prevention or elimination of problems or ineffectiveness in the organisation and compliance with legislation and good professional practice.

Compensation committee

The duties of the compensation committee are to evaluate the implementation of compensation policy in the companies within AS LHV Group and the effect of compensation-related decisions on compliance with requirements related to risk management, own funds and liquidity. The compensation committee consists of at least three supervisory board members of LHV Pank.

The compensation committee supervises the compensation of management board members and employees of companies within AS LHV Group, evaluates the implementation of compensation policy at least annually and, if necessary, proposes to update the compensation policy and prepares draft resolutions related to compensation for the supervisory board of AS LHV Group.

Compensation policy

The policy of compensating members of the management board and employees of LHV Pank is set and its implementation is evaluated by the compensation committee established on the level of AS LHV Group.

A monthly base salary is paid to members of the management board and employees of LHV Pank. A supplementary monthly incentive salary is paid to a small number of employees directly engaged in sales and new customer acquisition. The base salaries of members of the management board are determined by the supervisory board and the base salaries of employees are determined by the management board. The chairman of the management board is employed on the basis of service contract, everyone else is employed under employment contracts.

The Bank has made no major severance payments nor significant non-cash compensations.

Share options

In 2014, the general meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the management board members and equivalent employees and department managers and equivalent employees of group companies that are part of AS LHV Group. The aim of issuing share options is to align the interests of management board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labour market that is equal to competitors and comprehensive. Similarly to 2014 the share options were issued also in 2015 and in 2016.

The granting and size of share options was dependent upon the successful achievement of operational targets of the overall company and the targets of individual management board members and employees. In the beginning of 2016 share options were granted to six members of the management board of LHV Pank and thirty six employees in the total amount of 598 thousand euros. In 2015 share options were granted to five members of the management board of LHV Pank and thirty five employees in the total amount of 510 thousand euros. The company entered into share option agreements with the members of the management board and employees for a three-year term for the granting of share options. Share options issued in 2014 can be exercised between the period of 01.07.2017-30.09.2017 and shares with nominal value of 1 euro can be acquired for 2 euros per share. Share options issued in 2015 can be exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of 1 euro can be acquired for 2.4 euros per share. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of 1 euro can be acquired for 3.0 euros per share. Similarly to previous years, share options are most probably issued also in 2017.

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

Wages and salaries

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

Calculated gross salaries and wages *(EUR thousand)*	**Base salary**	**Incentive salary**	**Total**	**Number of employees**
Retail banking	2 569	71	2 640	154
Private and corporate banking	944	8	952	31
Support services	1 776	0	1 776	85
Information technology	1 552	0	1 552	75
Total	**6 841**	**79**	**6 920**	**345**

Business environment

Even though the final figures are yet to be revealed, the world economy is likely to have decelerated in 2016, for the second year in a row. According to IMF's January forecast, there is a good chance that the trend will be reversed, with the global economic growth expected to gain momentum and reach 3.4% this year.

The dynamics of the previous six months suggest that developed and developing markets have taken a different path. The new administration in the United States foresees a growth in budgetary expenditure. Similarly, the forecast for the Chinese economy has been upwardly revised against endless government stimulus. In Latin America, however, economic recovery has remained sluggish, failing all expectations. Mexico is suffering from US-related political uncertainty, and the Indian economy from backlashes of the banknote replacement.

The keyword for 2017 is "elections" – in Europe, the year will see elections in both Germany and France, while the newly inaugurated President of the United States is already revealing the first major changes in course. Growth in protectionist tendencies, review of international trade treaties and prolongation of the long-awaited structural reforms have the potential to re-shape the long-term economic outlook.

Economic growth in the euro area hovered around 1.7% in Q3, with the annual change expected to remain in the same ballpark. The IMF forecasts a marginal slow-down in growth, to 1.6%. The return of inflation, fuelled by the recovery in oil and energy prices, will start exerting pressure on domestic consumption (the main engine for growth so far), with the pressure on wage increase remaining non-existent. Consumption is positively affected by consistent growth in employment. Enhanced corporate profitability is bound to attract investments.

The Economic Sentiment Indicator of Estonia's key trade partners remained at five-year highs, strongly advancing in the second half of the year. A major advance in sentiment was evident in Finland and Lithuania in 2016, suggesting an improvement in the countries' economic outlook.

Despite overall optimism, the economic growth in Sweden is losing pace, dropping to 2.8% in Q3. This can mainly be attributed to stabilisation of domestic consumption, which, up to now, has been stimulated by low interest rates. The growth in investment volumes is also expected to slow down significantly. The forecast for Swedish economic growth this year is around 2%. Estonia's interests revolve around a strong growth in Swedish import volumes and investor-friendly tendencies in Swedish banks.

Finland is continuing its sluggish recovery, with the economy growing 1.7% in Q3. Consumer confidence rose above long-term average in 2016 and is nearing ten-year highs - the highest among EU Member States. The positive trend is reflected in the general economy, where domestic consumption has remained the main engine for growth for quite some time. The key for the upcoming year lies in the ability to boost export volumes. So far, this has remained quite a stumbling block. Similarly to Sweden, Estonia's interests lie in further growth in Finnish import volumes.

The economic growth in Lithuania - a major destination market for LHV - slowed down to 1.7% in Q3. This can mainly be attributed to shrinking volumes of projects financed through EU assistance funds, which also had an adverse effect on the construction sector. Strong domestic consumption remained the main engine for growth, fuelled by a quick increase in wages and decrease in unemployment. The Lithuanian economic growth is expected to improve, compared to the 2% growth last year. Growth in the volume of EU financed projects could provide a further stimulus, with the transition to the new programming period expected to contribute.

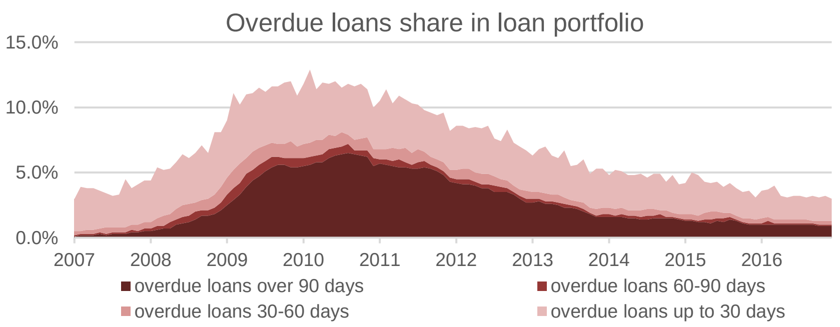
The Estonian economy in 2016 can mainly be characterised by failure to meet the overly optimistic forecasts – the estimated growth of 1% is the slowest in the post-crisis period. Difficulties in the oil shale industry and the energy sector, mainly conditioned by external factors, also had their bearing. The poor investment volumes in recent years have impeded the potential growth of Estonian economy. The economic forecast published by the Estonian Central Bank in December foresees a 2.6% growth for the year. Income increase is expected to continue, but the return of inflation will have a significant impact on growth in real wages. Consequently, export and investments are becoming increasingly important, alongside domestic consumption. Government expenditure is expected to rise, fuelled, among other things, by the EU Presidency and the local government elections in the autumn of 2017. The policy measures implemented by the new coalition have caused a greater-than-usual uncertainty with regard to the outlook for the upcoming year

Key economic indicators of Estonia*	2007	2008	2009	2010	2011	2012	2013	2014	2015	Eesti Pank forecast 2016E	Eesti Pank forecast 2017E
Nominal GDP (EUR billion)	16..25	16.52	14.15	14.72	16.67	17.93	18.89	19.76	20.25	20.78	21.73
GDP volume***	7.7%	-5.4%	-14.7%	2.3%	7.6%	4.3%	1.4%	2.8%	1.4%	1.0%	2.6%
Private consumption expenditures****	9.0%	-4.9%	-15.3%	-1.6%	3.7%	4.3%	3.8%	3.3%	4.7%	3.4%	2.7%
Government consumption expenditures	6.6%	4.6%	-3.2%	-0.4%	1.3%	3.2%	1.9%	2.7%	3.4%	-0.4%	2.4%
Fixed capital formation	10.3%	-13.1%	-36.7%	-2.7%	34.4%	12.7%	-2.8%	-8.1%	-3.3%	0.2%	4.1%
Exports	12.6%	0.9%	-20.3%	24.0%	24.2%	4.8%	2.3%	3.1%	-0.6%	3.6%	3.4%
Imports	13.0%	-6.2%	-30.6%	21.2%	27.2%	9.7%	3.2%	2.2%	-1.4%	5.0%	3.1%
CPI	6.6%	10.4%	-0.1%	3.0%	5.0%	3.9%	2.8%	-0.1%	-0.5%	0.1%**	2.8%
Unemployment rate (% of the labour force)	4.6%	5.5%	13.5%	16.7%	12.3%	10.0%	8.6%	7.4%	6.2%	6.8%	8.2%
Current account (% of GDP)	-15.0%	-8.7%	2.5%	1.8%	1.3%	-1.9%	-0.4%	0.9%	2.2%	2.2%	1.5%
Budget balance (% of GDP)*****	2.7%	-2.7%	-2.2%	0.2%	1.2%	-0.3%	-0.2%	0.7%	0.1%	0.3%	-0.4%

* Numbers reported are annual rates of change in per cent, if not noted otherwise; ** actual; *** GDP and its components are chain-linked; **** including NPISH; ***** the budget balance forecast considers only those measures on which sufficient information was available at the date of the forecast.
Sources: Eesti Pank, Eurostat, Statistics Estonia

LHV is not expecting any abrupt economic changes in Estonia over the 12-month horizon. Economic growth is expected to pick up pace, but is unlikely to achieve its full potential. The policy measures of the new coalition will be a major factor. Rapid growth in wages is exerting pressure on the already dropping corporate profits. Corporate adaptability and successful enhancement of productivity will thus play an increasingly important role. A qualitative leap in investments is required to achieve the objectives.

In terms of economic sectors, higher-than-average risks are evident in the processing industry and energy-related sectors, which are facing wage pressures. Special attention should also be paid to transport and warehousing as well as the risks of the construction sector, where the drop in profit figures has been significant, compared to previous periods. LHV has also taken a more conservative approach to the real estate market, carefully monitoring the dynamics on the local and Scandinavian markets. Rental property projects involve a significant risk of insufficient demand for absorbing the developed volumes in the near future, with corrections expected in either rental prices or vacancy rates.



Source: Eesti Pank

On a positive note, the financing environment remains favourable. Last year saw a growth in the balance of loans taken from credit institutions. The loan to deposit ratio and overdue loans have maintained their post-crisis lows. With the record-low interest rates and interbank competition having a positive impact on local entrepreneurship, the opportunities should be further exploited. LHV stands ready to boldly and efficiently contribute to the search of new sources of growth, offering a long-term partnership to enterprises and making an effort to create additional value.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of profit or loss and other comprehensive income

(in thousands of euros)	Note	2016	2015
Continuing operations			
Interest income		29 839	22 612
Interest expense		-4 287	-3 854
Net interest income	5	**25 552**	**18 758**
Fee and commission income		9 760	6 942
Fee and commission expense		-4 044	-2 090
Net fee and commission income	6	**5 716**	**4 852**
Net gains from financial assets measured at fair value	10	1 103	44
Foreign exchange rate gains/losses		-105	70
Other financial income		0	1
Net gains from financial assets		**998**	**115**
Other income		385	87
Staff costs	7	-9 676	-8 065
Administrative and other operating expenses	7	-7 961	-7 317
Profit before impairment losses on loans and advances		**15 014**	**8 430**
Impairment losses on loans and advances	12	-1 767	-670
Net profit for the year from continuing operations		**13 247**	**7 760**
Profit from discontinued operations	11	0	2 181
Net profit for the year		**13 247**	**9 941**
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Revaluation of available-for-sale financial assets	9	-17	-17
Total profit and other comprehensive income for the year		**13 230**	**9 924**
Total profit attributable to:			
Owners of the parent		12 097	9 406
Non-controlling interest		1 150	535
Total profit for the year		**13 247**	**9 941**
Total profit and other comprehensive income attributable to:			
Owners of the parent		12 080	9 389
Incl. continuing operations		*12 080*	*7 208*
Incl. discontinued operations		*0*	*2 181*
Non-controlling interest		1 150	535
Total profit and other comprehensive income for the year		**13 230**	**9 924**

Notes on pages 17 to 68 are an integral part of the consolidated financial statements.

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Consolidated statement of financial position

(in thousands of euros)	Note	31.12.2016	31.12.2015
Assets			
Due from central bank	8	265 127	199 844
Due from credit institutions	8	27 171	11 442
Due from investment companies	8	8 073	15 922
Available-for-sale financial assets	9	799	3 508
Financial assets at fair value through profit or loss	10	64 197	99 511
Loans and advances to customers	12	531 761	405 410
Receivables from customers	13	1 699	970
Other financial assets	14	941	940
Other assets	14	714	525
Tangible assets	15	1 002	606
Intangible assets	15	771	625
Total assets		**902 255**	**739 303**
Liabilities			
Deposits from customers and loans received	16	785 409	644 767
Financial liabilities at fair value through profit or loss	10	209	89
Accounts payable and other liabilities	17	16 469	18 078
Subordinated debt	19	20 000	15 000
Total liabilities		**822 087**	**677 934**
Equity			
Share capital	20	56 500	51 500
Statutory reserve capital		888	419
Other reserves	9	-40	-23
Retained earnings		20 902	8 705
Total equity attributable to owners of the parent		**78 250**	**60 601**
Non-controlling interest		1 918	768
Total equity		**80 168**	**61 369**
Total liabilities and equity		**902 255**	**739 303**

Notes on pages 17 to 68 are an integral part of the consolidated financial statements.

Consolidated statement of cash flows

(in thousands of euros)	Note	2016	2015
Cash flows from operating activities			
Interest received		29 409	23 180
Interest paid		-4 466	-3 794
Fees and commissions received		9 760	6 942
Fees and commissions paid		-4 044	-2 090
Other income received		385	87
Staff costs paid		-9 101	-7 667
Administrative and other operating expenses paid		-7 147	-6 519
Cash flows from operating activities before change in operating assets and liabilities		**14 796**	**10 139**
Net increase/(decrease) in operating assets:			
Net acquisition/disposal of trading portfolio		-287	-16
Loans and advances to customers		-128 433	-94 546
Term deposits with other credit institutions		0	1
Mandatory reserve at central bank		-1 598	-1 640
Security deposits		-1	-157
Other assets		-171	201
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers		187 136	168 048
Term deposits of customers		-31 506	-999
Loans received		0	5 645
Repayments of loans received		-14 731	-7 221
Financial liabilities held for trading at fair value through profit or loss		120	-213
Other liabilities		-1 699	13 705
Net cash from/(used in) operating activities from continuing operations		**23 626**	**92 947**
Cash generated from/(used in) operating activities from discontinued operations		0	2 781
Net cash from/(used in) operating activities		**23 626**	**95 728**
Cash flows from investing activities			
Purchase of tangible and intangible assets	15	-1 362	-1 271
Sale of tangible assets		10	0
Proceeds from disposal and redemption of investment securities available for sale	9	3 068	782
Net changes of investment securities at fair value through profit or loss	10	35 788	38 805
Cash from investment activities of discontinued operations	11	0	61
Net cash from/(used in) investing activities		**38 044**	**38 377**
Cash flows from financing activities			
Paid in share capital	20	5 000	6 000
Proceeds from subordinated debt	19	5 000	7 000
Repayment of subordinated debt	19	0	-4 000
Net cash from financing activities		**10 000**	**9 000**
Effect of exchange rate changes on cash and cash equivalents		**-105**	**70**
Net increase/(decrease) in cash and cash equivalents		**71 565**	**143 175**
Cash and cash equivalents at the beginning of the year	8	221 070	77 895
Cash and cash equivalents at the end of the year	**8**	**292 635**	**221 070**

Notes on pages 17 to 68 are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(in thousands of euros)	Attributable to owners of the parent: Share capital	Statutory reserve capital	Other reserves	Accumulated deficit/ retained earnings	Total	Non-controlling interest	Total equity
Balance as at 01.01.2015	**45 500**	**118**	**-6**	**-704**	**44 908**	**233**	**45 141**
Transfer to statutory reserve capital (Note 20)	0	301	0	-301	0	0	**0**
Paid in share capital (Note 20)	6 000	0	0	0	6 000	0	**6 000**
Share options (Note 20)	0	0	0	304	304	0	**304**
Profit for the year	*0*	*0*	*0*	*9 406*	*9 406*	*535*	***9 941***
Other comprehensive loss	*0*	*0*	*-17*	*0*	*-17*	*0*	***-17***
Total profit and other comprehensive income for 2015	0	0	-17	9 406	9 389	535	**9 924**
Balance as at 31.12.2015	**51 500**	**419**	**-23**	**8 705**	**60 601**	**768**	**61 369**
Balance as at 01.01.2016	**51 500**	**419**	**-23**	**8 705**	**60 601**	**768**	**61 369**
Transfer to statutory reserve capital (Note 20)	0	469	0	-469	0	0	**0**
Paid in share capital (Note 20)	5 000	0	0	0	5 000	0	**5 000**
Share options (Note 20)	0	0	0	569	569	0	**569**
Profit for the year	*0*	*0*	*0*	*12 097*	*12 097*	*1 150*	***13 247***
Other comprehensive loss	*0*	*0*	*-17*	*0*	*-17*	*0*	***-17***
Total profit and other comprehensive income for 2016	0	0	-17	12 097	12 080	1 150	**13 230**
Balance as at 31.12.2016	**56 500**	**888**	**-40**	**20 902**	**78 250**	**1 918**	**80 168**

Notes on pages 17 to 68 are an integral part of the consolidated financial statements.

Notes to the consolidated financial statements

NOTE 1 General information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2016 for AS LHV Pank (the "Bank") and its subsidiary AS LHV Finance (together hereinafter: the Group). AS LHV Pank holds 65% interest in AS LHV Finance.

AS LHV Pank (the Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia, Lithuania (till 31.03.2017) and till 9th January 2015 in Finland (discontinued operations in the previous reporting period, the business activity of the branch office in Helsinki was sold in January 2015). There are offices for client servicing in Tallinn, Tartu and Vilnius (will be closed 31.03.2017). LHV is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. As at 31.12.2016, the Group employed total of 261 people, including 13 non-active employees (as at 31.12.2015: 248 people, 13 non-active employees). LHV Finance offers hire-purchase services to merchants and consumer loans.

The consolidated annual report (incl. financial statements) was approved by the management board on 22 February 2017. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 25.90% of the voting rights and Andres Viisemann, who owns 9.81% of the voting rights (see also Note 20), have significant influence over AS LHV Group.

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

NOTE 2 Summary of significant accounting policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2016 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as: "financial assets and liabilities at fair value through profit or loss", including derivatives and assets available for sale.

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

The financial year started at 1 January 2016 and ended at 31 December 2016. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements which became mandatory for the Group's reporting periods beginning on or after 1 January 2016. The overview of these standards and the Group management's estimate of the potential impact of applying the new standards and interpretations are stated below.

(a) **Adoption of new or revised standards and interpretations**

The following new or revised standards and interpretations became effective for the Group from 1 January 2016.

Disclosure initiative - Amendments to IAS 1 (effective in the EU for annual periods beginning on or after 1 January 2016). The Standard was amended to clarify the concept of materiality and explains that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, even if the IFRS contains a list of specific requirements or describes them as minimum requirements. The Standard also provides new guidance on subtotals in financial statements, in particular, such subtotals (a) should be comprised of line items made up of amounts recognised and measured in accordance with IFRS; (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable; (c) be consistent from period to period; and (d) not be displayed with more prominence than the subtotals and totals required by IFRS standards. The application of the standard did not have any significant impact on the Group`s financial statements.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2016 that have a material impact on the Group.

(b) **New accounting pronouncements**

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2017, and which the Group has not early adopted.

IFRS 9, Financial instruments (effective for annual periods beginning on or after 1 January 2018). The standard is endorsed by the EU-commission. Earlier application is permitted but the Group does not intend to early adopt the standard. The Group intends to use relief of not restating comparative figures for 2017 in the annual report 2018 when first adopting IFRS 9. Key features of the new standard are as follows:

Financial assets are required to be classified into three measurement categories:

- assets to be measured subsequently at amortised cost
- assets to be measured subsequently at fair value through other comprehensive income (FVOCI)
- assets to be measured subsequently at fair value through profit or loss (FVTPL).

The classification and measurement requirements in IFRS 9 state that financial assets should be classified as and measured at, amortized cost, fair value through profit and loss or fair value through other comprehensive income. Classification for financial instruments is driven by the entity's business model for managing the financial instruments and whether the contractual cash flows represent solely payments of principal and interest. In order to assess the business model, the Group has divided its financial assets into portfolios and/or sub-portfolios based on how groups of financial assets are managed together to achieve a particular business objective. Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

The analysis of the business model, described above is still ongoing, current results have not indicated significant changes compared to how the financial instruments are measured under IAS 39. No significant impact is thus expected on the Group's financial position, financial performance or equity in the period of initial application. These conclusions are tentative and may be affected by the actual financial positions at the transition.

The impairments in IFRS 9 are based on an expected credit loss (ECL) model as opposed to the current incurred loss model in IAS 39. The scope of IFRS 9 impairment requirements is also broader than IAS 39, IFRS 9 requires all assets measured at amortized cost and fair value through other comprehensive income, as well as off-balance commitments including guarantees and loan commitments, to be included in the impairment test. The assets to test for impairment will be divided into three groups depending on the stage of credit deterioration. Stage 1 includes assets where there has been no significant increase in credit risk, stage 2 includes assets where there has been a significant increase in credit risk and stage 3 includes defaulted assets. Significant assets in stage 3 are tested for impairment on an individual basis, while for insignificant assets a collective assessment is performed. In stage 1, the provisions should equal the 12 month ECL. In stage 2 and 3, the provisions should equal the lifetime ECL.

One important driver for size of provisions under IFRS 9 is the trigger for transforming an asset from stage 1 to stage 2. The Group is in process of deciding what parameters to use for identifying the increase in credit risk and how much these parameters need to change in order to constitute a "significant increase". The analyses and decisions should be finalized latest in June 2017. For assets to be recognized going forward, changes to the lifetime Probability of Default (PD) will be used as the trigger. In addition customers with forbearance measures and customers with payments more than thirty days past due will also be transferred to stage 2.

The Group's current model for calculating collective provisions defines a loss event as a deterioration in rating/scoring, but it is not expected that the loss event in the current model will equal the triggering event for moving items from stage 1 to stage 2 under IFRS 9. The provisions under IFRS 9 will be calculated as the exposure at default (EAD) times the probability of default (PD) times the loss given default (LGD). For assets in stage 1 this calculation will only be based on the coming 12 months, while it for assets in stage 2 will be based on the expected lifetime of the asset.

For assets where there has been a significant increase in credit risk, the Group currently holds provisions based on the losses estimated to occur during the period between the date when the loss event occurred and the date when the loss event is identified on an individual basis, while IFRS 9 will require provisions equal to the lifetime expected loss. When calculating lifetime losses under IFRS 9, including the staging assessment, the calculation should be based on probability weighted forward looking information. It is expected the newer requirements will increase the volatility in loan loss provisions and have negative effect in equity in the period of initial application. It is not expected to have any material impact on large exposures. The impact on capital adequacy is not possible to determine as it is expected the Basel committee will issue new rules for the transition to IFRS 9, but these are not yet final. It is furthermore expected that the long term effects, once the transitional rules become obsolete, will be negative on capital adequacy, as the reduction in equity is expected to reduce CET 1 capital.

Impairment calculations under IFRS 9 will require more experienced credit judgement by the reporting entities than required by IAS 39 today and a higher subjectivity is thus introduced. The inclusion of forward looking information adds complexity and makes provisions more dependent on management's view of the future economic outlook. It is expected that the impairment calculations under IFRS 9 will be more volatile and pro-cyclical than under IAS 39, mainly due to the significant subjectivity applied in the forward looking scenarios.

The main change to the general hedge accounting requirements is that the standard aligns hedge accounting more closely with the risk management activities, these changes will not have direct effect on the Group, as the Group is currently not using hedge accounting. Same time we see that the regulation changes will generate some new possibilities to the Group to start using hedge accounting for reducing volatility in financial statements for positions which are hedged with ones treated differently in accounting.

Group has set up a project developing the needed changes both in risk management and in IT systems. The final outcome of the impact of the new standard on its financial statements is not clear yet and will be clear in second quarter 2017. Still Group is clear that there will be added new volatility to provisioning, the provisions models will be more complex and visibility will somewhat lower. We have calculated the impact to the cost of development and it's around EUR 500 thousand.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU). 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. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the new standard on its financial statements.

Disclosure initiative - amendments to IAS 7 (effective for annual periods beginning on or after 1 January 2017; not yet adopted by the EU). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. The Group is currently assessing the impact of the amendment on its financial statements.

IFRS 15, Revenue from contracts with customers (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. The Group is currently assessing the impact of the new standard on its financial statements.

Revenue from Contracts with Customers - Amendments to IFRS 15

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The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard.

The Group is currently assessing the impact of the amendments on its financial statements.

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

2.2 Consolidation

The 2016 consolidated financial statements include the financial statements of AS LHV Pank (parent company) and its subsidiary AS LHV Finance.

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

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

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

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

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

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27 "Separate Financial Statements". In the parent separate primary financial statements, disclosed to these consolidated financial statements (see Note 25), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized

Non-controlling interest

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

2.3 Foreign currency translations

(a) Functional and presentation currency

The functional and presentation currency of entities in the Group 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 under the line "Foreign exchange rate gains/losses". Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the statement of profit or loss under the line "Foreign exchange rate gains/losses".

2.4 Cash and cash equivalents

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

2.5 Financial assets

The Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss
- held-to-maturity financial investments
- available-for-sale financial assets
- loans and receivables

The classification depends on the purpose for which the financial assets were acquired. Management of the Group determines the classification of its financial assets at initial recognition.

	IAS 39 category	Class (applied by the Group)		31.12.2016	31.12.2015
Financial assets	Loans and receivables	Loans and advances to banks and investment companies		300 371	227 208
		Loans and advances to customers	Loans to legal entities	446 188	353 731
			Loans to individuals	85 573	51 679
		Other receivables		1 699	970
		Other financial assets		941	940
	Financial assets at fair value through profit or loss	Securities held for trading	Equity securities	130	43
			Listed debt securities	63 817	99 468
			Derivatives	250	0
	Available-for-sale financial assets	Investment securities	Listed debt securities	579	3 508
			Equity securities	220	0

a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

- financial assets held for trading (incl. derivatives)
- financial assets designated at fair value through profit or loss at inception

A financial asset is classified as **held for trading** if acquired or incurred principally for the purpose of selling or repurchasing it in the short term. Derivatives are classified as held for trading unless they are designated as hedges.

Regular way purchases and sales of financial investments are recognised at the trading date in the statement of financial position. In the previous reporting periods, the above mentioned purchases and sales were recognized at the settlement date. The amendment has no effect on the report as there were no such transactions as at 31.12.2015. Financial instruments included in this category are initially recognised at fair value; transaction costs are taken directly to the profit or loss. After initial recognition, financial assets in this category are measured at fair value. Interest income is calculated based on financial assets' amortised cost using the effective interest rate method and is recorded within interest income in the statement of profit or loss. Changes in fair values of these financial assets are recognised consistently, either as a profit or loss in the statement of profit or loss of the reporting period under "Net gains/losses from financial assets measured at fair value". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognised in the line "Dividend income" of the statement of profit or loss when the right to receive dividends by the Group is established.

In case of listed securities (i.e. the securities which have an active market), the current bid price is considered as the fair value of investments. To estimate the fair value of investments not actively traded in the market, alternative methods such as the price of recent transactions (under market conditions), the discounted cash flow method or option valuation models are used.

Derivative financial instruments (futures, forward, swap and option contracts) are initially recognised in the statement of financial position at fair value at the trade date and are subsequently valued at fair value through profit or loss. If derivatives are quoted on an active market, market value is used as the fair value. Otherwise, the valuation techniques are used to estimate the fair value. Gains and losses from derivatives are recognised as income or expense of the period in the statement of profit or loss under "Net gains/losses from financial assets measured at fair value". Derivatives are carried in the statement of financial position as assets, if their fair value is positive and as liabilities, if the fair value is negative. The fair values of derivative assets and liabilities recorded in the statement of financial position are not netted. The Group does not use hedge accounting to account for its derivative financial instruments.

Financial assets designated at fair value through profit or loss at inception - securities are classified into this group, if the Group has upon initial recognition designated the securities to be recorded as at fair value through profit or loss and as a result the changes in the fair value of these securities are consistently recognised in the profit or loss of the reporting period in the statement of profit or loss.

Financial assets and financial liabilities are designated at fair value through profit or loss when certain investments, such as debt or equity investments, are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

Refer to Note 3.6 for fair value of financial assets.

b) Held-to-maturity financial investments

Held-to-maturity financial investments are financial instruments quoted in an active market with a fixed due date and which the management board of the bank has an intention and opportunity to hold until their maturity. They do not include:

- investments designated as fair value through profit or loss upon their initial recognition;
- investments classified as available-for-sale assets; and
- investments which meet the criteria of loans and receivables.

These investments are initially recognised at fair value, plus all directly attributable transaction costs incremental to their acquisitions and they are subsequently measured at amortised cost using the effective interest rate method. Interest income on held-to-maturity investments is included within interest income in the statement of profit or loss. Impairment losses are deducted from the carrying amount of the investments and the impairment charge is recorded in the statement of profit or loss.

c) Available-for-sale financial assets

Available-for-sale financial assets are financial instruments which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Investment securities available-for-sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. Other changes in fair values of these financial assets are recognised in other comprehensive income.

d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates, and has no intention of trading the receivable. Loans and receivables are initially recognised at fair value plus transaction costs, and are derecognised only when they are repaid or written-off. After initial recognition, the Group recognises loans and receivables at amortised cost (less principal repayments and any potential impairment losses, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest method. In case of credit cards the borrower's actual use of limit is recorded in the statement of financial position.

Finance lease transactions are lease transactions under which all significant risks and rewards from using the assets are immediately transferred from the Group to the lessee. Legal ownership of assets is transferred to the customer at the end of the lease term. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of minimum lease payments (plus any unguaranteed residual value of the leased asset). Each lease payment received from the lessee is allocated between the receivable and finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. When there are service fees and initial direct attributable to the conclusion of lease agreements, they are included in the calculation of the effective interest rate of the lease and calculation of a finance lease receivable. The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased asset and excess collateral, the financial position and reliability of the customer. Impairment of receivables reduces the respective asset category in the statement of financial position.

Loans restructured because of significant changes in contract terms are recognised as new loans when a new loan has been issued, incl. refinancing an existing loan or increasing an existing loan for payment of the loan principal, interest, overdue penalties or other fees related to it. Loans which include a change in other contractual terms as a result of deterioration of the customer's credit quality do not qualify for derecognition.

Trade receivables arise from provision of services to the customers and are initially recognised at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method (less repayments and provision for incurred impairment losses).

The impairment of loans and advances is assessed in accordance with the principles described in clause 2.6.

2.6 Impairment of financial assets carried at amortised cost

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment.

The Group assesses the risks taking into consideration all known information about the solvency of the debtor and whether there are any objective circumstances indicating impairment (the buyer's financial difficulties, bankruptcy or inability to meet its obligations to the Group).

Corporate loans, overdrafts and leases are assessed individually, primarily based on the overdue status of loan and realizable value of related collateral, if any. Other criteria used to determine whether there is objective evidence that an impairment loss has occurred are financial position of the company, industry situation, reliability of the borrower, the competence of its management and other factors. Margin and repo loans secured by debt or equity securities both to legal as well as private individuals are assessed individually, using primarily the market value of collateral as the basis. Consumer loans, mortgage loans, credit card loans and hire-purchase loans are assessed as a group. Private individuals are assessed in terms of their timely fulfilment of obligations, solvency, value of the collateral, age, education, length of employment, savings habits and other factors impacting credit risk.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows in a group of financial assets that are collectively evaluated for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently. The Group regularly reviews future cash flow assessment methods and assumptions, in order to reduce potential differences between loss estimates and actual losses.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. Any impairment losses are charged to statement of profit of loss line "Impairment losses on loans and advances".

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year. The reversal of the impairment loss is recognised as income in the line "Impairment losses on loans and advances" in the statement of profit or loss.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

Interest income on loans is presented on the statement of profit or loss under "Interest income".

2.7 Discontinued operations

A discontinued operation is a component of the Group that is classified as held for sale, and represents a separate major line of business or geographical area of operations and is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations. Non-current asset or disposal group is classified as held for sale when their carrying amount is to be covered principally through a sale transaction rather than through continuing use, and the sale is considered highly probable within 12 months. The disposal group is recognized at carrying amount or fair value less costs to sell, depending on which is lower. The carrying amount of the assets of LHV Finnish branch, which are recognized as discontinued operations at the end of 2014, is equal to their fair value. Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented. Intragroup transactions between discontinued and continuing operations are eliminated depending on whether the transactions will continue after the sale transaction.

2.8 Tangible fixed assets

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

An item of tangible fixed assets is carried in the statement of financial position at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers, furniture and fixtures is 33%, for improvements of rental space either 20% p.a. or 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. The Group performs an impairment test when there are circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell or its value in use), it is written down immediately to its recoverable amount recognising an impairment loss in the statement of profit or loss for the period.

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

2.9 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis. The annual amortisation rate for purchased licenses is 33%. At each balance sheet date the appropriateness of amortization rates, methods and residual values is assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in statement of profit or loss for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use.

2.10 Financial guarantees and performance guarantees

The Group issues financial guarantees and commitments to provide loans. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the end of each reporting period.

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

2.11 Financial liabilities

The Group classifies financial liabilities to 2 categories:

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

b) financial liabilities measured at amortised cost

Recognition of a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.5.a. All other financial liabilities are subsequently measured at amortised cost using the effective interest method. Transaction costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the statement of profit or loss during the term of the instrument, using the effective interest rate. Interest costs are included in the statement of profit or loss line "Interest expenses".

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

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

2.12 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. The Group has no existing legal nor constructive obligations to make pension or similar payments supplementary to social security tax.

2.13 Share-based payments

LHV Pank owner AS LHV Group operates a share-based compensation plan, under which the parent company receives services from subsidiary 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 bank revises its estimates of the number of options that are expected to vest based on the vesting conditions (other than market conditions). It recognises the impact of the revision to original estimates, if any, in the statement of profit or loss, with a corresponding adjustment to equity.

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

2.14 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 the Group's current operating practice (legal or constructive obligation) that require probable outflow of resources, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the statement of financial position. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the statement of financial position in the amount which according to the management is necessary as at the 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.

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

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

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

Assets from which resources are expected to flow to the Group within 12 months are recognised as current assets. The portion of assets with expected inflows later than 12 months after the 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 the Group 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).

2.16 Revenues and expenses

Revenues and expenses are recorded on an accrual basis. Revenue is recognised when it is probable that the economic benefits associated with the transaction will be received by the Group, the amount of the revenue can be measured reliably and services were rendered by the Group. Revenue earned in the ordinary course of business is recognised at fair value of the fee received or receivable. Expenses are recognised when the Group has obligation to pay for the expense and/or the Group has received goods or services, and the latter occurs at an earlier date.

Fee and commission income (incl. custody and portfolio management fees) are recognised on an accrual basis when the service has been provided and the Group has a right of claim to the receivable. Loan commitment fees that are directly related with the undrawn portion of the loan commitment and which changes based on the portion of the unused commitment are recognised as interest income during the period when draw down is available. Commissions and fees arising from provision of advisory services to third parties (purchase or sale of businesses, acquisitions, etc.) are generally recognised upon completion of the underlying transaction or when service is provided over a longer period of time, based on the stage of completion method. Portfolio management, other consultation fees and management fees related to investment funds are recognised according to the agreement, usually over the period during which the service is provided. The same principle is applied to wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance linked fees or fee components are recognised when the performance criteria are fulfilled or based on the stage of completion. Other one-off service revenues and other revenues are recognised on an accrual basis at the moment of executing the respective transaction.

Fee and commission expenses are recognised after the service has been received and when the liability has incurred.

Interest income and expense is recognised in the statement of profit or loss for all financial instruments carried at amortised cost using the effective interest method or for debt securities measured at fair value through profit or loss. Transaction costs of debt securities measured at fair value through profit or loss is recognised as part of effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future impairment losses. The calculation includes all significant fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flows discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Dividend income is recognised when the legal right to receive dividends is established and inflow of economic benefits are probable.

2.17 Asset management services

The Group is engaged in providing asset management services (Note 21). Such assets have been given to the Group to be managed by third parties and these assets are recorded off-balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

2.18 Leases - Group as the lessee

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.

Payments made under operating leases are charged to the statement of profit or loss on a straight-line basis over the lease term. The Group primarily uses an operating lease for renting the premises. A rental expense is recognised in the statement of profit or loss as “Administrative and other operating expenses”.

2.19 Taxation and deferred income tax

Corporate income tax in Estonia

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 is 20/80 on net dividends paid. In certain circumstances, it is possible to distribute dividends without any additional income tax expense. 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.

Corporate income tax in other countries

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

Corporate income tax rates	2016	2015
Latvia	15%	15%
Lithuania	15%	15%
Finland	20%	20%

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

A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the statement of financial position. The maximum amount of income tax payable, which would arise from paying out the retained earnings as dividends, is disclosed in the Note 20 to the financial statements.

2.20 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. More detailed information in Note 3.8.

2.21 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.

NOTE 3 Risk management

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

3.1 Capital management

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

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

The amount of capital that the Group managed as of 31.12.2016 was 96 510 thousand euros (31.12.2015: 75 113 thousand euros). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

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

Own funds	**31.12.2016**	**31.12.2015**
Paid-in share capital	56 500	51 500
Statutory reserves transferred from net profit	848	396
Accumulated profit/deficit	7 838	-1 099
Intangible assets (subtracted)	-772	-626
Net profit for accounting period	12 096	9 406
Non-controlling interests	0	535
Total Tier 1 own funds	**76 510**	**60 113**
Subordinated debt	20 000	15 000
Total Tier 2 own funds	**20 000**	**15 000**
Total net own funds	**96 510**	**75 113**

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

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

In addition to the main requirements based on uniform rules, the directive defines the principles for forming capital buffers.

In Estonia, in addition to the baseline capital requirements, credit institutions have been subjected to capital maintenance and systemic risk buffers, which are 2.5% (imposed by the Financial Supervisory Authority) and 1.0% (imposed by Estonian Central Bank), respectively. As the aforementioned buffers are incremental to the Tier 1 and the total baseline capital requirements, the minimum Tier 1 requirement in Estonia is 9.5% and the total capital requirement is 11.5%. The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions.

An overview of capital requirements is provided in the table below:

Capital requirements	**CET1**	**Tier 1**	**CAD**
Base capital requirement	4.50%	6.00%	8.00%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemic risk buffer	1.00%	1.00%	1.00%
Minimal regulatory requirement	**8.00%**	**9.50%**	**11.50%**

Capital requirements valid until August 2016 are provided in the table below:

Capital requirements	**CET1**	**Tier 1**	**CAD**
Base capital requirement	4.50%	6.00%	8.00%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemic risk buffer	2.00%	2.00%	2.00%
Minimal regulatory requirement	**9.00%**	**10.50%**	**12.50%**

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

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. The information about the capital adequacy is presented on a consolidated basis in the report. Reports about the compliance with prudential and capital requirements for covering the risks are submitted regularly to supervision authorities. Those reports about the Bank as the Group's parent company are presented separately. LHV uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement. The Bank has complied with all capital requirements during the financial year and in previous year.

3.2 Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet its obligations to the Group. Credit risk arises from cash and cash equivalents, derivatives and deposits with banks and other financial institutions, debt securities, but mostly credit exposures to customers, including outstanding loans, given guarantees, other receivables and loan commitments. In order to mitigate credit risk, Group analyses the operations and financial position of its customers and business partners. After authorising the loan, the solvency of the customer and the value of the collateral are regularly monitored.

3.2.1 Distribution of credit risks

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

a) debt securities and derivatives
b) loans and advances to central bank and credit institutions (referred to as "banks" in the tables) and investment companies
c) leveraged loans (loans secured by debt or equity securities), incl. repo loans
d) corporate loans and overdraft
e) retail loans
f) consumer loans without collateral
g) credit cards and overdraft to individuals
h) leasing
i) hire-purchase
j) mortgage loans
k) financial guarantees
l) unused loan commitments

Maximum exposure to credit risk *(in thousands of euros)*	**31.12.2016**	**31.12.2015**
Loans and advances to banks and investment companies (note 8)	300 371	227 208
Financial assets at fair value (note 10)	64 197	99 511
Available-for-sale financial assets (note 9)	799	3 508
Loans and advances to customers (note 12)	531 761	405 410
Receivables from customers (note 13)	1 699	970
Other financial assets (note 14)	941	940
Total assets	**899 768**	**737 547**
Exposures related to off-balance sheet items (note 22), excluding performance guarantees	142 227	131 065
Total maximum exposure to credit risk	**1 041 995**	**868 612**

a) Debt securities and derivatives

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

No principal and accrued interest receivables arising from debt securities are overdue.

The Group´s debt securities at fair value through profit or loss (FVTPL) and available-for-sale (AFS) according to ratings given by Standard & Poor's or equivalent:

	FVTPL					
Ratings distribution	**Investment portfolio**	**Liquidity portfolio**	**Trading portfolio**	**Foreign Exchange forwards**	**AFS**	**Total 31.12.2016**
AAA	5 209	33 904	0	0	0	39 113
AA- to AA+	0	0	0	0	0	0
A- to A+	19 558	1 942	1 104	0	579	23 183
BBB- to BBB+	1 050	0	1 050	0	0	2 100
B- to BB+	0	0	0	0	0	0
Non-rated	0	0	0	250	0	250
Total (Note 9, 10)	**25 817**	**35 846**	**2 154**	**250**	**579**	**64 646**

As of 31.12.2016, the total amount of derivatives recognized in the report is EUR 250 thousand. Those derivatives are not rated. More detailed information about the derivatives is disclosed in Notes 3.3.1, 3.6 and 10.

	FVTPL				
Ratings distribution	**Investment portfolio**	**Liquidity portfolio**	**Trading portfolio**	**AFS**	**Total 31.12.2015**
AAA	43 041	44 208	0	2 910	90 159
AA- to AA+	0	2 078	0	0	2 078
A- to A+	6 948	0	51	598	7 597
BBB- to BBB+	0	0	2 148	0	2 148
B- to BB+	994	0	0	0	994
Non-rated	0	0	0	0	0
Total (Note 9, 10)	**50 983**	**46 286**	**2 199**	**3 508**	**102 976**

b) Loans and advances to banks and investment companies

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. No loans and advances to central bank, credit institutions and investments companies are overdue. The Group's funds are evaluated according to Standard & Poor's ratings or their equivalents. If different agencies have different ratings, conservatively the lower rating is used. The Group's funds are deposited (the central bank is unrated) as follows:

Rating	Credit institutions	Investment companies	Total 31.12.2016	Credit institutions	Investment companies	Total 31.12.2015
Central bank (The Bank of Estonia)	265 127	0	265 127	199 844	0	199 844
AA- to AA+	5 716	0	5 716	0	0	0
A- to A+	5 603	0	5 603	4 385	15 785	20 170
BBB to BBB+	11 454	7 919	19 373	233	0	233
Non-rated	4 398	154	4 552	6 824	137	6 961
Total (Note 8)	**292 298**	**8 073**	**300 371**	**211 286**	**15 922**	**227 208**

c) Leveraged loans

The Bank issues margin loans secured by debt or equity securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account, and on the general limit set by the Bank which is currently EUR 100 thousand (or an equivalent in a foreign currency) per customer. Granting loans above the threshold assumes an analysis of the portfolio offered as collateral by the customer and the decision is within the competence of the Credit Committee. The list of acceptable marketable financial instruments and the levels of the required collateral are published on LHV Pank's website **www.lhv.ee**. The risks arising from financial leverage are mitigated by constant monitoring of the market values of the financial instruments required as collateral. The Group has set sufficiently conservative limits to the ratio of the loan and the collateral assets value. When the value of collateral assets falls below the established limit, the Bank is entitled to demand a transfer of additional collateral to the account or pay off the loan in the customer's account without the customer's trade order, liquidating the collateral asset for this purpose. See Note 3.2.2. for more detailed information on the credit quality of loans.

Stress tests are carried out for evaluating the credit risk of leveraged loans in order to determine potential losses in case of changes in the value of collateral and for evaluating the credit risk of other loans, the probability of the lender becoming insolvent, the amount of loans not covered by collateral at the time of insolvency and the amount of the resulting related expected loss is assessed. If necessary, decisions are made in respect of allocating additional risk capital in order to cover credit risk.

The Bank had no impaired leveraged loans as at 31.12.2016 and 31.12.2015.

d) Corporate loans and overdraft

Each customer is assigned a credit rating between 1-13, where 1 means the lowest probability of default and 13 indicates insolvency. Credit rating is assigned to a customer considering combination of financial status and business risk. Financial status is the basis for financial rating focusing on the company's assets and liabilities structure, profitability, cash-flows and estimated results. The emphasis of financial analysis is focused on the following period to the loan issuance. In parallel with financial analysis the company's business risk, including management and owners, market situation and competition, diversification and history of activities, the quality of information and previous payment behaviour is analysed. Where there is consolidation group involved, credit risk for the whole group is evaluated. Credit rating is assigned by credit analyst and confirmed by Head of Credit, but final decision of risk taking is the unanimous decision by the Credit Committee.

The requirements for loan collateral are established in the Credit Policy of AS LHV Group and specified in Credit Risk management rules of the Bank. The preferred collateral is where there is no strong correlation between the clients default risk and value of the collateral. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance.

In addition to individual impairment assessment, corporate loans' provisions for potential credit loss is calculated based on historical performance of these loans and applied to current portfolio at the balance sheet date. For the purpose of recognition of group-based impairment losses, the receivables are grouped into subclasses on the basis of homogeneous credit risk features, considering customers' payment practice and past due time. For the receivables that have been grouped, the amount of the impairment loss is the multiple of the carrying amount of the receivables in the group and the group's percentage rate of impairment loss. The framework is based on the method of calculating the probability of default (PD), loss given default (LGD) and exposure at default (EAD). EAD consists of two components: the amount of the existing receivable and the amount of use of an estimated additional limit. For calculating the latter, the model includes the credit conversion factor (CCF).

After issuing the loan, follow-up monitoring of each customer's financial position is performed at least once a quarter. All client ratings are reviewed at least once a year. See Note 3.2.2. for more detailed information on the credit quality of loans. As at 31.12.2016, the group based impairment reserve makes up 0,5% of corporate loans and overdraft and the related interest receivables (31.12.2015: 0.6%).

e) Retail loans

In 2016 Group started offering micro loans. The loan is aimed to micro-enterprises in growth stage and the maximum loan amount is up to EUR 25 000. During the year, the existing corporate loan portfolio was divided into two. Credits below 250 thousand euros were given over to retail banking and all credits exceeding 250 thousand euros remained in corporate banking. Shifting smaller loans to retail banking was important to keep corporate banking and credit analyses focus on larger and more individual approach requiring credit clients. Credits below 250 thousand euros are analysed with more cost-efficient scoring process. The scoring is carried out at the request of the loan and it is one of the criterias for issuing the loan. Financial data and information on payment behaviour of the company is used when calculating the probability of default (PD). The structure of assets and liabilities are taken into account, also the profitability and cash flow ratios. Regarding the guarantees the same principles apply as for business loans and overdrafts. Thus, the essence of it does not constitute a new product, but only retail loans separation from corporate loans in 2016 distinction, then there is no comparative information as at 31 December 2015. The retail loans are included inside Loans to legal entities and Overdrafts to legal entities lines in the report.

f) Consumer loans without collateral

Issuing consumer loans, the creditworthiness of each customers is assessed by using scoring model. The probability of default assessment is one of the inputs to the loan decision. Customer-specific characteristics and payment practice are inputs to the scoring model.

As consumer loans are homogeneous loans, provisions for potential credit loss level is calculated based on historical performance of these homogeneous loans and applied to current portfolio at the balance sheet date. For the purpose of group-based impairment losses, the receivables are grouped on product basis. The calculations are based on clients payment behaviour which are divided to performing (overdue days below 90 days and not terminated), non-performing (overdue days above 90 days and/or terminated) and doubtful (initial payment schedule is terminated and no cash-flows occurred during 6-month period; fraud case, etc). The Group has entered into agreements where overdue consumer loans are sold – usually when loans reaching overdue of 76 days. For the receivables that have been grouped, the amount of the impairment loss is the multiple of the carrying amount of the receivables in the group and the group's percentage rate of impairment loss. The framework is based on the method of calculating the probability of default (PD), loss given default (LGD) and exposure at default (EAD). EAD consists of two components: the amount of the existing receivable and the amount of use of an estimated additional limit. For calculating the latter, the model includes the credit conversion factor (CCF). Loss rates are calculated from the past historical data for defaults and full history of recoveries. PD and LGD values are updated at least once a year with new historical data in order to maintain adequate provision levels on portfolio. If necessary, additional impairments will be made in the statement of financial position. If non-performing or doubtful loan recovery is neither economical nor practical to continue, the loan is written off as irrecoverable. As at 31.12.2016, the group-based impairment reserve makes up 3.8% of consumer loans and the related interest receivables (31.12.2015: 1.5%).

g) Credit cards

LHV Pank issues credit cards and Partner credit cards in cooperation with Tallinna Kaubamaja. Similarly with consumer loans, the credit card portfolio uses the credit scoring model to assess the customer's credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a loan.

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework is based on PD, LGD and EAD indicators. EAD consists of two components: the amount of the existing receivable and the amount of use of an estimated additional limit. For calculating the latter, the model includes the credit conversion factor (CCF). As of 31 December 2016, the group-based impairment reserve amounted to 2.4% of credit card loans and related receivables (31 December 2015: 3.1%).

h) Leasing

LHV Pank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using scoring models. Scoring model for corporate clients is similar with the retail loans scoring, including product specific variables. Private individual's client scoring model includes also similar variables as used in consumer loan scoring model and product specific variables. Similarly to other homogenous portfolios provisions are made based on the same framework as consumer loans, yet grouping and provisioning is based on distinguishing private individuals and legal entities. As of 31 December 2016, the group-based impairment reserve amounted to 0.5% of leasing portfolio (31.12.2015: 0.9%).

i) Hire-purchase

The Group offers hire-purchase services for merchants through its subsidiary LHV Finance. The creditworthiness of customers is assessed by using scoring models, which mainly consist of characteristics described for consumer loans and for corporate clients it is similar to retail loans' model. Similarly to other homogenous portfolios provisions are made based on the same framework as consumer loans. As of 31 December 2016, the group-based impairment reserve amounted to 1.0% of hire-purchase (31.12.2015: 1.4%).

j) Mortgage loans

In 2013 the Group started to offer on a limited bases mortgage loans to customers in Tallinn and Tartu region only. In the autumn of 2016, the Group started a full-scale issuance of mortgage loans.

The creditworthiness of customers is assessed by using scoring models and maximum loan amount is in line with the regulations set by Central Bank of Estonia. The provisions are made based on the same framework as for consumer loans.

As of 31 December 2016, the group-based impairment reserve amounted to 0.4% of mortgage loan portfolio (31.12.2015: 0.5%).

3.2.2 Credit quality of loans and advances to customers and off-balance sheet liabilities

Loans and advances to customers 31.12.2016	Neither past due nor impaired	Past due, but not impaired	Individually impaired	**Total**	Collective impairment	Individual impairment	**Net**
Loans to legal entities							
Loans to other subsidiaries of the parent company	30 580	0	0	**30 580**	0	0	**30 580**
Corporate loans	339 030	1 024	1 304	**341 358**	-1 758	-297	**339 303**
Retail loans	6 917	171	0	**7 088**	-101	0	**6 987**
Overdraft	31 248	0	85	**31 333**	-246	-37	**31 050**
Hire-purchase	264	0	1	**265**	-2	-1	**262**
Leveraged loans	4 383	0	0	**4 383**	0	0	**4 383**
Leasing	31 801	1 771	97	**33 669**	-141	-29	**33 499**
Credit card loans	130	0	0	**130**	-6	0	**124**
Loans to individuals							
Consumer loans	15 563	0	902	**16 465**	-592	-31	**15 842**
Hire-purchase	18 599	540	67	**19 206**	-159	-33	**19 014**
Leveraged loans	3 004	0	0	**3 004**	0	0	**3 004**
Leasing	7 394	294	6	**7 694**	-45	-2	**7 647**
Mortgage loans	35 451	0	0	**35 451**	-143	0	**35 308**
Credit card loans	4 773	0	15	**4 788**	-107	-5	**4 676**
Overdraft	82	0	0	**82**	0	0	**82**
Total loans and advances to customers (Note 12)	**529 219**	**3 800**	**2 477**	**535 496**	**-3 300**	**-435**	**531 761**

Loans and advances to customers 31.12.2015	Neither past due nor impaired	Past due, but not impaired	Indi-vidually impaired	Total	Collective impair-ment	Individual impairment	Net
Loans to legal entities							
Loans to other subsidiaries of the parent company	33 091	0	0	**33 091**	0	0	**33 091**
Corporate loans	254 238	572	2 330	**257 140**	-1 101	-456	**255 583**
Retail loans	0	0	0	**0**	0	0	**0**
Overdraft	29 380	0	168	**29 548**	-114	-15	**29 419**
Hire-purchase	211	0	9	**220**	-1	-4	**215**
Leveraged loans	4 733	0	0	**4 733**	0	0	**4 733**
Leasing	29 152	1 716	0	**30 868**	-291	0	**30 577**
Credit card loans	118	0	0	**118**	-5	0	**113**
Loans to individuals							
Consumer loans	6 425	0	2	**6 427**	-52	-1	**6 374**
Hire-purchase	17 995	431	215	**18 641**	-192	-107	**18 342**
Leveraged loans	2 712	0	0	**2 712**	0	0	**2 712**
Leasing	5 364	153	0	**5 517**	-51	0	**5 466**
Mortgage loans	15 395	0	0	**15 395**	-77	0	**15 318**
Credit card loans	3 451	0	52	**3 503**	-77	-28	**3 398**
Overdraft	69	0	0	**69**	0	0	**69**
Total loans and advances to customers (Note 12)	**402 334**	**2 872**	**2 776**	**407 982**	**-1 961**	**-611**	**405 410**

There are several criteria for the loan to be considered individually impaired. Group's internal default definition is in line with the generally accepted definition of default criteria, such as payment delay more than 90 days on any material credit obligation, distressed restructuring of the credit obligation, specific credit adjustment due to significant perceived decline in credit quality since inception, significant financial difficulties of the obligor or likely bankruptcy process, etc.

As part of risk analysis, the Group is regularly performing stress tests and sensitivity analysis regarding credit risk and its components (such as probability of default (PD), loss given default (LGD)). Collective impairment credit assessment of the Group is based on historical loss rate and credit rating. The Group has performed stress test scenarios when PD and LGD estimations will both increase by 10 percent (for example, from 1.0% to 1.1%). The impact of the described stress test to impairments is aggregated in the table below. The table includes loans which have collective impairment (therefore excluding leveraged loans) and which have material balances and potential impact.

Impact to impairment as at 31.12.2016 (in case PD and LGD levels will increase by 10%)	**Balance as at 31.12.2016**	**Impairment with increased PDs and LGDs**	**Impact to impairment booked**
Loans to legal entities			
Corporate loans (including overdraft)	372 691	-2 750	-418
Leasing	33 669	-204	-32
Loans to individuals			
Consumer loans	16 465	-749	-126
Hire-purchase	19 206	-244	-40
Mortgage loans	35 451	-173	-30
Leasing	7 694	-57	-10
Credit card loans	4 788	-135	-23
Total	**489 964**	**-4 298**	**-678**

LHV

Impact to impairment as at 31.12.2015 (in case PD and LGD levels will increase by 10%)	Balance as at 31.12.2015	Impairment with increased PDs and LGDs	Impact to impairment booked
Loans to legal entities			
Corporate loans (including overdraft)	286 688	-1 936	-250
Leasing	30 868	-347	-60
Loans to individuals			
Consumer loans	6 427	-117	-20
Hire-purchase	18 641	-303	-43
Mortgage loans	15 395	-93	-16
Leasing	5 517	-64	-11
Credit card loans	3 503	-128	-22
Total	**367 039**	**-2 988**	**-422**

The rating scale used for evaluating the probability of default of corporate loans consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk. Ratings 1 and 2 are attributed only on the basis of average ratings of rating agencies Fitch, Moody's and Standard & Poor's, and are subject to the Group's financial analysis as necessary. Thus, ratings 1 and 2 are attributed only to international enterprises, organisations, local governments and countries whose solvency has been confirmed by the rating agencies with their investment grade rating. Also rating classes 3 -13 are partly based on the evaluation of rating agencies, although this category includes mainly Estonian enterprises that do not have an international rating.

Distribution of internal ratings of corporate loans:

- 1 – minimum credit risk. The rating is only assigned on the basis of the ratings of rating agencies. The average of the ratings assigned by rating agencies must be the equivalent of at least AAA (Moody's Aaa).
- 2 – minimum credit risk. The rating is only assigned on the basis of the ratings of rating agencies. The average of the ratings assigned by rating agencies must be the equivalent of at least AA+ (Moody's Aa1).
- 3 – low credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least AA- (Moody's Aa3).
- 4 – low credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least A- (Moody's A3).
- 5 – low credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB+ (Moody's Baa1).
- 6 – low credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB (Moody's Baa2).
- 7 – average credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB- (Moody's Baa3).
- 8 – average credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BB (Moody's Ba2).
- 9 – heightened credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BB- (Moody's Ba3).
- 10 – high credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least B+ (Moody's B1).
- 11 – high credit risk. The rating is assigned on the basis of the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least B- (Moody's B3).
- 12 – non-satisfactory rating. The rating is assigned on the basis of the assessments of rating agencies or LHV. The Credit Analyst deems the company's financial position to be sufficiently weak indicating a very high probability of default. The average rating of rating agencies must be the equivalent of at least C (Moody's Caa3).
- 13 – the obligor is in default.

Distribution of corporate loans and overdraft by internal ratings as of 31.12.2016	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total
4 low credit risk	915	0	0	915
5 low credit risk	2 585	0	0	2 585
6 low credit risk	68 909	0	0	68 909
7 medium credit risk	103 073	0	0	103 073
8 medium credit risk	113 961	0	0	113 961
9 heightened credit risk	38 844	417	0	39 261
10 high credit risk	22 609	68	0	22 677
11 high credit risk	18 377	0	0	18 377
12 non-satisfactory rating	1 005	530	0	1 535
13 insolvent	0	9	1 389	1 398
Total	**370 278**	**1 024**	**1 389**	**372 691**

Distribution of corporate loans and overdraft by internal ratings as of 31.12.2015	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total
4 low credit risk	1 041	0	0	1 041
5 low credit risk	3 460	0	0	3 460
6 low credit risk	44 205	0	0	44 205
7 medium credit risk	83 089	0	0	83 089
8 medium credit risk	58 680	0	0	58 680
9 heightened credit risk	69 775	0	0	69 775
10 high credit risk	15 736	0	0	15 736
11 high credit risk	6 825	0	0	6 825
12 non-satisfactory rating	751	3	0	754
13 insolvent	56	569	2 498	3 123
Total	**283 618**	**572**	**2 498**	**286 688**

The Group considers the loan as non-performing and assesses impairment when the loan payments have not been collected by the due date and/or the expected cash flows from the realization of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments. The Group evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the carrying value of the receivable and expected cash flows discounted at the effective interest rate. In 2016, the Group provisioned corporate loans in the total amount of EUR 466 thousand (2015: EUR 31 thousand).

Loan customers with ratings of 10-13 are subject to more frequent monitoring during which the solvency of the borrower is evaluated. In case of a deterioration of payment behaviour, the requirement for individual provisioning is evaluated, considering, among other factors, the collateral of the loan, therefore some loans are not individually impaired. The ratings-based rate of the collective provisioning is applied to those loans.

In addition to loans issued, loan agreements have been concluded and signed for the unused loan commitment amount of 136 785 thousand euros at 31.12.2016 (31.12.2015: 125 696 thousand euros), see Note 22.

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2016 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans in total amount of 26 053 thousand euros (31.12.2015: 27 564 thousand euros) and a loan to the other subsidiary of the parent company AS LHV Group of 9 500 thousand euros (31.12.2015: 7 000 thousand euros). No provisions have been made for off-balance sheet liabilities because the value of collateral exceeds the value of potential liabilities.

All uncommissioned loans available to individuals have at least "Good" internal rating as at the end of each reporting period.

Credit quality of off-balance sheet liabilities (unused loan commitments for corporate loans and financial guarantees)	31.12.2016	31.12.2015
5 low credit risk	793	722
6 low credit risk	8 569	10 896
7 medium credit risk	30 336	31 133
8 medium credit risk	52 354	47 669
9 heightened credit risk	10 440	5 959
10 high credit risk	3 980	122
11 high credit risk	202	0
Total (Note 22)	**106 674**	**96 501**

Distribution of internal ratings for other loan products:

- Excellent – leveraged loans secured by debt or equity securities and loans with very low business risk.
- Very good – loans with lower business risks and no past due payments.
- Good – loans with lower business risks and past due payments up to 30 days.
- Satisfactory – loans with average business risk and up to 60 days past due.
- Weak or doubtful – loans carrying higher business risk, past due more than 60 days and portfolio in proceedings by the bailiff.

As of 31.12.2016	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Over-draft	Mortgage loans	Consumer loans	Total
Neither past due nor impaired									
Excellent	0	7 387	0	0	0	0	0	0	**7 387**
Good and very good	6917	0	4 903	39 195	18 863	82	35 451	15 563	**120 974**
Past due, but not impaired									
Good	171	0	0	1 193	342	0	0	0	**1 706**
Satisfactory	0	0	0	731	139	0	0	0	**870**
Weak or doubtful	0	0	0	141	59	0	0	0	**200**
Individually impaired									
Good	0	0	0	0	0	0	0	515	**515**
Satisfactory	0	0	0	0	0	0	0	210	**210**
Weak or doubtful	0	0	15	103	68	0	0	177	**363**
Total	**7 088**	**7 387**	**4 918**	**41 363**	**19 471**	**82**	**35 451**	**16 465**	**132 225**

As of 31.12.2015	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Over-draft	Mortgage loans	Consumer loans	Total
Neither past due nor impaired									
Excellent	0	7 445	0	0	0	0	0		**7 445**
Good and very good	0	0	3 569	34 516	18 206	69	15 395	6 425	**78 180**
Past due, but not impaired									
Good	0	0	0	1 717	313	0	0	0	**2 030**
Satisfactory	0	0	0	123	118	0	0	0	**241**
Weak or doubtful	0	0		29		0	0	2	**31**
Individually impaired									
Weak or doubtful	0	0	52	0	224	0	0	0	**276**
Total	**0**	**7 445**	**3 621**	**36 385**	**18 861**	**69**	**15 395**	**6 427**	**88 203**

Loans and advances to customers by collateral type and fair value are presented in the following table. Under-collateralized loans are included in the line „Unsecured loans".

Loans against collateral as at 31.12.2016	**Loans to other subsidiaries of the parent company**	**Corporate loans and retail loans (including overdraft**	**Leveraged loans**	**Credit cards and consumer loans**	**Leasing**	**Hire-pur-chase**	**Mortgage loans and overdraft to private individuals**	**Total**
Listed securities	0	0	7 387	0	0	0	0	7 387
Unlisted equity securities	0	70 354	0	0	0	0	0	70 354
Mortgages, real estate	0	214 121	0	0	0	0	35 451	249 572
Guarantee of KredEx and Rural Development Foundation	0	10 293	0	0	0	0	0	10 293
Pledges of rights of claim	30 580	8 182	0	0	0	0	0	38 762
Deposits	0	3 376	0	0	0	0	0	3 376
Leased assets	0		0	0	41 363	19 471	0	60 834
Others	0	34 451	0	82	0	0	0	34 533
Unsecured loans	0	39 002	0	21 383	0	0	0	60 385
Total	**30 580**	**379 779**	**7 387**	**21 465**	**41 363**	**19 471**	**35 451**	**535 496**

Loans against collateral as at 31.12.2015	**Loans to other subsidiaries of the parent company**	**Corporate loans and retail loans (including overdraft**	**Leveraged loans**	**Credit cards and consumer loans**	**Leasing**	**Hire-pur-chase**	**Mortgage loans and overdraft to private individuals**	**Total**
Listed securities	0	0	7 445	0	0	0	0	7 445
Unlisted equity securities	0	55 984	0	0	0	0	0	55 984
Mortgages, real estate	0	165 548	0	0	0	0	15 326	180 874
Guarantee of KredEx and Rural Development Foundation	0	12 271	0	0	0	0	0	12 271
Pledges of rights of claim	33 091	5 746	0	0	0	0	0	38 837
Deposits	0	4 534	0	0	0	0	0	4 534
Leased assets	0	0	0	0	36 385	18 861	0	55 246
Others	0	8 362	0	69	0	0	0	8 431
Unsecured loans	0	34 243	0	10 048	0	0	0	44 291
Total	**33 091**	**286 688**	**7 445**	**10 117**	**36 385**	**18 861**	**15 326**	**407 913**

Collaterals for leveraged loans are monitored on daily basis and if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31 December 2016, all leveraged loans and repurchase loans are over-collateralized. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing, hire-purchase, mortgage loans and overdraft to private individuals are all over-collateralized. The Group monitors customers in arrears of leasing and hire-purchases on regular basis.

In relation to under-collateralized corporate loans it should be taken into consideration, that the Group has assessed the market value of certain collaterals conservatively (personal sureties, commercial pledges). Under-collateralized loans are mainly considered to bear higher risk, for which the Group carries out monthly monitoring in credit committee, in order to hedge potential credit losses.

Under-collateralized loans include contracts more than 90 days overdue totalling 399 thousand (2015: 2 211 thousand) euros with a collateral value of 316 thousand (2015: 1 926 thousand) euros.

	Over-collateralized loans		Under-collateralized loans	
Corporate loans and corporate credit lines	Balance sheet value	Fair value of collateral	Balance sheet value	Fair value of collateral
As at 31.12.2016	314 139	731 661	65 640	26 638
As at 31.12.2015	223 903	766 558	62 785	28 542

Structure of past due but not impaired loans according to past due time (loans which have overdue interest or principal payments as at the balance sheet date, are divided in past due categories according to the past due time from the earliest outstanding payment):

As at 31.12.2016	Corporate loans (incl. overdraft)	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Total
Past due receivables								
1-30 days	494	171	0	0	1 193	342	0	**2 200**
31-60 days	530	0	0	0	731	139	0	**1 400**
61-90 days	0	0	0	0	141	59	0	**200**
91-180 days	0	0	0	0	0	0	0	**0**
181-360 days	0	0	0	0	0	0	0	**0**
more than 360 days	0	0	0	0	0	0	0	**0**
Total	**1 024**	**171**	**0**	**0**	**2 065**	**540**	**0**	**3 800**

As at 31.12.2015	Corporate loans (incl. overdraft)	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Total
Past due receivables							
1-30 days	3	0	0	1 717	313	0	**2 033**
31-60 days	49	0	0	123	118	0	**290**
61-90 days	7	0	0	1	0	0	**8**
91-180 days	170	0	0	28	0	0	**198**
181-360 days	343	0	0	0	0	0	**343**
more than 360 days	0	0	0	0	0	0	**0**
Total	**572**	**0**	**0**	**1 869**	**431**	**0**	**2 872**

Structure of individually impaired loans according to past due time (loans which have overdue interest or principal payments as at the balance sheet date, are divided in past due categories according to the past due time from the earliest outstanding payment):

As at 31.12.2016	Corporate loans	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Total
No past due payments	0	0	0	0	0	0	0	**0**
Past due receivables								
1-30 days	0	0	0	0	0	0	515	**515**
31-60 days	0	0	0	0	0	0	210	**210**
61-90 days	990	0	0	0	0	0	115	**1 105**
91-180 days	0	0	0	1	61	23	47	**132**
181-360 days	0	0	0	1	36	8	15	**60**
more than 360 days	399	0	0	13	6	37	0	**455**
Total	**1 389**	**0**	**0**	**15**	**103**	**68**	**902**	**2 477**

As at 31.12.2015	Corporate loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Total
No past due payments	0	0	0	0	0	0	**0**
Past due receivables							
61-90 days	353	0	1	0	29	2	**385**
91-180 days	0	0	13	0	23	0	**36**
181-360 days	2 038	0	18	0	172	0	**2 228**
more than 360 days	107	0	20	0	0	0	**127**
Total	**2 498**	**0**	**52**	**0**	**224**	**2**	**2 776**

Credit quality of other receivables	31.12.2016	31.12.2015
Receivables not impaired and not past due	2 604	1 876
Receivables past due (not impaired)	36	35
incl. receivables from individuals	1	7
incl. receivables from legal persons	35	28
Total (Note 13, 14)	**2 640**	**1 911**

As of 21 February 2017, other receivables of 17 thousand euros are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 14) in amount 941 (31.12.2015: 940) thousand euros are guarantee deposits on the Baltic stock exchanges held to guarantee. securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions. The Group considers the counterparties credit risk as very low.

3.3 Market risk

Market risk arises from the Group's trading and investment activities in the financial markets from interest rate products, foreign exchange and stock markets as well as lending activities and collecting financial resources. Market risk is a potential loss which may arise from unfavorable changes in foreign exchange rates, prices of securities or interest rates. Internal judgement is used to assess potential losses. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures.

3.3.1 Foreign currency risk

Foreign currency risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. The Treasury of LHV Pank is responsible for daily monitoring of open foreign currency positions. LHV Panks' foreign currency risk management is based on risk policies, limits and internal procedures. The internal limits for open foreign currency positions are proposed by Risk Control unit and Treasury and the limits are set internally by risk and capital committee. The limits set by the Committee are maximum nominal limits in euro equivalent with a respect to the Bank's net own funds. Limits imposed on individual currencies are in line with the boundaries proposed by the Bank of Estonia. If the open currency position exceeds the limits set by the Committee, measures are immediately implemented to close or reduce such positions (hedging the risk with relevant instruments, such as foreign currency forwards or futures).

Information regarding assets and liabilities bearing currency risk is presented in the following tables.

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to open currency positions on the total comprehensive income, with the assumption of other conditions remaining constant.

Impact on comprehensive income	Change	2016	2015
USD exchange rate	+/-10%	+/-2	+/-4
SEK exchange rate	+/-10%	+/-2	+/-1
GBP exchange rate	+/-10%	+/-2	+/-1
CHF exchange rate	+/-10%	+/-2	+/-1

Open currency exposures

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in euro equivalent in respective columns, according to the exchange rate prevailing at the balance sheet date. Derivatives reported at fair value in the statement of financial position have been included at contractual amounts under off-balance sheet assets and liabilities. Open currency exposure and the volume of financial assets and liabilities of the Group at the balance sheet date do not significantly differ from the average exposure during the year. The balances of total assets and total liabilities bearing currency risk do not include currency futures at their fair value, but they are shown here at their full contractual cash flow amounts as off-balance sheet assets and liabilities; also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

31.12.2016	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk							
Due from banks and investment companies (Note 8)	272 801	1 994	13 061	3 942	6 668	1 905	**300 371**
Financial assets at fair value (Note 9,10)	23 311	0	0	1	41 243	441	**64 996**
Loans and advances to customers (Note 12)	529 867	4	4	2	1 873	11	**531 761**
Receivables from customers (Note 13)	1 475	1	43	6	171	3	**1 699**
Other financial assets (Note 14)	210	0	0	0	731	0	**941**
Total assets bearing currency risk	**827 664**	**1 999**	**13 108**	**3 951**	**50 686**	**2 360**	**899 768**
Liabilities bearing currency risk							
Deposits from customers and loans received (Note 16)	708 702	1 983	13 264	3 869	55 924	1 667	**785 409**
Financial liabilities at fair value (Note 10)	0	0	0	0	72	137	**209**
Accounts payable and other financial liabilities (Note 17)	6 844	1	1 226	65	5 341	1 227	**14 704**
Subordinated debt (Note 19)	20 000	0	0	0	0	0	**20 000**
Total liabilities bearing currency risk	**735 546**	**1 984**	**14 490**	**3 934**	**61 337**	**3 031**	**820 322**
Open gross position derivative assets at contractual value	1 675	0	1 398	0	11 548	1 263	**15 884**
Open gross position derivative liabilities at contractual value	13 440	0	0	0	876	1 568	**15 884**
Open foreign currency position	**80 353**	**15**	**16**	**17**	**21**	**-976**	**79 446**

31.12.2015	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk							
Due from banks and investment companies (Note 8)	215 556	1 638	1 101	587	7 338	988	**227 208**
Financial assets at fair value (Note 9,10)	64 797	0	0	1	38 213	8	**103 019**
Loans and advances to customers (Note 12)	404 217	0	0	79	1 070	44	**405 410**
Receivables from customers (Note 13)	889	0	0	0	81	0	**970**
Other financial assets (Note 14)	233	0	0	0	707	0	**940**
Total assets bearing currency risk	**685 692**	**1 638**	**1 101**	**667**	**47 409**	**1 040**	**737 547**
Liabilities bearing currency risk							
Deposits from customers and loans received (Note 16)	591 124	1 605	2 549	353	48 279	857	**644 767**
Financial liabilities at fair value (Note 10)	89	0	0	0	0	0	**89**
Accounts payable and other financial liabilities (Note 17)	3 041	45	2 902	308	9 219	799	**16 314**
Subordinated debt (Note 19)	15 000	0	0	0	0	0	**15 000**
Total liabilities bearing currency risk	**609 254**	**1 650**	**5 451**	**661**	**57 498**	**1 656**	**676 170**
Open gross position derivative assets at contractual value	0	0	4 360	0	10 127	0	**14 487**
Open gross position derivative liabilities at contractual value	14 487	0	0	0	0	0	**14 487**
Open foreign currency position	**61 951**	**-12**	**10**	**6**	**38**	**-616**	**61 377**

3.3.2 Price risk

Financial instruments bearing price risk at LHV are securities held in the trading portfolio and investment portfolio (Note 9 and10). At the Group, limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for debt securities in the investment portfolio. The risk management unit monitors the compliance with limits. The Group does not hold significant amounts of equity securities in its position, due to which the sensitivity to change in the market value of these positions is marginal. The Group's debt securities portfolio recognised at the market price is short-term and of high quality, therefore, the effect of the changes in market risk premiums on the market value of the debt security portfolio should remain at around 1.0% (2015: 1.0%).

Sensitivity analysis of the impact to net result from the risk exposures against reasonable possible change (in thousands of euros):

Impact on statement of profit or loss	2016	2015
Equity securities +/-10%	+/-27	+/-2
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-636	+/-995
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-6	+/-35
Impact on other comprehensive income	**2016**	**2015**
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-6	+/-35

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. LHV'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. The basic measures of interest rate risk uses two scenarios – an increase and a decrease of interest rates to measure the effect on the group's net interest income for a 12 month period. Internal limits for interest rate risk management are set by LHV Pank's risk and capital committee and the operational risk management is the Treasury's responsibility.

The goal of monitoring, measuring and managing interest rate risk is to evaluate the profitability of the Group's interest-bearing products, to forecast interest income and to set limits for risk management in order to prevent significant reduction of income through limitation of risks in two aspects:

- cash flow interest rate risk whereby in case of a 1% change in market interest rates, a change in annual net interest income is limited as compared to the estimated actual income based on the term structure of instruments currently in the statement of financial position;
- fair value interest rate risk whereby in case of a 1% change in market interest rates, a change in the Group's economic value is limited (fair value of assets and liabilities is determined by discounting the future cash flows at the market rate of interest).

The balance sheet and margins on assets and deposits are assumed to be constant over time.

The deposits interest rates did not change in 2016 remaining at the level of up to 1.0 % (up to 1.0% in 2015).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2016, the interest rate on loans received for specific purposes was 1.5% (2015: 1.4%). The effective interest rate of subordinated debt entered into in 2016 and 2015 was 6.5%. The information about contractual interest rates is provided in Note 19.

As at 31.12.2016, an increase of 1 percentage point in interest rates would affect the Group's annual net interest income and profit by EUR +2 473 thousand (2015: EUR +4 003 thousand). In the same time, a decrease of 1 percentage point in interest rates would affect the Group's annual net interest income (profit) by EUR -1 119 thousand (2015: -2 361 thousand). A 1 percentage point increase in market interest rates would raise the Group's economical value, i.e. equity, by EUR 7 599 thousand (2015: EUR 463 thousand). A 1 percentage point decrease in market interest rates would decrease the Group's economical value (equity) by EUR -8 207 thousand (2015: EUR -655 thousand). The effect on the Group's economic value in both scenarios is positive due to the fact that the Group has majorly invested in current assets and because of the prolonged nature of demand deposits, hence the average duration of interest-earning assets is shorter than the average duration of interest-bearing liabilities.

The table below shows the structure of the financial assets and financial liabilities of LHV Pank according to the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.

In terms of the impact of a change in net interest income on the profit and stimulation of a change in economic capital, when interest rates decrease, contract terms have been considered in the asset side, and, in liabilities, an assumption has been made that interest rates of accumulated deposits will not be negative.In stimulating interest rate growth, the Bank adheres to the principle of prudency - despite the fact that the levels of derivatives transactions on the market indicate that interest rates of term deposits will not change drastically on the market in the next two years, enabling us to move significant amounts of demand deposits to term deposits, we have considered, however, that the ratio of demand and term deposit will equalize. Demand deposits have a duration of two years because of their behavioural nature. Demand deposits interest rates are not sensitive to fluctuations in the market.

31.12.2016	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impairments	Total
Financial assets								
Due from banks and investment companies (Note 8)	300 371	0	0	0	**300 371**	0	0	**300 371**
Financial assets at fair value (debt securities) (Note 9,10)	6 947	34 789	16 560	3 332	**61 628**	3 368	0	**64 996**
Loans and advances to customers (Note 12)	234 029	258 063	40 947	461	**533 500**	1 996	-3 735	**531 761**
Total	**541 347**	**292 852**	**57 507**	**3 793**	**895 499**	**5 364**	**-3 735**	**897 128**
Financial assets								
Deposits from customers and loans received (Note 16)	66 588	82 914	635 393	0	**784 895**	514	0	**785 409**
Subordinated debt * (Note 19)	0	0	0	20 000	**20 000**	150	0	**20 150**
Total	**66 588**	**82 914**	**635 393**	**20 000**	**804 895**	**664**	**0**	**805 559**
Net interest sensitivity cap	**474 759**	**209 938**	**-577 886**	**-16 207**	**90 604**			

31.12.2015	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impairments	Total
Financial assets								
Due from banks and investment companies (Note 8)	227 208	0	0	0	**227 208**	0	0	**227 208**
Financial assets at fair value (debt securities) (Note 9,10)	27 023	60 281	11 046	2 592	**100 942**	2 077	0	**103 019**
Loans and advances to customers (Note 12)	184 816	186 468	34 764	264	**406 312**	1 670	-2 572	**405 410**
Total	**439 047**	**246 749**	**45 810**	**2 856**	**734 462**	**3 747**	**-2 572**	**735 637**
Financial assets								
Deposits from customers and loans received (Note 16)	66 039	208 943	367 190	1 824	**643 996**	771	0	**644 767**
Subordinated debt * (Note 19)	0	0	0	15 000	**15 000**	94	0	**15 094**
Total	**66 039**	**208 943**	**367 190**	**16 824**	**658 996**	**865**	**0**	**659 861**
Net interest sensitivity cap	**373 008**	**37 806**	**-321 380**	**-13 968**	**75 466**			

* The contractual term of subordinated debt received in 2016 and 2015 is 10 years and the interest rate is fixed at 6.5%. The contractual term of received in 2014 is 10 years and the interest rate is 7.25%.

3.4 Liquidity risk

Liquidity risk relates to the solvency of LHV Pank to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. LHV Panks' liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, LHV Panks' liquidity management reflects a conservative approach towards liquidity risk. The liquidity risk management includes stress testing and business continuity plan for liquidity management. Stress testing framework includes a survival period metrics, which represents a combined liquidity risk scenario, including both idiosyncratic and market-wide stress. Internal metrics are complemented by the Basel III metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) which LHV Pank is fully compliant with as of 31.12.2016 and 31.12.2015. The aim of the liquidity coverage ratio (LCR) standard is to ensure that the bank has an adequate amount of unencumbered assets of high quality and liquidity that could be monetised without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The bank's liquidity coverage ratio level as at 31.12.2016 was 221% (2015: 272%).

The objective of the net stable funding ratio (NSFR) is to ensure that the bank has adequate stable funding sources to finance longer-term assets. According to the proposals published in the banking regulation and the banking committee of Basel in October 2014, the bank's NSFR level as at 31.12.2016 was 152% (31.12.2015: 157%). The net stable funding ratio will be imposed as minimum requirement from the year 2018.

The Treasury of LHV Pank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period, also the concentration of bank's liabilities by maturities is monitored. To enable covering unexpected monetary outflows, LHV Pank holds a liquidity buffer. The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Treasury, which can be readily sold or used as a collateral in funding operations with the central bank. LHV Pank has a sufficient supply of liquid resources to enable issuing standby loans. As at 31.12.2016 and 31.12.2015, the Group does not have any debts past due.

Short-term loans can be obtained from the central bank, secured by the majority of instruments from the bond portfolio.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and in a separate column the statement of financial position balance is disclosed. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows). Explanation of the fair value of these financial assets and liabilities is presented in Note 3.6.

31.12.2016	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**	**Carrying amount**
Liabilities by contractual maturity dates							
Deposits from customers and loans received (Note 16)	632 047	67 007	83 814	3 357	0	**786 225**	**785 409**
Subordinated debt (Note 19)	0	341	1 022	5 455	24 829	**31 647**	**20 000**
Accounts payable and other financial liabilities (Note 17)	0	14 704	0	0	0	**14 704**	**14 704**
Unused loan commitments (Note 22)	0	136 785	0	0	0	**136 785**	**0**
Financial guarantees by contractual amounts (Note 22)	0	5 442	0	0	0	**5 442**	**0**
Foreign exchange derivatives (gross settled)	0	15 156	0	728	0	**15 884**	**0**
Financial liabilities at fair value (Note 10)	0	209	0	0	0	**209**	**209**
Total liabilities	**632 047**	**239 644**	**84 836**	**9 540**	**24 829**	**990 896**	**820 322**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	300 298	73	0	0	0	300 371	300 371
Financial assets at fair value (debt securities) (Note 9,10)	0	7 666	36 123	18 474	3 613	65 876	64 866
Loans and advances to customers (Note 12)	0	32 156	121 165	399 450	40 710	593 481	531 761
Receivables from customers (Note 13)	0	1 699	0	0	0	1 699	1 699
Other financial assets (Note 14)	941	0	0	0	0	941	941
Foreign exchange derivatives (gross settled)	0	15 156	0	728	0	15 884	0
Total assets held for managing liquidity risk	301 239	56 750	157 288	418 652	44 323	978 252	899 638
Maturity gap from assets and liabilities	-330 808	-182 894	72 452	409 112	19 494	-12 644	79 316

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31.12.2015	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates							
Deposits from customers and loans received (Note 16)	444 897	66 578	110 230	23 284	716	**645 705**	**644 767**
Subordinated debt (Note 19)	0	260	779	4 155	19 324	**24 518**	**15 000**
Accounts payable and other financial liabilities (Note 17)	0	16 314	0	0	0	**16 314**	**16 314**
Unused loan commitments (Note 22)	0	125 696	0	0	0	**125 696**	**0**
Financial guarantees by contractual amounts (Note 22)	0	5 369	0	0	0	**5 369**	**0**
Foreign exchange derivatives (gross settled)	0	14 487	0	0	0	**14 487**	**0**
Financial liabilities at fair value (Note 10)	0	26	63	0	0	**89**	**89**
Total liabilities	**444 897**	**228 730**	**111 072**	**27 439**	**20 040**	**832 178**	**676 170**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	227 208	0	0	0	0	**227 208**	**227 208**
Financial assets at fair value (debt securities) (Note 9,10)	0	19 250	69 575	11 901	2 771	**103 497**	**102 976**
Loans and advances to customers (Note 12)	0	32 258	93 894	303 389	19 297	**448 838**	**405 410**
Receivables from customers (Note 13)	0	970	0	0	0	**970**	**970**
Other financial assets (Note 14)	940	0	0	0	0	**940**	**940**
Foreign exchange derivatives (gross settled)	0	14 487	0	0	0	**14 487**	**0**
Total assets held for managing liquidity risk	**228 148**	**66 965**	**163 469**	**315 290**	**22 068**	**795 940**	**737 504**
Maturity gap from assets and liabilities	**-216 749**	**-161 765**	**52 397**	**287 851**	**2 028**	**-36 238**	**61 334**

The following table shows the distribution of short- and long-term assets and liabilities.

(in thousands of euros)	**31.12.2016**	**31.12.2015**
Current assets		
Due from with central banks (Note 8)	265 127	199 844
Due from credit institutions (Note 8)	27 171	11 442
Due from investment companies (Note 8)	8 073	15 922
Available-for-sale financial assets (Note 9)	799	3 508
Financial assets at fair value through profit or loss (Note 10)	43 339	84 892
Loans and advances to customers (Note 12)	158 449	112 717
Receivables from customers (Note 13)	1 699	970
Other assets (Note 14)	714	525
Total current assets	**505 371**	**429 820**
Non-current assets		
Financial assets at fair value through profit or loss (Note 10)	20 858	14 619
Other financial assets (Note 14)	941	940
Loans and advances to customers (Note 12)	373 312	292 693
Tangible assets (Note 15)	1 002	606
Intangible assets (Note 15)	771	625
Total non-current assets	**396 884**	**309 483**
Total assets	**902 255**	**739 303**
Liabilities		
Current liabilities		
Deposits from customers and loans received (Note 16)	781 436	621 778
Financial liabilities at fair value through profit or loss (Note 10)	209	89
Accounts payable and other liabilities (Note 17)	16 469	18 078
Total current liabilities	**798 114**	**639 945**
Non-current liabilities		
Deposits from customers and loans received (Note 16)	3 973	22 989
Subordinated debt (Note 19)	20 000	15 000
Total non-current liabilities	**23 973**	**37 989**
Total liabilities	**822 087**	**677 934**

3.5 Risk concentration

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2016, the loans issued to 11 customers and 1 correspondent banks (2015: total 9) had a large risk exposure, i.e. more than 10% of the net own funds (NOF) of LHV Pank either individually or via group risk, totalling 174% of NOF (2015: 114%).

The Group has invested in the bonds of 3 issuers (2015: 3) with a large risk exposure, totalling 98% of NOF (2015: 80%). In 2016 the Group granted loans to another subsidiary of the parent company totalling 30 580 thousand euros (2015: 33 091), which is 33% of the Group NOF (2015: 45%). Unused loan commitments in amount of 127 285 (2015: 118 696) thousand euros are for Estonian residents and 9 500 (2015: 7 000) thousand euros for other subsidiaries of the parent company.

31.12.2016	Estonia	Latvia	Lithuania	Finland	Nether-lands	Germany	Other EU	USA	Other	Total
Due from banks and investment companies (Note 8)	283 581	0	886	0	0	0	5 100	7 919	2 885	**300 371**
Financial assets at fair value (Note 9,10)	1 121	2 737	18 788	0	0	33 660	8 658	2	30	**64 996**
Loans and advances to customers (Note 12)	484 578	245	31 138	512	7	46	14 508	51	676	**531 761**
Receivables from customers (Note 13)	1 689	1	6	0	0	0	3	0	0	**1 699**
Other financial assets (Note 14)	108	0	0	0	0	0	0	833	0	**941**
Total financial assets	**771 077**	**2 983**	**50 818**	**512**	**7**	**33 706**	**28 269**	**8 805**	**3 591**	**899 768**
Deposits from customers and loans received (Note 16)	674 698	1 617	2 024	1 072	1	201	71 983	746	33 067	**785 409**
Subordinated debt (Note 19)	20 000	0	0	0	0	0	0	0	0	**20 000**
Accounts payable and other financial liabilities (Note 17)	14 615	0	46	27	0	0	13	3	0	**14 704**
Financial liabilities at fair value (Note 10)	209	0	0	0	0	0	0	0	0	**209**
Total financial liabilities	**709 522**	**1 617**	**2 070**	**1 099**	**1**	**201**	**71 996**	**749**	**33 067**	**820 322**

31.12.2015	Estonia	Latvia	Lithuania	Finland	Nether-lands	Germany	Other EU	USA	Other	Total
Due from banks and investment companies (Note 8)	206 950	0	809	0	874	0	1 081	15 786	1 708	**227 208**
Financial assets at fair value (Note 9,10)	618	3 624	3 327	0	0	36 944	47 454	11 051	1	**103 019**
Loans and advances to customers (Note 12)	362 002	585	33 636	20	7	1	9 139	0	20	**405 410**
Receivables from customers (Note 13)	962	2	6	0	0	0	0	0	0	**970**
Other financial assets (Note 14)	108	0	0	0	0	0	0	832	0	**940**
Total financial assets	**570 640**	**4 211**	**37 778**	**20**	**881**	**36 945**	**57 674**	**27 669**	**1 729**	**737 547**
Deposits from customers and loans received (Note 16)	551 485	2 406	1 776	625	29	302	40 024	2 211	45 909	**644 767**
Subordinated debt (Note 19)	15 000	0	0	0	0	0	0	0	0	**15 000**
Accounts payable and other financial liabilities (Note 17)	16 271	0	0	27	0	0	13	3	0	**16 314**
Financial liabilities at fair value (Note 10)	89	0	0	0	0	0	0	0	0	**89**
Total financial liabilities	**582 845**	**2 406**	**1 776**	**652**	**29**	**302**	**40 037**	**2 214**	**45 909**	**676 170**

Distribution of loans granted by industry (gross):	31.12.2016	%	31.12.2015	%
Individuals	86 690	16.2%	52 264	12.8%
Real estate	149 145	27.9%	106 836	26.2%
Financial services	99 561	18.6%	79 978	19.6%
Manufacturing	43 534	8.1%	36 919	9.0%
Professional, scientific and technical activities	12 451	2.3%	2 482	0.6%
Wholesale and retail	14 719	2.7%	16 555	4.1%
Other servicing activities	15 021	2.8%	23 176	5.7%
Art and entertainment	29 143	5.4%	25 724	6.3%
Transport and logistics	12 834	2.4%	14 477	3.6%
Agriculture	8 341	1.6%	8 834	2.2%
Administrative activities	11 953	2.2%	11 355	2.7%
Construction	11 686	2.2%	6 632	1.6%
Education	1 294	0.2%	1 618	0.4%
Information and communication	9 607	1.8%	4 791	1.2%
Other areas at activities	29 517	5.6%	16 341	4.0%
Total (Note 12)	**535 496**	**100%**	**407 982**	**100%**

3.6 Fair value of financial assets and financial liabilities

	Level 1	Level 2	Level 3	31.12.2016	Level 1	Level 2	Level 3	31.12.2015
Financial assets at fair value through profit or loss								
Shares and fund units (Note 10)	80	0	50	**130**	43	0	0	**43**
Available-for-sale financial assets (Note 9)	799	0	0	**799**	3 508	0	0	**3 508**
Debt securities at fair value through profit or loss (Note 10)	63 817	0	0	**63 817**	99 468	0	0	**99 468**
Interest rate swaps and foreign exchange forwards (Note 10)	0	250	0	**250**	0	0	0	**0**
Total financial assets	**64 696**	**250**	**50**	**64 996**	**103 019**	**0**	**0**	**103 019**
Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards (Note 10)	0	**209**	0	**209**	0	**89**	0	**89**
Total financial liabilities	**0**	**209**	0	**209**	**0**	**89**	0	**89**

The management board of LHV Pank has assessed the fair value of assets and liabilities carried at amortised cost in the balance sheet. 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

Interest rate swaps and foreign exchange forwards are instruments where active markets supply observable inputs to the valuation model which is used for establishing the fair value. The fair value for such over-the-counter derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.

As at 31.12.2016 the fair value of corporate loans is EUR 2 354 thousand (0.63%) lower than their carrying amount (31.12.2015: 49 thousand, 0.02% lower). The loans have been issued at market conditions in the segment that the Group operates in and therefore their fair value is not much different from their carrying amount as at 31.12.2016 and 31.12.2015. The fair value level of corporate loans and overdraft is 3 as significant judgmental assumptions are used for the valuation process (discounted cash flow method with current market interest). Interest rate used is the average interest rate of corporate loans issued in last 6 months of the reporting period (2016: 4.54%, 2015: 4.52%).

EUR thousand	Carrying value	Fair value	Diffe-rence	Level
31.12.2016	374 494	372 140	-0,63%	3
31.12.2015	289 139	289 188	0,02%	3

Lease interest rates offered to customers generally correspond to interest rates prevailing in the market for such products. Considering that the interest rate environment has been relatively stable since the bank started to provide leasing, consequently the fair value of lease agreements does not materially differ from their carrying amount. As significant management judgment is required to determine fair value, leases are classified as level 3 in the fair value hierarchy.

Mortgage loans interest rates offered to customers correspond to interest rates prevailing in the market for such products. As mortgage product is long-term product, then bank has set up separate process monitoring the rates offered by competitors. Considering that bank has started offering the product only in October 2016, the interest rate environment has not changed, consequently the fair value of mortgage agreements does not differ from their carrying amount. As significant management judgment is required to determine fair value, mortgage loans are classified as level 3 in the fair value hierarchy.

Leveraged loans, hire-purchase and credit cards granted to customers are of sufficiently short-term nature and they have been issued at market terms, therefore the fair market rate of interest and also the fair value of loans do not change significantly during the loan term. The effective interest rate of consumer loans issued is at the same level as the interest rate of the loan product offered in the market and it can be stated that the carrying amount of loans does not significantly differ from their fair value. The fair value level of leveraged loans, hire-purchase, credit cards and consumer loans is 3 as significant judgmental assumptions are used for the valuation process.

Trade receivables (other than the receivables related to loans and advances to customers) and accrued expenses and other liabilities have been incurred in the course of ordinary business and are payable in the short-term, therefore, the management estimates that their fair value does not significantly differ from their carrying amount. These receivables and liabilities are interest-free. The fair value level of those receivables, accrued expenses and other financial liabilities is 3.

Customer deposits and loans received with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount. The fair value level of customer deposits is 3 as significant judgmental assumptions are used for the valuation process.

The subordinated debt in the amount of EUR 8 000 was received in 2014 and the remainder in 2015 and 2016. These loans carry interest rates in the same magnitude (2014: 7.25% and 2015, 2016: 6.5%) and considering the interest rate 6.5% of the loan received in May 2016 and taking into account the market situation it can be concluded that no material changes have occurred in interest rates as of the balance sheet date. Therefore, the fair value of loans does not differ significantly from their carrying amount. As significant management judgment is required to determine fair value, loans are classified as level 3 in the fair value hierarchy.

For the term structure of financial assets and financial liabilities, refer to Note 3.4.

3.7 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's working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of LHV Pank and to evaluate capital requirements. The analysis of cases collected into the database enables LHV Pank 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 control manager of the bank 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 Credit Institutions Act and Securities Market Act, the main task of Compliance Officer is to define the risks of non-compliance of the activities of LHV Pank with legislation, recommended guidelines of the Financial Supervision Authority and procedure rules of LHV Pank, 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 the Group's performance and adding value. Internal audit helps achieving the goals of the Group, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.8 Offsetting assets and liabilities

The group has offset the following assets and liabilities:

31.12.2016	Gross amounts before offsetting in the statement of financial position	Offsetting	Net amount of exposure presented in the statement of financial position	Related arrangements not set off in the statement of financial position: Financial instru-ments	Related arrangements not set off in the statement of financial position: Cash collateral received	Net amounts
Assets						
Client receivables (leveraged loans, incl. repo loans) (Note 12)	7 387	0	7 387	-7 387	0	0
31.12.2015						
Assets						
Client receivables (leveraged loans, incl. repo loans) (Note 12)	7 445	0	7 445	-7 445	0	0

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the 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 (Notes 3.2, 8, 9, 10, 11 and 12).

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 Net interest income

Interest income	**2016**	**2015**
Loans to companies (incl retail loans)	17 593	14 250
incl. loans to related parties (Note 23)	36	47
Hire-purchase	4 431	3 694
Leasing	1 600	1 356
incl. loans to related parties (Note 23)	*4*	*3*
Loans to other Group companies	1 167	1 170
Leveraged loans and lending of securities	505	715
From debt securities	365	351
incl. debt securities available-for-sale	27	*36*
incl. debt securities at fair value through profit or loss	*338*	*315*
Credit card loans	553	408
Consumer loans	2 634	233
From balances with credit institutions and investment companies	73	91
Other loans	918	344
incl. loans to related parties (Note 23)	*12*	*5*
Total	**29 839**	**22 612**
Interest expense		
Deposits from customers and loans received	-2 236	-2 763
From balances with central bank	-811	-176
Subordinated debt (Note 19, 23)	-1 240	-915
Total	**-4 287**	**-3 854**
Net interest income	**25 552**	**18 758**

Interest income of loans by customer location (interests from bank balances and debt securities not included):	**2016**	**2015**
Estonia	28 133	20 868
Latvia	11	31
Lithuania	1 257	1 271
Total	**29 401**	**22 170**

Interests calculated on impaired loans in 2016 is EUR 137 (2015: 88) thousand.

NOTE 6 Net fee and commission income

Fee and commission income	2016	2015
Security brokerage and commission fees	3 088	2 572
Asset management and related fees	1 439	1 032
Currency exchange fees	1 109	731
Fees from cards and settlements	3 584	2 128
Other fee and commission income	540	479
Total	**9 760**	**6 942**
Fee and commission expense		
Security brokerage and commission fees paid	-831	-707
Expenses related to bank cards	-1 059	-619
Expenses related to acquiring	-1 280	-441
Other fee and commission expense	-874	-323
Total	**-4 044**	**-2 090**
Net fee and commission income	**5 716**	**4 852**

Fee and commission income by customer location:	2016	2015
Estonia	9 459	6 519
Latvia	17	80
Lithuania	284	343
Total	**9 760**	**6 942**

NOTE 7 Operating expenses

	2016	2015
Wages, salaries and bonuses	7 380	6 154
Social security and other taxes*	2 296	1 911
Total staff costs	**9 676**	**8 065**
IT expenses	1 358	986
Information services and bank services	476	491
Marketing expenses	951	1 223
Office expenses	447	372
Transportation and communication costs	181	165
Training and travelling expenses of employees	301	229
Other outsourced services	1 483	1 141
Other administrative expenses	1 020	1 077
Depreciation	812	736
Operating lease payments	793	726
Other operating expenses	139	171
Total other operating expenses	**7 961**	**7 317**
Total operating expenses	**17 637**	**15 382**

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

The average number of employees working for the Group in 2016 was 250 (2015: 210).

NOTE 8 Due from central bank, credit institutions and investment companies

	31.12.2016	31.12.2015
Demand and term deposits with maturity less than 3 months*	35 244	27 364
Statutory reserve capital at central bank	7 736	6 138
Demand deposit from central bank*	257 391	193 706
Total	**300 371**	**227 208**
* cash and cash equivalents in the statement of cash flows	292 635	221 070

Distribution of receivables by countries is presented in Note 3.5.

Mandatory banking reserve as at 31.12.2016 was 1% (2015: 1%) of all financial resources taken in (deposits from customers and loans received). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 9 Available-for-sale financial assets

The Group has available-for-sale debt securities and equities portfolio as at 31.12.2016. The balance of other reserve in equity as of 31.12.2016 is -40 thousand euros (31.12.2015: EUR -23 thousand).

In 2016 and 2015, no gains or losses arose from the sales of debt securities. In 2016, VISA share was revaluated to EUR 889 thousand, which profit on disposal was recycled to profit and loss statement during 2016.

Available-for-sale financial assets 31.12.2014	**4 273**
Proceeds from disposal of assets available-for-sale	-784
Interest income (Note 5)	36
Revaluation of available-for-sale assets	-17
Available-for-sale financial assets 31.12.2015	**3 508**
Proceeds from disposal of assets available-for-sale	-3 608
Interest income (Note 5)	27
Revaluation of available-for-sale assets	-17
Revaluation reclassified through profit or loss	889
Available-for-sale financial assets 31.12.2016	**799**

NOTE 10 Financial assets and liabilities at fair value through profit or loss

Securities held for trading:	**31.12.2016**	**31.12.2015**
Shares and fund units	130	43
Debt securities	63 817	99 468
Foreign exchange forwards	250	0
Total financial assets	**64 197**	**99 511**
Interest rate swaps and foreign exchange forwards	209	89
Total financial liabilities	**209**	**89**

Financial assets at fair value through profit or loss 31.12.2014	138 290
Net changes of investment securities at fair value through profit or loss	-38 805
Interest income (Note 5)	315
Revaluation	-289
Financial assets at fair value through profit or loss 31.12.2015	**99 511**
Net changes of investment securities at fair value through profit or loss	-35 955
Interest income (Note 5)	338
Revaluation	-303
Financial assets at fair value through profit or loss 31.12.2016	**64 197**

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.6). In 2016, a gain of 213 thousand euros was recognised on the revaluation of bonds (2015: 124 thousand euros). No gain or loss was obtained from the revaluation of interest rate swaps (2015: 12 thousand euros). Interest income from bonds is recognized in interest income.

NOTE 11 Discontinued operations

At 9th of January 2015, the Group disposed of the business of the branch in Finland, therefore in 2015 financial statements branch-related income and expenses were presented separately from continuing operations.

Net income from discontinued operations:	2016	2015
Other financial income	0	2 936
Total expenses	0	-755
Net profit for the year from discontinued operations	**0**	**2 181**

NOTE 12 Loans and advances to customers

	31.12.2016	31.12.2015
Loans to legal entities	**448 806**	**355 718**
incl. loans to other subsidiaries of the parent company	30 580	33 091
incl. corporate loans	341 358	257 140
incl. retail loans	7 088	0
incl. overdraft	31 333	29 548
incl. hire-purchase	265	220
incl. leveraged loans	4 383	4 733
incl. leasing	33 669	30 868
incl. credit card loans	130	118
Loans to individuals	**86 690**	**52 264**
incl. consumer loans	16 465	6 427
incl. hire-purchase	19 206	18 641
incl. leveraged loans	3 004	2 712
incl. leasing	7 694	5 517
incl. credit card loans	4 788	3 503
incl. mortgage loans	35 451	15 395
incl. overdraft	82	69
Total	**535 496**	**407 982**
Impairment provisions	-3 735	-2 572
Total	**531 761**	**405 410**

As at 31.12.2016 loans have been issued to related parties in the amount of EUR 33 290 thousand and the loans have been issued on market terms (as at 31.12.2015 EUR 35 676 thousand). See also Note 23.

In 2016, the average effective interest rate of new consumer loans issued to individuals was 22-24%.The average effective interest rate for hire-purchase was around 24%, credit cards 13% and leasing 4%. The contractual interest rate of leveraged loans issued to individuals is generally equal to their effective interest rate, because no other significant fees have been received upon their issue.

Changes in impairments in 2016	**Corporate loans, incl. overdraft**	**Retail loans**	**Mort-gage loans**	**Credit cards**	**Hire-purchase**	**Consu-mer loans**	**Leasing**	**Leveraged loans**	**Total**
Balance as at January 1	**-1 686**	**0**	**-77**	**-110**	**-305**	**-53**	**-341**	**0**	**-2 572**
Impairment provisions set up during the year	-847	-101	-66	-42	-133	-686	87	0	**-1 788**
Written off during the year	195	0	0	34	243	116	37	0	**625**
Balance as at December 31	**-2 338**	**-101**	**-143**	**-118**	**-195**	**-623**	**-217**	**0**	**-3 735**

Changes in impairments in 2015	**Corporate loans, incl. overdraft**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consu-mer loans**	**Leasing**	**Leveraged loans**	**Total**
Balance as at January 1	**-1 541**	**0**	**-91**	**-197**	**0**	**-246**	**-18**	**-2 093**
Impairment provisions set up during the year	-149	-77	-63	-227	-53	-95	0	-664
Written off during the year	4	0	44	119	0	0	18	185
Balance as at December 31	**-1 686**	**-77**	**-110**	**-305**	**-53**	**-341**	**0**	**-2 572**

Net and gross investments on leasings according to remaining maturity	**Gross investment**	**Unearned future interest income**	**Impairment loss provision**	**Present value of lease payments receivable**
up to 1 year	13 380	-1 379	-65	11 936
1-5 years	30 862	-1 837	-149	28 876
over 5 years	573	-19	-3	551
Total as at 31.12.2016	**44 815**	**-3 235**	**-217**	**41 363**
up to 1 year	11 151	-1 074	-94	9 983
1-5 years	27 960	-1 487	-245	26 228
over 5 years	180	-4	-2	174
Total as at 31.12.2015	**39 291**	**-2 565**	**-341**	**36 385**

For credit risk exposures and loan collateral, see Note 3.2. Distribution of loans granted by currencies is disclosed in Note 3.3. Distribution of loans granted by due dates is disclosed in Note 3.4. The regional distribution of loans granted is disclosed in Note 3.5. For interest income on loans granted, see Note 5.

NOTE 13 Receivables from customers

	31.12.2016	31.12.2015
Asset management fees from customers	11	5
Other fees for providing services to customers	1 673	957
Payments in transit	15	8
Total	**1 699**	**970**

All fees, other than receivables related to collection of receivables, are receivable within 12 months of the balance sheet date, and are considered as current asset.

NOTE 14 Other assets

	31.12.2016	31.12.2015
Financial assets		
Guarantee deposits of Baltic stock exchanges	8	8
Guarantee deposit of MasterCard and VISA	933	932
Subtotal	**941**	**940**
Non-financial assets		
Prepayments to Financial Supervision Authority	183	151
Other prepayments *	531	374
Subtotal	**714**	**525**
Total	**1 655**	**1 465**

* Prepayments include office rent, insurance, communication services, periodicals and training.

Prepayments are expected to be received or used within 12 months of the balance sheet date, and are therefore considered current assets. Guarantee deposits on the Baltic stock exchanges are held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions, and should therefore both be considered non-current assets.

NOTE 15 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2014			
Cost	1 877	1 459	3 336
Accumulated depreciation and amortisation	-1 581	-937	-2 518
Assets of discontinued operations, classified as held for sale	-60	0	-60
Carrying amount	**236**	**522**	**818**
Changes in 2015:			
Purchase of non-current assets	534	675	1 209
Depreciation/amortisation charge	-164	-572	-736
Write-off of non-current assets	-60	0	-60
Balance as at 31.12.2015			
Cost	2 411	2 134	4 545
Accumulated depreciation and amortisation	-1 805	-1 509	-3 314
Carrying amount	**606**	**625**	**1 231**
Changes in 2016:			

Purchase of non-current assets	716	649	1 365
Disposal of non-current assets	-13	0	-13
Accumulated depreciation/amortisation of sold non-current assets	5	0	5
Write-offs	-2	0	-2
Depreciation/amortisation charge	-310	-503	-813
Balance as at 31.12.2016			
Cost	3 112	2 783	5 895
Accumulated depreciation and amortisation	-2 110	-2 012	-4 122
Carrying amount	**1 002**	**771**	**1 773**

Tangible assets include computer technology and office equipment, furniture, capitalized costs of office renovation. Intangible assets include licences and development costs.

In 2016 and 2015, there was no indication of impairment of tangible and intangible assets.

NOTE 16 Deposits from customers and loans received

	Individuals	Legal entities	Public sector	**31.12.2016 total**	Individuals	Legal entities	Public sector	**31.12.2015 total**
Demand deposits	202 725	420 969	8 260	631 954	127 084	314 555	3 179	444 818
Term deposits	63 749	81 945	6 469	152 163	81 949	97 421	4 299	183 669
Loans received	0	0	778	778	0	13 000	2 510	15 510
Accrued interest liability	209	285	20	514	322	419	29	770
Total	**266 683**	**503 199**	**15 527**	**785 409**	**209 355**	**425 395**	**10 017**	**644 767**
incl. related parties (Note 23)	*1 165*	*14 093*	*0*	*15 258*	*828*	*12 587*	*0*	*13 415*

Loans received from public sector includes loans from Maaelu Edendamise Sihtasutus (Rural Development Foundation) in the amount of 778 thousand euros (31.12.2015: 2 510 thousand) with an intended purpose to finance loans to small enterprises operating in rural areas. As at 31.12.2015 received loans included a loan from the European Central Bank, secured with the bond portfolio, in the amount of 13 028 thousand euros and interest rate 0.15%. The nominal interest rates of most deposits from customers and loans received equal their effective interest rates as no other significant fees have been paid.

Distribution of deposits from customers and loans received by currency is presented in Note 3.3.

Distribution of deposits from customers and loans received by maturity is presented in Note 3.4.

Distribution of deposits from customers and loans received by geography is presented in Note 3.5.

NOTE 17 Accounts payable and other liabilities

Financial liabilities	**31.12.2016**	**31.12.2015**
Trade payables	1 803	1 951
Other short-term financial liabilities	1 551	681
Accrued interest on subordinated loans (Note 19)	150	94
Payments in transit	11 063	13 455
Financial guarantee contracts issued	137	133
Subtotal	**14 704**	**16 314**

Non-financial liabilities		
Prepaid expenses	184	137
Performance guarantee contracts issued	228	158
Tax liabilities	584	706
Payables to employees	769	763
Subtotal	**1 765**	**1 764**
Total	**16 469**	**18 078**

Payables to employees consist of unpaid salaries; bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in the number of employees during the year. Payments in transit consist of foreign payments and payables to customers related to intermediation of securities transactions. All liabilities, except for financial guarantees, are payable within 12 months and are therefore recognised as current liabilities.

NOTE 18 Operating lease

The Group leases office premises under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The future unilaterally non-cancellable lease payables in the next period are disclosed in the table below. In 2016, the operating lease payments for office premises in the amount of EUR 723 thousand (2015: EUR 726 thousand).

	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as of **31.12.2015**	693	2 953	**3 646**
Non-cancellable lease payables as of **31.12.2016**	747	2 741	**3 488**

NOTE 19 Subordinated debts

The Group has received subordinated debts in order to increase long-term capital. In the case of default of the Group, the subordinated debts are repayable after all other debts have been paid, but before debts to shareholders are paid. The balances of subordinated debt as at the end of each reporting period is disclosed in the table below.

In June 2014, subordinated bonds were issued totalling 8 000 thousand euros carrying a rate of interest at 7.25%. The due date of the bonds is 20 June 2024.

In June 2015, subordinated bonds were issued totalling 4 000 thousand euros carrying a rate of interest at 6.50%. The due date of the bonds is 29 October 2025.

In August 2015, subordinated bonds were issued totalling 3 000 thousand euros carrying a rate of interest at 6.50%. The due date of the bonds is 29 October 2025.

In June 2015 the issuer used the right to prematurely redeem the bonds issued in 2012 in the amount of EUR 4 000 thousand. These subordinated bonds were issued in 2012 and the due date of these bonds were 20 December 2020 and the interest rate was 7% during the first three-year period.

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

The balances of subordinated debt as at the end of each reporting period is disclosed in the table below. Interest liabilities are accounted in the statement of financial position using the effective interest rate.

(in thousands of euros)

Subordinated debt as at 31.12.2014	**12 000**
Subordinated bonds redeemed	-4 000
Subordinated bonds issued	7 000
Subordinated debt as at 31.12.2015	**15 000**
Subordinated bonds issued	5 000
Subordinated debt as at 31.12.2016	**20 000**

(in thousands of euros)

Accrued interest on subordinated debts as at 31.12.2014	**249**
Interest calculated for 2015 (Note 5)	915
Paid out during 2015	-1 070
Accrued interest on subordinated debts as at 31.12.2015	**94**
Interest calculated for 2016 (Note 5)	1 240
Paid out during 2016	-1 184
Accrued interest on subordinated debts as at 31.12.2016	**150**

NOTE 20 Shareholders' equity in the public limited company

The sole shareholder of the Group is a company registered in Estonia, AS LHV Group. Rain Lõhmus who owns 25.9% of the voting rights and Andres Viisemann who owns 9.81% of the voting rights in AS LHV Group have significant influence over the company (31.12.2015: 28.0% and 10.6%, respectively). According to the Company's articles of association, the minimum share capital is 25 million euros and the maximum share capital is 100 million euros (at 31.12.2015: 25 million euros and 100 million euros, respectively). The share capital is paid in full through cash contributions. In 2016, the share capital of AS LHV Pank was increased by 5 million euros and in 2015 by 6 million euros through a cash contribution by the sole shareholder AS LHV Group. The bank's share capital increased to 56.5 million euros by the year-end 2016.

As at 31.12.2016, the adjusted unconsolidated retained earnings of the Group amounted to 20 896 thousand euros (31.12.2015: 8 701 thousand euros). Thus, as of 31.12.2016 it is possible to pay out dividends in amount 16 717 (2015: 6 961) thousand euros and the related income tax charge would be 4 179 (2015: 1 740) thousand euros. If the dividends are to be paid, the Group's capital adequacy would remain compliant.

	31.12.2016	**31.12.2015**
Share capital (in EUR thousand)	56 500	51 500
Number of shares (pcs)	56 500 000	51 500 000
Par value of a share	1 EUR	1 EUR

In 2014, the general meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the management board members and equivalent employees and department managers and equivalent employees of group companies that are part of AS LHV Group. The aim of issuing share options is to align the interests of management board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labour market that is equal to competitors and comprehensive. The share options were issued in 2015 and also in 2016.

In 2016 share options were granted to six members of the management board of LHV Pank and thirty six employees in the total amount of 598 thousand euros. In 2015 share options were granted to five members of the management board of LHV Pank and thirty five employees in the total amount of 510 thousand euros. The company entered into share option agreements with the members of the management board and employees for a three-year term for the granting of share options. Share options can be exercised after the expiry of a three-year period.

Share options issued in 2014 can be exercised between the period of 01.07.2017-30.09.2017 and shares with nominal value of 1 euro can be acquired for 2 euros per share. Share options issued in 2015 can be exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of 1 euro can be acquired for 2.4 euros per share. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of 1 euro can be acquired for 3.0 euros per share.

Statutory reserve capital in equity is composed of:

(in thousands of euros)

Statutory reserve capital as at 31.12.2014	**118**
Transferred from 2014 net profit	301
Statutory reserve capital as at 31.12.2015	**416**
Transferred from 2015 net profit	469
Statutory reserve capital as at 31.12.2016	**888**

NOTE 21 Assets under management

LHV Pank, operating as an account manager for its customers, has custody of or intermediates the following customer assets:

	31.12.2016	31.12.2015
Cash balance of customers	11 657	8 416
Securities of customers	**1 069 151**	**1 261 320**
incl. parent company	*87 900*	*56 759*
incl. shareholders of the parent company and related entities (Note 23)	*76 803*	*38 085*
Total	**1 080 808**	**1 269 736**

Asset management fees for the management of these assets have been in the range of 0.015 – 0.025 % (for, respective income, see Note 6).

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by the Bank, have been recognised as off-balance sheet assets. Due to the nature of the system, the Bank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by the Bank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. The Bank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the Group's financial statement. The Bank has provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), with the primary collateral being the securities used as collateral for leveraged loans. The customer has similar guarantee to the Bank and therefore, the Bank has in substance transferred the guarantee to end customer. To avoid potential losses, the Bank has a daily practice to monitor the potential decrease of collateral and deficiency of customer accounts. In its current practice, no such losses in respect of which the guarantee provided by the Bank would apply have incurred and the Bank has not paid any compensation relating to the guarantee.

NOTE 22 Contingent assets and liabilities

Irrevocable transactions	Performance guarantees	Financial guarantees	Unused loan commitments	Total
Liability in contractual amount 31.12.2016	12 695	5 442	136 785	**154 922**
Liability in contractual amount 31.12.2015	7 853	5 369	125 696	**138 918**

Tax authorities have the right to review the company's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Group during 2015 - 2016. The Group's management estimates that there are no such circumstances which may lead the tax authorities to impose significant additional taxes on the Group.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the insured event (i.e. the failure to perform the contractual obligation by another party) occurs. The key risks the Group faces are significant fluctuations in the frequency and severity of payments incurred on such contracts relative to expectations. The Group uses historical data and statistical techniques to predict levels of such payments. Claims must be made before the contract matures and most claims are settled within short term. This allows the Group to achieve a high degree of certainty about the estimated payments and therefore future cash-flows. The Group manages such risks by constantly monitoring the level of payments for such products and has the ability to adjust its fees in the future to reflect any change in claim payments experience. The Group has a claim payment requests handling process which includes the right to review the claim and reject fraudulent or non-compliant requests.

The exposure and concentration of performance guarantees expressed at the amounts guaranteed is as follows:

According to sectors	31.12.2016	31.12.2015
Construction	7 170	5 525
Water supplies	2 062	1 789
Manufacturing	1 594	110
Professional, scientific and technical activities	152	77
Other areas at activities	1 718	352
Total	**12 695**	**7 853**

According to internal ratings	31.12.2016	31.12.2015
5 low credit risk	55	267
6 low credit risk	964	2 913
7 medium credit risk	5 591	3 284
8 medium credit risk	1 393	441
9 heightened credit risk	710	912
10 high credit risk	107	20
11 high credit risk	1 531	0
12 non-satisfactory rating	2 344	16
Total	**12 695**	**7 853**

Performance guarantees are over-collateralised as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2016 nor in previous periods.

NOTE 23 Transactions with related parties

In preparing the financial statements of AS LHV Pank, the following entities have been considered related parties:

- owners that have significant impact on the Group and the entities related to them;
- members of the management board and legal entities controlled by them (together referred to as management);
- members of the supervisory board;
- close relatives of the persons mentioned above and the entities related to them.

Transactions	Note	2016	2015
Interest income	**5**	**1 220**	**1 232**
incl. management		17	7
incl. entities in the consolidation group of the parent		1 203	1 225
Interest expenses	**5**	**1 281**	**915**
incl. management		*3*	*0*
incl. parent company		*1 235*	*770*
incl. shareholders, related entities and close relatives that have significant influence		*43*	*145*
Fee and commission income	**6**	**5**	**0**
incl. management		*1*	*0*
incl. shareholders, related entities and close relatives that have significant influence		*4*	*0*
Other income		**72**	**33**
incl. shareholders, related entities and close relatives that have significant influence		*72*	*33*
Other expenses		***22***	***16***
incl. shareholders, related entities and close relatives that have significant influence		*22*	*16*

Balances	Note	31.12.2016	31.12.2015
Loans and receivables as at the year-end	**12**	**33 290**	**35 676**
incl. management		*1 314*	*762*
incl. shareholders, related entities and close relatives that have significant influence		*31 976*	*34 914*
Deposits and loans received as at the year-end		**15 258**	**28 509**
incl. management	*16*	*236*	*764*
incl. parent company	*19*	*7 638*	*15 094*
incl. shareholders, related entities and close relatives that have significant influence	*16*	*7 384*	*12 651*

The table provides an overview of the material balances and transactions involving related parties. All other transactions involving the close relatives and the entities related to members of the management board and supervisory board and the minority shareholders of the parent company AS LHV Group have occurred in the course and on the terms of ordinary business.

In 2015 the Group granted loans to another subsidiary of the parent company in amount of 6 million euros. The amount of 2.5 million euros of these loans was repaid in 2016. The interest rate of this loan is dependant of financing cost and capital requirements of the Group and is changed on quarterly basis. As of 31.12.2016 the interest rate was 3.51% (31.12.2015: 3.87%). As of 31.12.2016 the Group has taken a commitment to grant loans up to 40 million euros.

As at 31.12.2016, the management did not have term deposits and the interest rate on demand deposits corresponds to the overall price list applicable to customers. As at 31.12.2015, the term deposits due to the management are with maturities in April to October 2016 with interest rates 0.9-1.0%.

The subordinated loan received in June 2014 has the interest rate of 7.25%. The subordinated debt received in June and in August 2015 and in May 2016 have the interest rate of 6.5%.

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

In 2016, salaries and other compensations paid to the management of LHV totalled 706 thousand EUR (2015: 681 thousand), including all taxes. The management board of the Bank had 6 members in 2015 like in 2014. As at 31.12.2016, remuneration for December and accrued holiday pay in the amount of EUR 58 thousand (as at 31.12.2015: 55 thousand) is reported as a payable to management (Note 17). The Group did not have any long-term payables or commitments to the members of the management board and the supervisory board as at 31.12.2016 and 31.12.2015 (pension liabilities, termination benefits, etc). In 2016 and 2015 no remuneration was paid to the members of the supervisory board.

The Group has signed contracts with the members of the management board, which do not provide for severance benefits upon termination of the contract. In any matters not regulated by the contract, the parties adhere to the procedure specified in the legislation of the Republic of Estonia.

Information on assets of related parties held as an account manager is presented in Note 21.

NOTE 24 Subsidiary

As at 31.12.2016 the Bank has one subsidiary which has been consolidated in these financial statements:

- AS LHV Finance (ownership interest 65%)

AS LHV Pank paid EUR 325 thousand euros of monetary contribution for 65% of ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand euros of monetary contribution for 35% of ownership. The contribution of the non-controlling interest has been reflected in the consolidated statement of financial position on the line “Non-controlling interest”.

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

	AS LHV Finance	
Summarised statement of Financial Position	**31.12.2016**	**31.12.2015**
Loans and advances to customers and other current assets	35 454	25 233
Non-current assets	66	132
Current liabilities	1 982	2 041
Non-current liabilities	28 041	21 123
Total net assets	**5 497**	**2 201**

	AS LHV Finance	
Summarised statement of Profit or Loss and Other Comprehensive Income	**2016**	**2015**
Total net interest and fee income	5 566	3 283
Profit before income tax	3 289	1 528
Income tax expense	0	0
Net profit	**3 289**	**1 528**
Total comprehensive income	3 289	1 528
Profit and other comprehensive income allocated to non-controlling interests	1 151	535

	AS LHV Finance	
Summarised statement of Cash Flows	**2016**	**2015**
Cash generated from operations	-5 790	-9 957
Interest paid	-1 109	-633
Income tax paid	0	0
Net cash generated from/(used in) operating activities	-6 899	-10 590
Net cash generated from/(used in) investing activities	-18	-62
Net cash generated from/(used in) financing activities	6 917	10 652
Net increase/(decrease) in cash and cash equivalents	**0**	**0**
Cash and cash equivalents at beginning of year	0	0
Cash and cash equivalents at end of year	0	0

NOTE 25 Separate financial statements of parent company

In accordance with the Estonian Accounting Act, information on the separate primary financial statements of the parent of the consolidation group shall be disclosed in the notes to the financial statements.

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

(in thousands of euros)	**2016**	**2015**
Continuing operations		
Interest income	23 903	19 182
Interest expense	-4 286	-3 678
Net interest income	**19 617**	**15 504**
Fee and commission income	9 735	6 907
Fee and commission expense	-3 650	-2 084
Net fee and commission income	**6 085**	**4 823**
Net gains from financial assets measured at fair value	1 103	44
Foreign exchange rate losses	-105	70
Dividends	0	1
Net gains from financial assets	**998**	**115**
Other income	386	90
Administrative and other operating expenses	-16 181	-13 910
Profit before impairment losses on loans and advances	**10 905**	**6 622**
Impairment losses on loans and advances	-947	-390
Net profit for the year from continuing operations	**9 958**	**6 232**
Profit from discontinued operations	**0**	**2 181**
Net profit for the year	**9 958**	**8 413**
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss:		
Available-for-sale investments:		
Revaluation of available-for-sale financial assets	-17	-17
Total profit and other comprehensive income for the year	**9 941**	**8 396**

Statement of financial position of the parent

(in thousands of euros)	31.12.2016	31.12.2015
Assets		
Due from central bank	265 127	199 844
Due from credit institutions	27 171	11 442
Due from investment companies	8 073	15 922
Available-for-sale financial assets	799	3 508
Other financial assets at fair value through profit or loss	64 197	99 511
Loans and advances to customers	524 785	401 683
Receivables from customers	1 386	696
Other assets	1 651	1 461
Subsidiaries	325	325
Tangible assets	990	579
Intangible assets	717	520
Total assets	**895 221**	**735 491**
Liabilities		
Deposits from customers and loans received	785 409	644 767
Financial liabilities at fair value through profit or loss	209	89
Accrued expenses and other liabilities	14 607	16 144
Liabilities of discontinued operations, classified as held for sale	0	0
Subordinated debt	20 000	15 000
Total liabilities	**820 225**	**676 000**
Equity		
Share capital	56 500	51 500
Statutory reserve capital	888	419
Other reserves	-40	-23
Retained earnings	17 648	7 595
Total equity	**74 996**	**59 491**
Total liabilities and equity	**895 221**	**735 491**

Statement of cash flows of the parent

(in thousands of euros)	2016	2015
Cash flows from operating activities		
Interest received	23 583	19 927
Interest paid	-4 487	-3 657
Fees and commissions received	9 735	6 907
Fees and commissions paid	-3 650	-2 084
Other operating income received	386	90
Staff costs paid	-8 382	-7 134
Administrative and other operating expenses paid	-6 451	-5 702
Cash flows from operating activities before change in operating assets and liabilities	**10 734**	**8 347**
Net increase/decrease in operating assets:		
Net acquisition/disposal of trading portfolio	-287	-16
Loans and advances to customers	-124 418	-92 491
Term deposits with other credit institutions	0	1
Mandatory reserve at central bank	-1 598	-1 640
Security deposits	-1	-157
Other assets	-189	177
Net increase/decrease in operating liabilities:		
Demand deposits of customers	187 136	168 048
Term deposits of customers	-31 506	-999
Loans received and repayments	-14 731	-1 576
Financial liabilities for trading at fair value through profit or loss	120	-213
Other liabilities	-1 652	13 404
Net cash generated from operating activities from continuing operations	**23 626**	**92 885**
Cash generated from operating activities from discontinued operations	0	2 781
Net cash generated from operating activities	**23 626**	**95 666**
Cash flows from investing activities		
Purchase of non-current assets	-1 334	-1 209
Proceeds from disposal and redemption of investment securities available for sale	3 608	784
Net changes of investment securities at fair value through profit or loss	35 788	38 803
Investment in share capital of subsidiary	0	0
Cash from investment activities of discontinued operations	0	61
Net cash from investing activities	**38 044**	**38 439**
Cash flows from financing activities		
Paid in share capital	5 000	6 000
Proceeds from subordinated debt	5 000	3 000
Net cash from financing activities	**10 000**	**9 000**
Effect on exchange rate change on cash and cash equivalents	**-105**	**70**
Net increase in cash and cash equivalents	**71 565**	**143 175**
Cash and cash equivalents at the beginning of the year	221 070	77 895
Cash and cash equivalents at the end of the financial year	**292 635**	**221 070**

Statement of changes in shareholders' equity

(in thousands of euros)	Share capital	Statutory reserve capital	Other reserves	Accumulated deficit/ Retained earnings	Total
Balance as at 01.01.2015	**45 500**	**119**	**-6**	**-813**	**44 799**
Paid in statutory reserve capital	0	301	0	-301	**0**
Paid in share capital	6 000	0	0	0	**6 000**
Share options	0	0	0	296	**296**
Profit for the year	*0*	*0*	*0*	*8 413*	***8 413***
Other comprehensive income	*0*	*0*	*-17*	*0*	***-17***
Total comprehensive income for 2015	0	0	-17	8 413	**8 396**
Balance as at 31.12.2015	**51 500**	**419**	**-23**	**7 595**	**59 491**
Carrying amount of holdings under control and significant influence	0	0	0	-325	-325
Value of holdings under control and significant influence under equity method	0	0	0	1 431	1 431
Adjusted unconsolidated equity as at 31.12.2015	**51 500**	**419**	**-23**	**8 701**	**60 597**
Balance as at 01.01.2016	**51 500**	**419**	**-23**	**7 595**	**59 491**
Paid in statutory reserve capital	0	469	0	-469	**0**
Paid in share capital	5 000	0	0	0	**5 000**
Share options	0	0	0	563	**563**
Profit for the year	*0*	*0*	*0*	*9 958*	***9 958***
Other comprehensive income	*0*	*0*	*-17*	*0*	***-17***
Total comprehensive income for 2016	0	0	-17	9 958	**9 941**
Balance as at 31.12.2016	**56 500**	**888**	**-40**	**17 647**	**74 995**
Carrying amount of holdings under control and significant influence	0	0	0	-325	-325
Value of holdings under control and significant influence under equity method	0	0	0	3 574	3 574
Adjusted unconsolidated equity as at 31.12.2016	**56 500**	**888**	**-40**	**20 896**	**78 244**

Signatures of the management board to the consolidated annual report

The management board has prepared the management report and the consolidated financial statements of AS LHV Pank for the financial year ended on 31 December 2016. The consolidated financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

22.02.2017

/signed/
Erki Kilu ______________________
Chairman of the management board

/signed/
Andres Kitter ______________________
Member of the management board

/signed/
Indrek Nuume ______________________
Member of the management board

/signed/
Jüri Heero ______________________
Member of the management board

/signed/
Meelis Paakspuu ______________________
Member of the management board

/signed/
Martti Singi ______________________
Member of the management board

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of AS LHV Pank

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS LHV Pank (the Company) and its subsidiary (together the Group) as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

We audited the Group's consolidated financial statements that comprise:
- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of profit or loss and other comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of 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 contained in the consolidated annual report in addition to the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

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

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

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

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.

- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

AS PricewaterhouseCoopers

/signed/	/signed/
Ago Vilu Auditor's Certificate No.325	Verner Uibo Auditor's Certificate No.568

28 February 2017

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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 LHV Pank proposes to the general meeting of shareholders to distribute the profit of the financial year 2016 as follows:

- transfer EUR 604 thousand to statutory reserve capital
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 11 476 thousand to the accumulated deficit.

Signatures of the supervisory board to the annual report

The supervisory board has reviewed the annual report which consists of the management report and the financial statements, the independent auditor's report and the profit allocation proposal, and approved it for presentation at the general meeting of shareholders.

22.02.2017

Madis Toomsalu ___________________
Chairman of the supervisory board

Rain Lõhmus ___________________
Member of the supervisory board

Andres Viisemann ___________________
Member of the supervisory board

Tiina Mõis ___________________
Member of the supervisory board

Raivo Hein ___________________
Member of the supervisory board

Heldur Meerits ___________________
Member of the supervisory board

Allocation of income according to EMTA classificators

EMTAK	Activity	2016	2015
66121	Security and commodity contracts brokerage	4 527	3 604
64191	Credit institutions (banks) (granting loans)	33 472	24 418
64911	Finance lease	1 600	1 356
	Total income	**39 599**	**29 378**