AS LHV Pank
Consolidated Annual Report 2017

(Translation of the Estonian original)

Consolidated Annual Report	**01.01.2017 – 31.12.2017**
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	Madis Toomsalu
	Rain Lõhmus
	Andres Viisemann
	Tiina Mõis
	Heldur Meerits
	Raivo Hein
Auditor	
Auditors' legal name	AS PricewaterhouseCoopers
Auditors' Commercial Registry no.	10142876
Auditors' legal address	Pärnu mnt.15, 10141 Tallinn, Estonia

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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 offers all the necessary universal banking services. For corporate clients, the Bank offers flexible and suitable financing and managing of everyday financial operations through different payment solutions. The products and services provided by the Bank are simple, transparent and appropriate. Customer interaction is mainly conducted using modern electronic communication channels. Costs avoided will reach the customers of the Bank through affordable cost of everyday service.

The branch offices of the Bank are located in Tallinn and Tartu. The Bank employs more than 290 people. Over 130 000 customers use the services of the Bank. The Bank consolidates 65% of its subsidiary AS LHV Finance that provides hire-purchase and consumer finance services (hereinafter: the Group).

Business activities

In 2017, opening of new accounts and customer activity continued to grow at very good momentum. The number of customers increased by 23 000. 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 98% year-on-year, amounting to EUR 1 551 million (2016: EUR 785 million). A very large part of this increase was related to the deposits of financial intermediaries, amounting to EUR 607 million at the end of the year 2017. The Bank continued with focusing on growing the volume of stable deposits and reducing interest expense. The European Central Bank continued to keep the base interest rates low, which resulted in increased costs of holding liquid assets. The proportion of demand deposits continued to grow, reaching 92% of all deposits at the end of the year (31.12.2016: 81%). The Bank concluded its first loan agreement with an international creditor – European Investment Fund. The loan amount is EUR 12.5 million and the period is 10 years. The funds are intended to be lent to small and medium-sized enterprises. The conditions of the loan are very good; and without collateral, which provides a good basis for negotiations with potential lenders in the future. By the end of the year, the loan amount taken into use amounted to EUR 6 million.

The loan portfolio volume grew by 35% year-on-year and amounted to EUR 719 million (2016: EUR 532 million). Corporate loans, which also include retail loans for companies, increased by 30% to EUR 585 million (2016: EUR 449 million) and loans issued to private individuals increased by 63% to EUR 141 million (2016: EUR 87 million). The majority of the loan portfolio still consist of corporate loans, followed by mortgage loans, leasing, consumer loans and hire-purchase. The Bank has issued a loan to UAB Mokilizingas, the other subsidiary of the parent company AS LHV Group, the amount of which at the year-end was EUR 36.8 million (2016: EUR 30.5 million). The net profit of the Bank in 2017 amounted to EUR 15.5 million (2016: EUR 13.2 million). During the year, the Bank was able to maintain the fee and commission income at a very good level. At the same time, the profitability of the loan portfolio decreased due to the lower share of the loans with higher margins.

On 27.11.2017, the Estonian Financial Supervision Authority, and on 27.01.2018, the Financial Conduct Authority of the UK made a positive decision to establish the branch of the Bank in the UK, after which the Bank started registering the branch in the Registrar of Companies.

The Bank of Estonia made a decision to consider AS LHV Pank as a systemically important bank starting from 01.01.2018.

During 2017, the auditor of the Group has provided other assurance services, which are required to be performed by auditors according to Credit Institutions Act, Securities Market Act and Investment Funds Act.

Product development

At the beginning of the year, a new offer of Private Banking was completed. The new offer consists of 1% of interest from the amount for up to EUR 1 million on the demand deposit, Private Banking debit card and Platinum credit card, which includes travel insurance for the whole family of the customer, purchase insurance, unrestricted access rights of Priority Pass and the travel services of Estravel Platinum Club. At the beginning of the year, a completely new and world-class portfolio management reporting system was introduced to customers.

A Salary Payment solution for small enterprises was introduced to the market in cooperation with the Estonian Tax and Customs Board. When processing the salary payment in the Internet a special form for the payment can be selected and using that special form data exchange with the Estonian Tax and Customs

Board will occur. Thereafter the Estonian Tax and Customs Board automatically prepares a declaration of income and social taxes for the enterprise taking into account all the necessary taxes. There is an option for enterprises to immediately pay the taxes or to make it transfer automatically the next month. The Salary Payment solution was awarded with this year's Innovation Award by the Estonian Banking Association.

The chat robot connected to the Bank’s Facebook page, also known as chatbot, is a recurring question type robot that searches for answers to the questions of the customers from a range of different responses related to a variety of topics.

The Bank introduced Smart-ID and video recognition as authentication tools. Smart-ID is the fastest way to identify yourself in the electronic channels of the bank. Via video identification, there is an opportunity to become a client of the bank without physically getting to the bank. By the end of 2017, 650 customers signed the client contract via video identification.

Developments in mobile and Internet banking continued. As a new service for the customers, all the loan agreements of the customers are now visible. The Internet bank was supplemented by the option of prematurely ending standard credit agreement for the customer. The mobile bank was supplemented by the information on Pillar 2 Pension Funds.

In the beginning of 2017, the subsidiary of the Bank, AS LHV Finance, introduced car loan and home repair loan to the market. In the second half of the year, the hire-purchase product for smart phones called Uus & Parem was added to the assortment in cooperation with Euronics. The main goal of new products is to get new customers with lower risk profile in order to increase the volume of the loan portfolio faster.

Smaller innovations like mTasku in cooperation with Telia, and LHV’s home insurance in cooperation with Compensa were introduced to the market. To reduce card payments fraud on the Internet the 3-D Secure was taken into use.

Organization

The organizational structure of the Bank is divided into four major business areas: Retail Banking, Private Banking, Financial Intermediary Banking and Corporate Banking; and three major support services: Information Technology, Finance and Operations, and Risk Management. Marketing and Communication, and Human Resource Department operate throughout the Bank.

In the end of March, the Lithuanian cross-border branch office was closed. The Bank’s activity in Lithuania was small, providing only brokerage services. The Bank bases its plans primarily on the business interests of its customers and follows them. Estonian companies today need services and support rather in the direction of Western Europe. On this basis, the Financial Intermediary Banking business line was allocated from Retail Banking in the middle of 2017.

The number of employees of the Group increased by 39 people in a year to 309 employees (including passive and part-time), including 29 employees of AS LHV Finance. The number of active full-time equivalent employees was 288 in total.

During the year, the Bank was recognized with several significant awards. For the fifth time, NASDAQ named the Bank the Member of the Year of the Baltic stock Exchange market. For the second year in a row, a market survey company, Dive, ranked AS LHV Pank as the bank with the best customer service in Estonia. In March, the Bank received a third place as the most preferred employer in IT sector in the annual reputation survey conducted by EMOR.

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 Cyclist Union, the Estonian Entrepreneur of the Year contest, the Gazelle Movement, the Tallinn Restaurant Week, Enn Soosaar Foundation and the Estonian Music.

Financial results

In 2017, the net profit of the Bank increased by 17% compared to the previous year, amounting to EUR 15.5 million (2016: EUR 13.2 million). Net interest income increased by 22% and net fee and commission income increased by 35%. Financial income decreased by 31% compared to the previous year.

The increase of the net interest income is attributable to the increase in of the 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 16% year-on-year, which was expected given the current phase of high growth and new business development.

Loan losses were 103% higher compared to the previous year.

The total volume of the Bank's loan portfolios at the end of December amounted to EUR 719 million (31.12.2016: EUR 532 million). The portfolio volume grew by 35% year-on-year. The majority of the loan portfolio consists of loans for companies, which grew by 34% year-on-year to EUR 505 million (31.12.2016: EUR 377 million). The Bank has issued a loan to UAB Mokilizingas, the other subsidiary of the parent company AS LHV Group, the amount of which at the year-end was EUR 36.8 million (2016: EUR 30.5 million). The portfolio of loans issued to private individuals increased by 63% to EUR 141 million (2016: EUR 87 million).

The volume of deposits of the Bank grew by 98% year-on-year and reached EUR 1 551 million by year-end (31.12.2016: EUR 785 million).

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 91% of all deposits as at the end of December (31.12.2016: 81%).

Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Bank, calculated according to the definitions of the Basel Committee, was 121% at the end of December (31.12.2016: 221%). The Bank includes cash and bond portfolios, accounting for 58% of the balance sheet total, among its liquidity buffer (31.12.2016: 40%). The Bank's loan-to-deposit ratio at the end of 2017 was 46% (31.12.2016: 68%).

The debt security portfolio decreased by 23% during 2017 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 the European Central Bank instead.

AS LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) for EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2017, the loan amount taken into use by the Bank amounted to EUR 6 million.

As a result of the issue of shares by the Bank's parent company, AS LHV Group, the Bank's share capital was increased by EUR 3 million.

The Bank's level of own funds as at 31.12.2017 was EUR 110.4 million (31.12.2016: EUR 96.5 million). The Bank is well capitalized as at the end of the reporting period with a capital adequacy level of 16.8% (31.12.2016: 18.7%).

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 Group 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 31.12.2017 was 4.99% (31.12.2016: 8.2%). Leverage ratio is calculated as bank's total Tier 1 own funds divided by its total risk exposure measure (including 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)*	**2017**	**2016**	**change**
Net interest income	31.13	25.55	22%
Net fee and commission income	7.70	5.72	35%
Other financial income	0.69	1.00	-31%
Total net operating revenues	39.52	32.27	22%
Other income	0.01	0.39	-97%
Operating expenses	-20.42	-17.64	16%
Loan losses	-3.58	-1.77	103%
Net profit	15.53	13.25	17%

Volumes, *(EUR million)*	**31.12.2017**	**31.12.2016**	**change**
Loan portfolio	719.4	531.8	35%
Bond portfolio	50.0	64.9	-23%
Deposits	1 551.0	785.0	98%
Equity	99.5	80.2	24%
Number of customers holding assets in bank	133 655	112 998	18%

Key figures, *(EUR million)*	**2017**	**2016**	**change**
Net profit	15.5	13.2	17%
Net profit attributable to owners of the parent	13.9	12.1	15%

Average equity	89.8	70.8	27%
Return on equity (ROE) %*	16.0	17.1	-1.1
Average assets	1 320	821	60%
Return on assets (ROA) %	1.1	1.5	-0,4
Net interest income	31.1	25.6	22%
Average assets exposed to interest risk	1 314	817	61%
Net interest margin (NIM) %	2.37	3.13	-0.76
Spread %	2.33	3.10	-0.77
Cost / Income ratio %	52%	54%	-2

* 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 interest earning assets * 100

Spread = Yield on interest earning assets – 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 interest bearing liabilities * 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 organized by Risk management unit. The purpose of the risk management is to identify, assess, monitor and manage all risks related with the Group in order to ensure the Group's reliability, stability and profitability. In the Group, risk management is based on three lines of defense. Business units as the first line of defense are responsible for taking and managing risks. The second line of defense – which includes the risk management unit – is responsible for developing and maintenance of the risk management framework. The third line of defense, 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 *(EUR thousand)*	**31.12.2017***	**31.12.2017**	**31.12.2016**
Paid-in share capital	59 500	59 500	56 500
Statutory reserves paid in from net profit	1 528	1 528	848
Accumulated profit/deficit	19 891	19 891	7 838
Intangible assets (subtracted)	-951	-951	-772
Net profit for accounting period	13 909	13 909	12 096
Dividend offer (with tax)	-4 188	0	0
Total Tier 1 capital	**89 689**	**93 877**	**76 510**
Subordinated debt	20 000	20 000	20 000
Total Tier 2 capital	**20 000**	**20 000**	**20 000**
Net own funds for capital adequacy calculation	**109 689**	**113 877**	**96 510**
Capital requirements			
Central governments and central banks under standard method	945	945	1 498
Credit institutions and investment companies under standard method	5 886	5 886	6 190
Companies under standard method	465 202	465 202	364 895
Retail claims under standard method	107 197	107 197	87 549
Public sector under standard method	185	185	216
Housing real estate under standard method	20 039	20 039	7 079
Overdue claims under standard method	20 915	20 915	1 869
Other assets under standard method	10 169	10 169	4 654
Total capital requirements for covering the credit risk and counterparty credit risk	**630 539**	**630 539**	**473 950**
Capital requirement against foreign currency risk	409	409	225
Capital requirement against interest position risk	412	412	1 709
Capital requirement against equity portfolio risks	585	585	601
Capital requirement against credit valuation adjustment risks under standard method	15	15	24
Capital requirement for operational risk under base method	47 754	47 754	39 664
Total capital requirements for adequacy calculation	**679 714**	**679 714**	**516 173**
Capital adequacy (%)	**16.14**	**16.75**	**18.70**
Tier 1 Capital Ratio (%)	**13.20**	**13.81**	**14.82**

*audited numbers including the dividend offer

Management and compensation policy

AS 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.

The Management Board calls General meetings of shareholders. 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 25.14% and Andres Viisemann and persons related to him with 9.87%.

Supervisory Board

The Supervisory Board is a governing body of AS LHV Pank that plans the activities of AS LHV Pank, organizes the management of AS 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 AS 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 organizes the Supervisory Board's activities.

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

Management Board

The Management Board is a governing body of AS LHV Pank that represents and manages AS 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 organizes the work of the Management Board. The company may be represented by two Management Board members jointly in each transaction.

The Management Board of AS 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 analyze 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 organization 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 AS 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 AS 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 AS LHV Pank. A supplementary monthly incentive salary is paid to a small number of employees directly engaged in sales and new customer acquisition. The Supervisory Board determines the base salaries of members of the Management Board and the Management Board determines the base salaries of employees. The Chairman of the Management Board is employed based on a 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 labor market that is equal to competitors and comprehensive. Similarly to 2014, the share options were issued in 2015, in 2016 and in 2017. In 2017, the options issued in 2014 were fully exercised.

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 2017, share options were granted to six members of the Management Board of AS LHV Pank and fifty-four employees in the total amount of EUR 1 204 thousand. In 2016, share options were granted to six members of the Management Board of AS LHV Pank and thirty-six employees in the total amount of EUR 598 thousand. In 2015, share options were granted to five members of the Management Board of AS LHV Pank and thirty-five employees in the total amount of EUR 510 thousand. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options. Share options issued in 2014 were exercised in 2017, when shares with nominal value of EUR 1 could be acquired for EUR 2 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 EUR 1 can be acquired for EUR 2.4 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 EUR 1 can be acquired for EUR 3.0 per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share. Similarly to previous years, share options are most probably issued also in 2018.

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, 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	2 408	33	2 441	160
Private and corporate banking	1 059	12	1 071	33
Support services	2 557	31	2 588	117
Information technology	1 808	3	1 811	77
Total	**7 832**	**79**	**7 911**	**387**

Business environment

The global economic picture continued to improve in 2017, and this year it is expected to accelerate the cyclical growth of the global economy for the second year in a row. The recovery is supported by a significant upturn in trade and the growth of investment and industrial production, with improved business and consumer confidence. Although the lack of pressure on inflation so far has promised to continue with supportive monetary policy, the developed country's central banks are quietly following the US leadership in switching the direction. The volatile asset values reflect the historically low volatility environment that emerged from the expansive monetary policy of the past, in which investors are increasingly reluctant to accept the expected long-term return on their risk. Geopolitical tensions have decreased compared to the summer of last year.

Anti-EU movements did not achieve any significant success in the elections held in major Member States of the European Union last year and therefore Brussels and Paris are expected to lead in taking a direction on even closer integration between the Member States. Separatist movements have been sent a robust message both in the form of the difficult Brexit process as well as leaving the Catalonian campaign for independence to be settled domestically. The next important milestone is the general elections in Europe's fourth largest economy, Italy, on 4 March.

Economic growth in the euro area sped up to 2.6%, which is the fastest pace in the past six years. The general economic outlook has improved, manifesting on a larger scale in more countries and sectors. The good outlook allows the European Central Bank to exit the former expansive monetary policy – the purchase of bonds will continue according to the existing plan in a reduced volume until September, but an increase in interest rates is still not expected until the next year. Consumer prices rose by 1.4% in December and have remained in a narrow range since August. Inflationary pressures continue to be low, expected to remain below the long-term average of 2.0%, established as the objective by the European Central Bank. The consensus forecasts that economic growth in the euro area will slow down to 2.2% in 2018 and to 1.9% in 2019. A continual drop in unemployment and a growth in the labor force participation rate, which should sooner or later bring about the long-awaited acceleration in the growth of wages, support consumption. The increased order volumes and use of production capacities should stimulate a growth in investments. After years of tightening the belt, governments are expected to loosen their fiscal policy. The continued strengthening of the euro against other currencies is seen as somewhat of a worry and seems to be exerting pressure on the competitiveness of the export sector.

The economic sentiment indicator of Estonia's key trade partners in Europe is close to the all-time high achieved during the economic boom in 2007 and has risen to the highest level of the past 17 years across the 19 euro zone countries.

In Sweden, economic growth increased to 2.9% in the third quarter, which was significantly below expectations. Continually strong domestic demand and a growth in investments had a positive effect, but a robust increase in import volumes had a negative impact on net export. In September, Sweden's real estate market experienced a price turnaround and the prices of dwellings have been dropping for four months in a row by now. This is a welcomed phenomenon, but it is important to ensure that the price correction remains within reasonable limits. Currently, market participants are not concerned – sentiment indicators and consumer confidence remain high and real estate prices are expected to stabilize this year. Sweden will hold parliamentary elections in September and the expected even results are anticipated to bring about a probability of expansive fiscal policy. The consensus forecasts that Sweden's economic growth will slow down to 2.4% in 2018 and to 2.2% in 2019. Estonia's interests revolve around the continual growth of Swedish import volumes, the outlook for which is good, with Swedish banks being investor friendly.

The Finnish economy continued at a good pace in the third quarter, growing by 3.0%. The economic sentiment is strong, on a broad basis. The main driving engines were a growth in investments and net export, with private consumption also remaining strong. The economic growth of 2017 turned out to be the fastest in the past nine years for Finland. The consensus forecasts that the Finnish economic growth will slow down to 2.6% in 2018, but the economic sentiment will remain strong on a broad basis. The 2019 economic growth is expected to be at 2.2%. Similarly to Sweden, Estonia's interests lie in further growth of Finnish import volumes, the prospects for which are good.

Economic growth in Lithuania – a major destination market for LHV – continued at a good pace, accelerating to 3.4% in the third quarter. The economic sentiment is strong, on a broad basis, but the rapid growth of private consumption in Lithuania is being affected by one of the highest rates of inflation in the euro zone. On a balancing note, the economy was supported by an increase in investments, which should gain a more significant role in the coming years. Strong external demand, a lack of qualified labor and a record use of production capacities – all this is forcing companies to make new investments. The volume of projects financed with the EU support is also increasing. The consensus forecasts that economic growth in Lithuania will slow down to 3.2% in 2018 and to 3.0% in 2019.

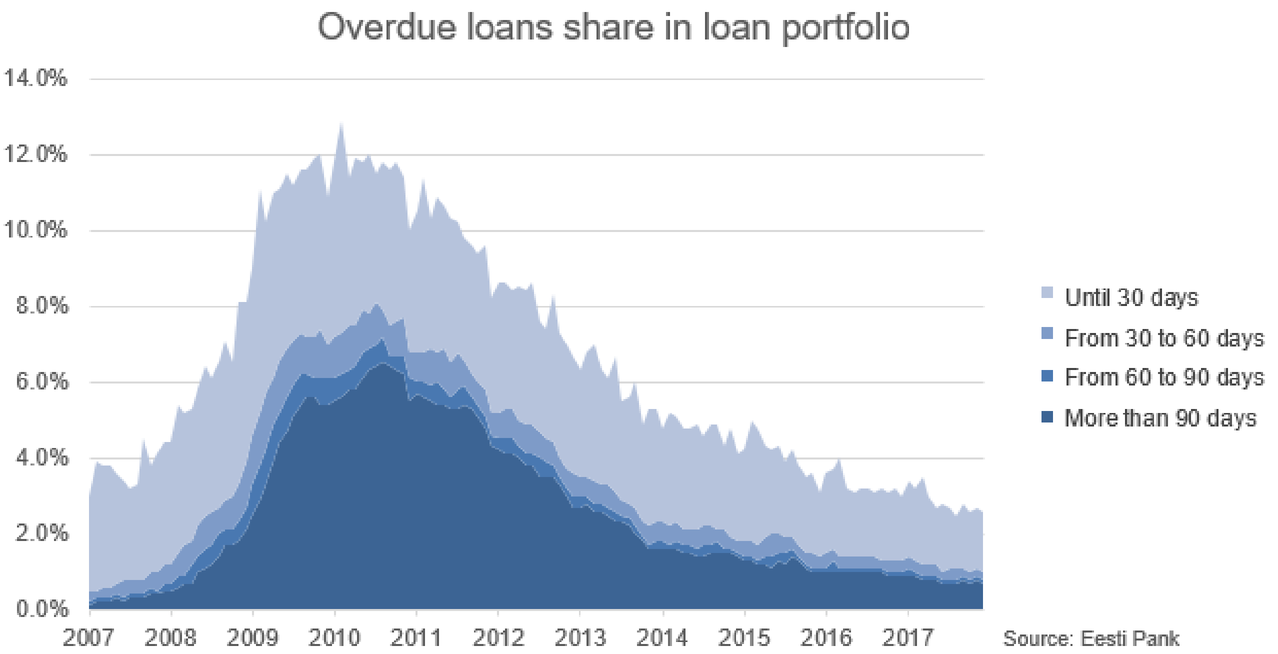
Economic growth in Estonia slowed down to 4.2% in the third quarter, which is nevertheless a very high pace. This was supported mainly by domestic demand driven by investments and private consumption. The construction sector's contribution to economic growth was again one of the largest. There was a decrease in the export of low-margin electronic equipment, which had largely been fueling the decrease in export volumes, and the negative effect of net export. The inflation rate, which rocketed last year, significantly slowed the growth in private consumption. Consumer prices increased by 3.4% in December. An important aspect is that despite the continuation of the rapid growth in wages, corporate profits have recovered and productivity has improved. The sentiment indicators reflecting the different sectors remain strong, continuing to indicate a positive sentiment. In its forecast published in December, the Bank of Estonia considerably raised its expectations of economic growth. It is estimated to remain around 4.2% this year and 3.1% in 2019. Private consumption and investments will be the driving engines, while the contribution of net export into economic growth is negative. Private consumption continues to be positively influenced by a rapid increase in wages and the steep rise of the income-tax-free minimum wage accompanied by a marginal decrease in the pace of inflation. Investments are driven by a more active use of the resources of the EU structural funds in the public sector. Despite strong external demand, the investment volumes of enterprises will not grow in 2018 due to the impact of ship purchases in the reference base. The key problems revolve around the shortage of labor and its potential magnification in connection with the increase in general government expenditure. The priority lies in the achievement of sustainable, long-term economic growth, balanced between the different sectors.

											Eesti Pank forecast	
Key economic indicators of Estonia*	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017E**	**2018E**
Nominal GDP (EUR billion)	16.25	16.52	14.15	14.72	16.67	17.93	18.89	19.76	20.25	21.20	22.99	24.94
GDP volume**	7.7%	-5.4%	-14.7%	2.3%	7.6%	4.3%	1.4%	2.8%	1.4%	2.1%	4.3%	4.2%
Private consumption expenditures***	9.0%	-4.9%	-15.3%	-1.6%	3.7%	4.3%	3.8%	3.3%	4.7%	4.4%	2.7%	5.1%
Government consumption expenditures	6.6%	4.6%	-3.2%	-0.4%	1.3%	3.2%	1.9%	2.7%	3.4%	1.9%	1.2%	2.1%
Fixed capital formation	10.3%	-13.1%	-36.7%	-2.7%	34.4%	12.7%	-2.8%	-8.1%	-3.3%	-1.2%	13.3%	2.0%
Exports	12.6%	0.9%	-20.3%	24.0%	24.2%	4.8%	2.3%	3.1%	-0.6%	4.1%	2.1%	2.6%
Imports	13.0%	-6.2%	-30.6%	21.2%	27.2%	9.7%	3.2%	2.2%	-1.4%	5.3%	3.1%	4.5%
CPI	6.6%	10.4%	-0.1%	3.0%	5.0%	3.9%	2.8%	-0.1%	-0.5%	0.1%	3.5%	3.2%
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%	5.9%	7.3%
Current account (% of GDP)	-15.0%	-8.7%	2.5%	1.8%	1.3%	-1.9%	-0.4%	0.9%	2.2%	1.9%	2.1%	0.3%
Budget balance (% of GDP)*****	2.7%	-2.7%	-2.2%	0.2%	1.2%	-0.3%	-0.2%	0.7%	0.1%	-0.3%	-0.5%	-0.4%

* Numbers reported are annual rates of change in per cent, if not noted otherwise; ** GDP and its components are chain-linked; *** including NPISH; **** employment by domestic production units; ***** the budget balance forecast considers only those measures on which sufficient information was available at the date of the forecast Source: National Statistics, Eesti Pank

LHV is expecting the positive trends in the Estonian economy to continue in the next twelve months. The economy will continue to grow quickly and exceed the potential long-term sustainability level. The lack of available resources makes it increasingly important to enhance the adaptability and success in productivity enhancement of companies, which requires additional investments to continue vigorously.

By economic sectors, the risks remain higher-than-average in the overheating construction sector, and transport and warehousing sectors. LHV remains conservative with regard to the real estate market, monitoring the dynamics on the local and Scandinavian markets and paying particular attention to developments in Sweden. Rental property projects involve a risk of insufficient demand for absorbing the developed volumes in the near future, with corrections expected in either rental prices or vacancy rates.



On a positive note, the financing environment remains favorable. The balance of loans taken from credit institutions continues to grow, but the pace has somewhat slowed down compared to the beginning of the year. The growth of housing loans has been steadily increasing. The loan to deposit ratio and overdue loans have maintained their post-crisis lows. With the record-low interest rates and tight 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

(EUR thousand)	Note	2017	2016
Interest income		35 492	29 839
Interest expense		-4 358	-4 287
Net interest income	5	**31 134**	**25 552**
Fee and commission income		13 096	9 760
Fee and commission expense		-5 401	-4 044
Net fee and commission income	6	**7 695**	**5 716**
Net gains from financial assets measured at fair value	10	420	1 103
Foreign exchange rate gains/losses		265	-105
Net gains from financial assets		**685**	**998**
Other income		6	385
Staff costs	7	-11 287	-9 676
Administrative and other operating expenses	7	-9 128	-7 961
Operating profit		**19 105**	**15 014**
Impairment losses on loans and advances	11	-3 584	-1 767
Net profit for the year		**15 521**	**13 247**
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Revaluation of available-for-sale financial assets	9	76	-17
Net profit and other comprehensive income for the year		**15 597**	**13 230**
Net profit attributable to:			
Owners of the parent		13 909	12 097
Non-controlling interest		1 612	1 150
Net profit for the year		**15 521**	**13 247**
Net profit and other comprehensive income attributable to:			
Owners of the parent		13 985	12 080
Non-controlling interest		1 612	1 150
Net profit and other comprehensive income for the year		**15 597**	**13 230**

Notes on pages 18 to 69 are an integral part of the consolidated financial statements.

Consolidated statement of financial position

(EUR thousand)	**Note**	**31.12.2017**	**31.12.2016**
Assets			
Due from central bank	8	920 714	265 127
Due from credit institutions	8	20 991	27 171
Due from investment companies	8	14 186	8 073
Available-for-sale financial assets	9	775	799
Financial assets at fair value through profit or loss	10	49 239	64 197
Loans and advances to customers	11	719 390	531 761
Receivables from customers	12	7 357	1 699
Other financial assets	13	2 289	941
Other assets	13	836	714
Tangible assets	14	1 225	1 002
Intangible assets	14	952	771
Total assets		**1 737 954**	**902 255**
Liabilities			
Deposits from customers and loans received	15	1 556 573	785 409
Financial liabilities at fair value through profit or loss	10	2	209
Accounts payable and other liabilities	16	61 858	16 469
Subordinated debt	18	20 000	20 000
Total liabilities		**1 638 433**	**822 087**
Equity			
Share capital	19	59 500	56 500
Statutory reserve capital	19	1 492	888
Other reserves	9	36	-40
Retained earnings		34 963	20 902
Total equity attributable to owners of the parent		**95 991**	**78 250**
Non-controlling interest		3 530	1 918
Total equity		**99 521**	**80 168**
Total liabilities and equity		**1 737 954**	**902 255**

Notes on pages 18 to 69 are an integral part of the consolidated financial statements.

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Consolidated statement of cash flows

(EUR thousand)	Note	2017	2016
Cash flows from operating activities			
Interest received		35 133	29 409
Interest paid		-4 642	-4 466
Fees and commissions received		13 107	9 760
Fees and commissions paid		-5 412	-4 044
Other income received		6	385
Staff costs paid		-10 386	-9 101
Administrative and other operating expenses paid		-8 254	-7 147
Cash flows from operating activities before change in operating assets and liabilities		**19 552**	**14 796**
Net increase/(decrease) in operating assets:			
Net acquisition/disposal of trading portfolio		278	-287
Loans and advances to customers		-196 515	-128 433
Mandatory reserve at central bank	8	-7 639	-1 598
Security deposits	13	-1 348	-1
Other assets		-92	-171
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers	15	791 270	187 136
Term deposits of customers	15	-25 052	-31 506
Loans received	15	6 000	0
Repayments of loans received	15	-779	-14 731
Financial liabilities held for trading at fair value through profit or loss		-207	120
Other liabilities		45 226	-1 699
Net cash from/(used in) operating activities		**630 694**	**23 626**
Cash flows from investing activities			
Purchase of tangible and intangible assets	14	-1 277	-1 362
Proceeds from sale of tangible and intangible assets		0	10
Proceeds from disposal and redemption of investment securities	9	124	3 608
Net changes of investment securities at fair value through profit or loss	10	15 075	35 788
Net cash from/(used in) investing activities		**13 922**	**38 044**
Cash flows from financing activities			
Paid in share capital	19	3 000	5 000
Proceeds from subordinated debt	18	0	5 000
Net cash from financing activities		**3 000**	**10 000**
Effect of exchange rate changes on cash and cash equivalents		**265**	**-105**
Net increase/(decrease) in cash and cash equivalents		**647 881**	**71 565**
Cash and cash equivalents at the beginning of the year	8	292 635	221 070
Cash and cash equivalents at the end of the year	**8**	**940 516**	**292 635**

Notes on pages 18 to 69 are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(EUR thousand)	Share capital	Statutory reserve capital	Other reserves	Accumulated deficit/ retained earnings	Total	Non-controlling interest	Total equity
	Attributable to owners of the parent						
Balance as at 01.01.2016	**51 500**	**419**	**-23**	**8 705**	**60 601**	**768**	**61 369**
Transfer to statutory reserve capital (Note 19)	0	469	0	-469	0	0	**0**
Paid in share capital (Note 19)	5 000	0	0	0	5 000	0	**5 000**
Share options (Note 19)	0	0	0	569	569	0	**569**
Net profit of the year	*0*	*0*	*0*	*12 097*	*12 097*	*1 150*	***13 247***
Other comprehensive loss	*0*	*0*	*-17*	*0*	*-17*	*0*	***-17***
Net 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**
Balance as at 01.01.2017	**56 500**	**888**	**-40**	**20 902**	**78 250**	**1 918**	**80 168**
Transfer to statutory reserve capital (Note 19)	0	604	0	-604	0	0	**0**
Paid in share capital (Note 19)	3 000	0	0	0	3 000	0	**3 000**
Share options (Note 19)	0	0	0	756	756	0	**756**
Net profit of the year	*0*	*0*	*0*	13 909	13 909	1 612	**15 521**
Other comprehensive income	*0*	*0*	*76*	0	76	0	**76**
Net profit and other comprehensive income for 2017	0	0	76	13 909	13 985	1 612	**15 597**
Balance as at 31.12.2017	**59 500**	**1 492**	**36**	**34 963**	**95 991**	**3 530**	**99 521**

Notes on pages 18 to 69 are an integral part of the consolidated financial statements.

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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 2017 for AS LHV Pank (hereinafter the Bank) and its subsidiary AS LHV Finance (together hereinafter: the Group or LHV). AS LHV Pank holds 65% interest in AS LHV Finance.

AS LHV Pank (Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia and until 31.03.2017 to customers in Lithuania. There are offices for client servicing in Tallinn and Tartu (Vilnius was closed on 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 31.12.2017, the Group employed 291 people, including 16 non-active employees (31.12.2016: 261 people, 13 non-active employees). LHV Finance offers hire-purchase services to merchants and consumer loans.

The Management Board approved the consolidated annual report (incl. financial statements) on 22 February 2018. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 25.14% of the voting rights and Andres Viisemann, who owns 9.87% of the voting rights (see also Note 19), have significant influence over AS LHV Group.

The consolidated annual report approved by the Management Board shall be authorized 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 2017 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 2017 and ended at 31 December 2017. 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 2017. 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 2017.

Disclosure Initiative - Amendments to IAS 7 (effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. The Group has disclosed the required information related to the new standard in the Note 18.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning

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on or after 1 January 2017 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). Early application is permitted but the Group does not intend to early adopt the standard. The Group intends to use relief of not restarting 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 amortized cost (AC)
- 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 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). In order to assess the business model, the Group has dividend its financial assets into portfolios and/or sub-portfolios based on how groups of financial assets are managed together to achieve a particular business objectives. If a debt instrument is held to collect, it may be carried at amortized 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 impairments in IFRS 9 are based on an expected credit loss model 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 expected loss. In stage 2 and 3, the provisions should equal the lifetime expected losses.

One important driver for size of provisions under IFRS 9 is the trigger for transforming an asset from stage 1 to stage 2. As a consequence of implementing IFRS 9, the provisions of loans increased by EUR 712 thousand. 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 provisions under IFRS 9 will be calculated as the exposure at default times the probability of default times the loss given default. 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, LHV 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.

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 LHV, as LHV is currently not using hedge accounting. At the same time, we see that the regulation changes will generate some new possibilities to LHV to start using hedge accounting for reducing volatility in financial statements for positions, which are hedged with ones treated differently in accounting.

The following table shows the carrying amount of financial assets taking into account their historical measurement categories in accordance with IAS 39 and the new measurement categories for the transition to IFRS 9 on 01.01.2018:

(EUR thousand)	**Category**		Carrying amount according to IAS 39 (as at 31.12.2017)	**Impact** Conversion	Carrying amount according to IFRS 9 (as at 31.12.2017)
	IAS 39	**IFRS 9**		**ECL**	
Due from credit institutions (Note 8)	L&R	AC	20 911	0	20 911
Due from investment companies (Note 8)	L&R	AC	14 186	0	14 186
Due from central bank (Note 8)	L&R	AC	920 714	0	920 714
Total Cash and cash equivalents			**955 811**	**0**	**955 811**
Debt instruments (Note 9)	AFS	FVOCI	555	0	555
Debt instruments (Note 10)	FVTPL	FVTPL	49 239	0	49 239
Total Debt instruments			**49 794**	**0**	**49 794**
Equity instruments (Note 9)	AFS	FVOCI	220	0	220
Total Equity instruments			**220**	**0**	**220**
Loans and advances to customers (Note 11)	L&R	AC	719 390	-712	718 678
Receivables from customers (Note 12)	L&R	AC	7 357	0	7 357
Other financial assets (Note 13)	L&R	AC	2 289	0	2 289
Total Financial assets			**1 734 861**	**-712**	**1 734 149**

There were no reclassifications as financial assets were in the same category according to IAS 39 and IFRS 9.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time 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 recognize: (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. As at 31.12.2017, the Group had unilaterally non-cancellable operating lease payables in total amount of EUR 1 460 thousand (Note 17). From 01.01.2019 the total amount of unilaterally non-cancellable operating lease payables will be recognized on the balance sheet as both, assets and liabilities, therefore the new standard will increase the Group’s balance sheet.

IFRS 15, Revenue from contracts with customers (effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognized 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 recognized, 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 recognized if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalized and amortized over the period when the benefits of the contract are consumed. The Group does not have significant impact on transition to IFRS 15.

Revenue from Contracts with Customers - Amendments to IFRS 15 (effective for annual periods beginning on or after 1 January 2018). 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 license should be recognized 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 assesses the impact of the new standard on its financial statements insignificant.

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 2017 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) and business operations. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed. According to the acquisition method, the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary are recognized at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

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

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognized 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 unrealized gains on transactions between group companies are eliminated; unrealized 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 24), 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 owners 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)**		**31.12.2017**	**31.12.2016**
Financial assets	Loans and receivables	Loans and advances to banks and investment companies		955 891	300 371
		Loans and advances to customers	Loans to legal entities	579 588	446 188
			Loans to individuals	139 802	85 573
		Other receivables		7 357	1 699
		Other financial assets		2 289	941
	Financial assets at fair value through profit or loss	Securities held for trading	Equity securities	71	130
			Listed debt securities	49 138	63 817
			Derivatives	30	250
	Available-for-sale financial assets	Investment securities	Listed debt securities	550	579
			Equity securities	220	220

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 recognized at the trading date in the statement of financial position. Financial instruments included in this category are initially recognized 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' amortized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognized at fair value, plus all directly attributable transaction costs incremental to their acquisitions and they are subsequently measured at amortized 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 recognized in profit or loss. Other changes in fair values of these financial assets are recognized 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 recognized at fair value plus transaction costs, and are derecognized only when they are repaid or written-off. After initial recognition, the Group recognizes loans and receivables at amortized 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 capitalized 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 recognized 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 recognized 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 recognized at fair value plus transaction costs and subsequently measured at amortized 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 amortized cost

Impairment losses are recognized 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 affecting 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 amortized 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 recognized 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 collateralized 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 recognized (such as an improvement in the debtor’s credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account through profit or loss for the year. The reversal of the impairment loss is recognized 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 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 recognized 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 recognized 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 recognizing 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 “Administrative and other operating expenses” or “Other income”.

2.8 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licenses. 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 amortization and any accumulated impairment losses. Amortization is calculated on a straight-line basis. The annual amortization 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 recognized 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.

2.9 Impairment of assets

Assets that have indefinite useful lives (including goodwill) are not subject to amortization but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts.

Assets with an unlimited useful life and depreciable assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount.

An impairment loss is recognized for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount of the asset is the higher of an asset’s fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit).

Impairment losses are recognized in profit or loss.

At each following balance sheet date, assets that have been written down are assessed to determine whether their recoverable amount has increased (except for impairment losses of goodwill that are not reversed). If the impairment test indicates that the recoverable amount of an asset or asset group (cash-generating unit) has increased above its carrying amount, the previous impairment loss is reversed up to the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years. Reversals of impairment losses are recognized in the income statement as a reduction of the impairment loss.

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 recognized at their fair value, which is normally evidenced by the amount of fees received. This amount is amortized 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 unamortized 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 recognized at their fair value, which is normally evidenced by the amount of fees received. This amount is amortized 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 unamortized 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 recognized 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 two categories:

a) financial liabilities measured at fair value through profit or loss
b) financial liabilities measured at amortized 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 amortized 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 recognized 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 amortized 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 recognized 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 recognized 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 recognized at fair value less transaction costs and are subsequently carried at amortized 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 recognized 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 recognizes 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 recognized 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 realization 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 recognized as provisions in the statement of financial position. The provisions are recognized based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognized 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 realized 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 realization of which is less probable than non-realization 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 recognized 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 recognized as current assets. The portion of assets with expected inflows later than 12 months after the balance sheet date is recognized 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 authorized for issue, are recognized 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 recognized 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 recognized at fair value of the fee received or receivable. Expenses are recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 recognized when the performance criteria are fulfilled or based on the stage of completion. Other one-off service revenues and other revenues are recognized on an accrual basis at the moment of executing the respective transaction.

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

Interest income and expense is recognized in the statement of profit or loss for all financial instruments carried at amortized 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 recognized as part of effective interest method.

The effective interest method is a method of calculating the amortized 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 recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Dividend income is recognized 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 20). 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 recognized 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 recognized 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 and Lithuania that has been adjusted for the permanent and temporary differences as stipulated by law is subject to corporate income tax.

Corporate income tax rates	2017	2016
Latvia	15%	15%
Lithuania	15%	15%

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 utilized. 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 utilized. 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 19 to the financial statements.

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

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 recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. More detailed information in 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 recognize 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 minimizing 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 defense where the first line of defense, the business units, are responsible for taking risk and for day-to-day management. The second line of defense, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of defense, 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 at 31.12.2017, was EUR 113 877 thousand (31.12.2016: EUR 96 510 thousand). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

- The Group must be adequately capitalized at all times, having necessary capital to ensure economic preservation and enabling financing of new profitable growth opportunities;
- The main focus of the capital management is on 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	**31.12.2017**	**31.12.2016**
Paid-in share capital	59 500	56 500
Statutory reserves transferred from net profit	1 528	848
Accumulated profit/deficit	19 891	7 838
Intangible assets (subtracted)	-951	-772
Net profit for accounting period	13 909	12 096
Total Tier 1 own funds	**93 877**	**76 510**
Subordinated debt	20 000	20 000
Total Tier 2 own funds	**20 000**	**20 000**
Total Net own funds	**113 877**	**96 510**

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 behavior 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 0.92% (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 9.42% and the total capital requirement is 11.42%. 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	0.92%	0.92%	0.92%
Minimal regulatory requirement	**7.92%**	**9.42%**	**11.42%**

Capital requirements valid until August 2017 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	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 authorizing 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 *(EUR thousand)*	**31.12.2017**	**31.12.2016**
Loans and advances to banks and investment companies (Note 8)	955 891	300 371
Financial assets at fair value (Note 10)	49 239	64 197
Available-for-sale financial assets (Note 9)	775	799
Loans and advances to customers (Note 12)	719 390	531 761
Receivables from customers (Note 13)	7 357	1 699
Other financial assets (Note 14)	2 289	941
Total assets	**1 734 941**	**899 768**
Exposures related to off-balance sheet items (Note 21), excluding performance guarantees	177 578	142 227
Total Maximum exposure to credit risk	**1 912 519**	**1 041 995**

a) Debt securities and derivatives

The Credit Committee sets limits for taking credit risk associated with debt securities considering the issuers rating. The Risk Capital Committee or authorized 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**	**AFS**	**Ratings distribution**	**Total 31.12.2017**
AAA	0	29 869	0	0	0	29 869
A- to A+	18 223	0	1 046	0	555	19 824
Non-rated	0	0	0	30	0	30
Total (Note 9, 10)	**18 223**	**29 869**	**1 046**	**30**	**555**	**49 723**

As at 31.12.2017, the total amount of derivatives recognized in the report is EUR 30 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**	**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
Non-rated	0	0	0	250	0	250
Total (Note 9, 10)	**25 817**	**35 846**	**2 154**	**250**	**579**	**64 646**

As at 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.

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 and unsecured. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating). In case there are ratings available from more than one rating agency, the most conservative rating is used. The positions are held as follows:

Rating	Credit institutions	Investment companies	Total 31.12.2017	Credit institutions	Investment companies	Total 31.12.2016
Central bank (The Bank of Estonia)	920 714	0	920 714	265 127	0	265 127
AA- to AA+	1 306	0	1 306	5 716	0	5 716
A- to A+	6 352	0	6 352	5 603	0	5 603
BBB to BBB+	6 294	14 116	20 410	11 454	7 919	19 373
Non-rated	7 039	70	7 109	4 398	154	4 552
Total (Note 8)	**941 705**	**14 186**	**955 891**	**292 298**	**8 073**	**300 371**

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 AS 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 31.12.2017 and 31.12.2016.

d) Corporate loans and overdraft

Corporate loans are evaluated on individual basis. 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 behavior is analyzed. 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 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 31.12.2017, the group-based impairment reserve makes up 0.5% of corporate loans and overdraft and the related interest receivables (31.12.2016: 0.5%).

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 thousand. During the year 2016, the existing corporate loan portfolio was divided into two. Credits below EUR 250 thousand were given over to retail banking and all credits exceeding EUR 250 thousand 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 EUR 250 thousand are analyzed with more cost-efficient scoring process. The scoring is carried out at the request of the loan and it is one of the criteria for issuing the loan. Financial data and information on payment behavior 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. The retail loans are included inside Loans to legal entities and Overdrafts to legal entities in the report. As at 31.12.2017, the group-based impairment reserve makes 1.1% of retail loans and the related interest receivables (31.12.2016: 1.4%).

f) Consumer loans without collateral

Issuing consumer loans, the creditworthiness of each customer 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 behavior 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 31.12.2017, the group-based impairment reserve makes up 3.3% of consumer loans and the related interest receivables (31.12.2016: 3.8%).

g) Credit cards

AS 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 behavior. 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 at 31.12.2017, the group-based impairment reserve amounted to 1.3% of credit card loans and related receivables (31.12.2016: 2.4%).

h) Leasing

AS 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 at 31.12.2017, the group-based impairment reserve makes 0.3% of leasing portfolio (31.12.2016: 0.5%).

i) Hire-purchase

LHV Pank offers leasing products for individuals and legal entities. 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 at 31.12.2017, the group-based impairment reserve amounted to 1.22% of hire-purchase portfolio (31.12.2016: 1.0%).

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 at 31.12.2017, the group-based impairment reserve amounted to 0.3% of mortgage loans portfolio (31.12.2016: 0.4%).

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

Loans and advances to customers 31.12.2017	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	36 775	0	0	**36 775**	0	0	**36 775**
Corporate loans	443 822	3 766	9 160	**456 748**	-2 161	-1 518	**453 069**
Retail loans	13 049	581	26	**13 656**	-155	0	**13 501**
Overdraft	34 309	0	4 883	**39 192**	-122	-793	**38 277**
Hire-purchase	268	0	1	**269**	-2	-2	**265**
Leveraged loans	4 547	0	0	**4 547**	0	0	**4 547**
Leasing	31 534	2 141	57	**33 732**	-132	-614	**32 986**
Credit card loans	172	0	0	**172**	-4	0	**168**
Loans to individuals							
Consumer loans	23 468	0	1 209	**24 677**	-733	-86	**23 858**
Hire-purchase	18 463	496	63	**19 022**	-201	-30	**18 791**
Leveraged loans	2 621	0	0	**2 621**	0	0	**2 621**
Leasing	11 091	210	19	**11 320**	-17	-7	**11 296**
Mortgage loans	77 471	169	0	**77 640**	-243	0	**77 397**
Credit card loans	5 673	0	165	**5 838**	-75	-5	**5 758**
Overdraft	77	1	3	**81**	0	0	**81**
Total loans and advances to customers (Note 11)	**703 340**	**7 364**	**15 586**	**726 290**	**-3 845**	**-3 055**	**719 390**

Loans and advances to customers 31.12.2016	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	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 11)	**529 219**	**3 800**	**2 477**	**535 496**	**-3 300**	**-435**	**531 761**

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 31.12.2017 (in case PD and LGD levels will increase by 10%)	Balance as at 31.12.2017	Impairment with increased PDs and LGDs	Impact to impairment booked
Loans to legal entities			
Corporate loans (including overdraft)	495 940	-5 061	-467
Leasing	33 732	-774	-28
Retail loans	13 656	-188	-33
Loans to individuals			
Mortgage loans	77 640	-294	-51
Consumer loans	24 677	-982	-163
Hire-purchase	19 022	-276	-45
Leasing	11 320	-28	-4
Credit card loans	5 838	-96	-16
Total	**681 825**	**-7 699**	**-807**

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PricewaterhouseCoopers, Tallinn

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**

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, organizations, 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 at 31.12.2017	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total
4 low credit risk	794	0	0	794
5 low credit risk	18 637	0	0	18 637
6 low credit risk	113 983	0	0	113 983
7 medium credit risk	126 335	0	0	126 335
8 medium credit risk	139 264	0	0	139 264
9 heightened credit risk	44 452	0	0	44 452
10 high credit risk	23 649	0	0	23 649
11 high credit risk	6 898	3 716	0	10 613
12 non-satisfactory rating	4 119	50	0	4 169
13 insolvent	0	0	14 043	14 043
Total	**478 131**	**3 766**	**14 043**	**495 940**

Distribution of corporate loans and overdraft by internal ratings as at 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**

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 2017, the Group provisioned corporate loans in the total amount of EUR 1 710 thousand (2016: EUR 466 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 behavior, 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 EUR 171 528 thousand as at 31.12.2017 (31.12.2016: EUR 136 785 thousand), see Note 21.

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2017 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans in total amount of EUR 37 554 thousand (31.12.2016: EUR 26 053 thousand) and a loan to the other subsidiary of the parent company AS LHV Group of EUR 3 300 thousand (2016: EUR 9 500 thousand). 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)	31.12.2017	31.12.2016
5 low credit risk	5 632	793
6 low credit risk	13 135	8 569
7 medium credit risk	25 582	30 336
8 medium credit risk	57 446	52 354
9 heightened credit risk	28 932	10 440
10 high credit risk	4 176	3 980
11 high credit risk	342	202
13 insolvent	760	0
Non-rated	719	0
Total (Note 21)	**136 724**	**106 674**

Distribution of internal ratings for other loan products:

- Excellent – leveraged loans secured by equity or debt 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 at 31.12.2017	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Over-draft	Mortgage loans	Consumer loans	Total
Neither past due nor impaired									
Excellent	0	7 168	0	0	0	0	0	0	**7 168**
Good and very good	13 049	0	5 845	42 625	18 731	77	77 471	23 468	**181 266**
Past due but not impaired									
Good	481	0	0	1 686	361	0	169	0	**2 697**
Satisfactory	61	0	0	654	96	1	0	0	**812**
Weak or doubtful	39	0	0	11	39	0	0	0	**89**
Individually impaired									
Good	0	0	78	0	0	0	0	682	**760**
Satisfactory	0	0	46	0	0	0	0	212	**258**
Weak or doubtful	26	0	41	76	64	3	0	315	**525**
Total	**13 656**	**7 168**	**6 010**	**45 052**	**19 291**	**81**	**77 640**	**24 677**	**193 575**

As at 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	6 917	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**

In the table below, collateral information of loans and advances are disclosed based on the collateral type and carrying value or fair value of collateral held if it is lower. The under-collateralized amount is presented as "Unsecured loans".

Loans against collateral as at 31.12.2017	Loans to other subsidiaries of the parent company	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purchase	Mortgage loans	Total
Listed securities	0	0	7 168	0	0	0	0	7 168
Unlisted equity securities	0	36 603	0	0	0	0	0	36 603
Mortgages, real estate	0	233 876	0	0	0	0	77 640	311 516
Guarantee of KredEx and Rural Development Foundation	0	4 410	0	0	0	0	0	4 410
Pledges of rights of claim	36 775	15 163	0	0	0	0	0	51 938
Deposits	0	3 262	0	0	0	0	0	3 262
Leased assets	0	0	0	0	45 052	19 291	0	64 343
Others	0	90 915	0	81	0	0	0	90 996
Unsecured loans	0	125 367	0	30 687	0	0	0	156 054
Total	**36 775**	**509 596**	**7 168**	**30 768**	**45 052**	**19 291**	**77 640**	**726 290**

Loans against collateral as at 31.12.2016	Loans to other subsidiaries of the parent company	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purchase	Mortgage loans	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**

Collaterals for leveraged loans are monitored on daily basis and if collateral value is falling, immediate measures are taken to avoid credit losses. As at 31.12.2017, 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 behavior. 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 totaling EUR 1 383 thousand (2016: EUR 399 thousand) with a collateral value of EUR 0 thousand (2016: EUR 316 thousand).

	Over-collateralized loans		Under-collateralized loans	
Corporate loans and overdraft	**Balance sheet value**	**Fair value of collateral**	**Balance sheet value**	**Fair value of collateral**
As at 31.12.2017	208 356	552 362	301 002	175 873
As at 31.12.2016	314 139	731 661	65 640	26 638

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The valuation of the market value of collaterals is based on the principle of conservatism, which takes into account the type of collateral, the location, the likelihood of realization and liquidity. Expert evaluations are used to evaluate immovables. In order to ensure that market values are up to date, the individual assessments of commercial real estate are updated at least once a year. In the case of residential and other homogeneous types of real estate, statistical indexation models are also used for regular re-evaluation.

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 31.12.2017	Corporate loans (incl. overdraft)	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Overdraft to private individuals	Mortgage loan	Total
Past due receivables									
1-30 days	56	481	0	0	1 686	361	0	169	**2 753**
31-60 days	3 710	61	0	0	654	96	1	0	**4 522**
61-90 days	0	39	0	0	11	39	0	0	**89**
91-180 days	0	0	0	0	0	0	0	0	**0**
181-360 days	0	0	0	0	0	0	0	0	**0**
more than 360 days	0	0	0	0	0	0	0	0	**0**
Total	**3 766**	**581**	**0**	**0**	**2 351**	**496**	**1**	**169**	**7 364**

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

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 31.12.2017	Corporate loans	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Overdraft to private individuals	Consumer loans	Total
No past due payments	0	0	0	0	0	0	0	0	**0**
Past due receivables									
1-30 days	0	0	0	78	0	0	0	682	**760**
31-60 days	0	0	0	46	0	0	0	212	**258**
61-90 days	0	0	0	23	0	0	0	142	**165**
91-180 days	12 664	26	0	9	76	35	0	109	**12 919**
181-360 days	0	0	0	4	0	9	3	54	**70**
more than 360 days	1 379	0	0	5	0	20	0	10	**1 414**
Total	**14 043**	**26**	**0**	**165**	**76**	**64**	**3**	**1 209**	**15 586**

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

Credit quality of other receivables	31.12.2017	31.12.2016
Receivables not impaired and not past due	9 238	2 604
Receivables past due (not impaired)	408	36
incl. receivables from individuals	215	1
incl. receivables from legal persons	193	35
Total (Note 12, 13)	**9 646**	**2 640**

As at 22 February 2018, other receivables of EUR 175 thousand are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 13) in amount of EUR 2 289 thousand (31.12.2016: EUR 941 thousand) 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 Pank's 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	2017	2016
USD exchange rate	+/-10%	+/-16	+/-2
SEK exchange rate	+/-10%	+/-4	+/-2
GBP exchange rate	+/-10%	+/-1	+/-2
CHF exchange rate	+/-10%	+/-1	+/-2

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.

31.12.2017	**EUR**	**CHF**	**GBP**	**SEK**	**USD**	**Other**	**Total**
Assets bearing currency risk							
Due from banks and investment companies (Note 8)	917 109	2 587	28 237	892	1 359	5 707	**955 891**
Financial assets at fair value (Note 9,10)	15 379	0	0	4	34 603	28	**50 014**
Loans and advances to customers (Note 11)	717 512	0	4	14	1 832	28	**719 390**
Receivables from customers (Note 12)	6 914	7	204	11	145	76	**7 357**
Other financial assets (Note 13)	288	0	0	0	2 001	0	**2 289**
Total assets bearing currency risk	**1 657 202**	**2 594**	**28 445**	**921**	**39 940**	**5 839**	**1 734 941**
Liabilities bearing currency risk							
Deposits from customers and loans received (Note 15)	1 471 237	2 534	33 134	3 558	42 646	3 464	**1 556 573**
Financial liabilities at fair value (Note 10)	56 909	66	260	82	54	2 775	**60 146**
Accounts payable and other financial liabilities (Note 16)	0	0	0	1	1	0	**2**
Subordinated debt (Note 18)	20 000	0	0	0	0	0	**20 000**
Total liabilities bearing currency risk	**1 548 146**	**2 600**	**33 394**	**3 641**	**42 701**	**6 239**	**1 636 721**
Open gross position derivative assets at contractual value	699	0	4 959	2 763	3 615	450	**12 486**
Open gross position derivative liabilities at contractual value	11 787	0	0	0	699	0	**12 486**
Open foreign currency position	**97 968**	**-6**	**10**	**43**	**155**	**51**	**98 220**

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 11)	529 867	4	4	2	1 873	11	**531 761**
Receivables from customers (Note 12)	1 475	1	43	6	171	3	**1 699**
Other financial assets (Note 13)	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 15)	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 16)	6 844	1	1 226	65	5 341	1 227	**14 704**
Subordinated debt (Note 18)	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**

3.3.2 Price risk

Financial instruments bearing price risk at LHV are securities held in the trading portfolio and investment portfolio (Note 9, 10). 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 recognized 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% (2016: 1.0%).

Sensitivity analysis of the impact to net result from the risk exposures against reasonable possible change (EUR thousand):

Impact on statement of profit or loss	**2017**	**2016**
Equity securities +/-10%	+/-51	+/-27
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-491	+/-636
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-6	+/-6
Impact on other comprehensive income	**2017**	**2016**
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-6	+/-6

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 AS 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 constant over time.

The deposits interest rates did not change in 2017 remaining at the level of up to 1.0 % (up to 1.0% in 2016).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2017, the interest rate on loans received for specific purposes was 1.0% (2016: 1.5%). 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 18.

As at 31.12.2017, an increase of 1 percentage point in interest rates would affect the Group's annual net interest income and profit by EUR +5 584 thousand (2016: EUR +2 473 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 -1 567 thousand (2016: EUR -1 119 thousand). A 1 percentage point increase in market interest rates would raise the Group's economical value, i.e. equity, by EUR 7 520 thousand (2016: EUR 7 599 thousand). A 1 percentage point decrease in market interest rates would decrease the Group's economical value (equity) by EUR 16 639 thousand (2016: EUR -8 207 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, the loans granted to customers are largely based on the 6-month Euribor, the level of which does not fall below 0% according to loan agreements, and due to the longer-term nature of the demand obligations, the average duration of interest-bearing assets is shorter than the average duration of interest-bearing liabilities.

When calculating the effects of the change in the net interest income on profit and the simulation of the change in the economic capital, in the case of a decline in interest rates, the terms of loan contracts are taken into account and the assumption is made, that the interest rates of the deposits involved will not become negative. When simulating the increase in interest rates, the bank has followed the principles of conservatism – despite the fact that the market levels of derivative transactions give rise to a presumption, that in the next two years the market interest rates on term deposits will not drastically change, which could result in a significant amount of cash being transferred from demand deposits to term deposits – we have presumed, that the ratio of demand deposits to term deposits becomes equal.

Demand deposits have a duration of 2 years due to their behavioral nature. The interest rate of demand deposits is not sensitive to market rate fluctuations.

The table below shows the structure of the interest-bearing assets and interest-bearing liabilities of AS LHV Pank grouped by 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.

31.12.2017	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair-ments	Total
Financial assets								
Due from banks and investment companies (Note 8)	955 891	0	0	0	**955 891**	0	0	**955 891**
Financial assets at fair value (debt securities) (Note 9, 10)	0	29 715	15 834	2 000	**47 549**	2 465	0	**50 014**
Loans and advances to customers (Note 11)	289 735	360 503	58 727	14 851	**723 816**	2474	-6 900	**719 390**
Total	**1 245 626**	**390 218**	**74 561**	**16 851**	**1 727 256**	**4 939**	**-6 900**	**1 725 295**
Financial liabilities								
Deposits from customers and loans received (Note 15)	567 004	96 246	893 085	0	**1 556 335**	238	0	**1 556 573**
Subordinated debt* (Note 18)	0	0	0	20 000	**20 000**	150	0	**20 150**
Total	**567 004**	**96 246**	**893 085**	**20 000**	**1 576 335**	**388**	**0**	**1 576 723**
Net interest sensitivity gap	**678 622**	**293 972**	**-818 524**	**-3 149**	**150 921**			

31.12.2016	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair-ments	Total
Financial assets								
Due from banks and investment companies (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 11)	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 liabilities								
Deposits from customers and loans received (Note 15)	66 588	82 914	635 393	0	**784 895**	514	0	**785 409**
Subordinated debt* (Note 18)	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 gap	**474 759**	**209 938**	**-577 886**	**-16 207**	**90 604**			

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

The contractual term of subordinated debts received in 2014 is 10 years and the interest rate is fixed at 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 Pank's liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, LHV Pank's liquidity management reflects

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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 at 31.12.2017 and 31.12.2016. 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 monetized 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 31.12.2017 was 121% (2016: 221%).

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 31.12.2017 was 142% (31.12.2016: 152%). 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 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 31.12.2017 and 31.12.2016, 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 andin 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.

31.12.2017	**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 15)	1 423 306	37 104	90 332	3 335	2 864	**1 556 941**	**1 556 573**
Subordinated debt (Note 18)	0	341	1 022	5 455	23 466	**30 284**	**20 000**
Accounts payable and other financial liabilities (Note 16)	0	60 126	0	0	0	**60 126**	**60 126**
Unused loan commitments (Note 21)	0	171 528	0	0	0	**171 528**	**0**
Financial guarantees by contractual amounts (Note 21)	0	5 999	0	0	0	**5 999**	**0**
Foreign exchange derivatives (gross settled)	0	11 825	0	661	0	**12 486**	**0**
Financial liabilities at fair value (Note 10)	0	2	0	0	0	**2**	**2**
Total liabilities	**1 423 306**	**286 925**	**91 354**	**9 451**	**26 330**	**1 837 366**	**1 636 701**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	955 891	0	0	0	0	**955 891**	**955 891**
Financial assets at fair value (debt securities) (Note 9,10)	0	180	30 952	17 005	2 084	**50 221**	**50 014**
Loans and advances to customers (Note 11)	0	45 720	149 634	505 058	95 517	**795 929**	**719 390**
Receivables from customers (Note 12)	0	7 357	0	0	0	**7 357**	**7 357**
Other financial assets (Note 13)	2 289	0	0	0	0	**2 289**	**2 289**
Foreign exchange derivatives (gross settled)	0	11 825	0	661	0	**12 486**	**0**
Total assets held for managing liquidity risk	**958 180**	**65 082**	**180 586**	**522 724**	**97 601**	**1 824 173**	**1 734 941**
Maturity gap from assets and liabilities	**-465 126**	**-221 894**	**89 232**	**513 273**	**71 271**	**-13 244**	**98 240**

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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 15)	632 047	67 007	83 814	3 357	0	**786 225**	**785 409**
Subordinated debt (Note 18)	0	341	1 022	5 455	24 829	**31 647**	**20 000**
Accounts payable and other financial liabilities (Note 16)	0	14 704	0	0	0	**14 704**	**14 704**
Unused loan commitments (Note 21)	0	136 785	0	0	0	**136 785**	**0**
Financial guarantees by contractual amounts (Note 21)	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 11)	0	32 156	121 165	399 450	40 710	**593 481**	**531 761**
Receivables from customers (Note 12)	0	1 699	0	0	0	**1 699**	**1 699**
Other financial assets (Note 13)	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**

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

(EUR thousand)	31.12.2017	31.12.2016
Current assets		
Due from with central banks (Note 8)	920 714	265 127
Due from credit institutions (Note 8)	20 991	27 171
Due from investment companies (Note 8)	14 186	8 073
Available-for-sale financial assets (Note 9)	775	799
Financial assets at fair value through profit or loss (Note 10)	30 427	43 339
Loans and advances to customers (Note 11)	209 216	158 449
Receivables from customers (Note 12)	7 357	1 699
Other assets (Note 13)	836	714
Total current assets	**1 204 502**	**505 371**
Non-current assets		
Financial assets at fair value through profit or loss (Note 10)	18 812	20 858
Other financial assets (Note 13)	2 289	941
Loans and advances to customers (Note 11)	510 174	373 312
Tangible assets (Note 14)	1 225	1 002
Intangible assets (Note 14)	952	771
Total non-current assets	**533 452**	**396 884**

Total assets	**1 737 954**	**902 255**
Liabilities		
Current liabilities		
Deposits from customers and loans received (Note 15)	1 550 527	781 436
Financial liabilities at fair value through profit or loss (Note 10)	2	209
Accounts payable and other liabilities (Note 16)	61 858	16 469
Total current liabilities	**1 612 387**	**798 114**
Non-current liabilities		
Deposits from customers and loans received (Note 15)	6 046	3 973
Subordinated debt (Note 18)	20 000	20 000
Total non-current liabilities	**26 046**	**23 973**
Total liabilities	**1 638 433**	**822 087**

3.5 Risk concentration

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2017, the loans issued to 14 customers and 1 correspondent banks (2016: total 12) 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, totaling 215% of NOF (2016: 174%).

The Group has invested in the bonds of two issuers (2016: three) with a large risk exposure, totaling 42% of NOF (2016: 98%). As at 31.12.2017 the Group granted loans to another subsidiary of the parent company totaling EUR 30 580 thousand (2016: EUR 30 580 thousand), which is 32% of the Group NOF (2016: 33%). Of customer deposits, the deposits of five customers have a high risk concentration, which amounts to 551% of NOF. Unused loan commitments in amount of EUR 168 228 thousand (2016: EUR 127 285 thousand) are for Estonian residents and EUR 3 300 thousand (2016: EUR 9 500 thousand) for other subsidiaries of the parent company.

31.12.2017	**Estonia**	**Latvia**	**Lithuania**	**Finland**	**Nether-lands**	**Germany**	**EU**	**USA**	**Other**	**Total**
Due from banks and investment companies (Note 8)	916 853	0	0	0	0	0	3 051	28 152	7 835	**955 891**
Financial assets at fair value (Note 9,10)	846	779	17 456	0	0	29 867	1 064	2	0	**50 014**
Loans and advances to customers (Note 11)	650 871	42	37 218	998	91	42	26 580	45	3 503	**719 390**
Receivables from customers (Note 12)	7 351	1	5	0	0	0	0	0	0	**7 357**
Other financial assets (Note 13)	109	0	0	0	0	0	0	2 180	0	**2 289**
Total financial assets	**1 576 030**	**822**	**54 679**	**998**	**91**	**29 909**	**30 695**	**30 379**	**11 338**	**1 734 941**
Deposits from customers and loans received (Note 16)	862 286	5 024	825	2 717	12 505	632	639 608	2 855	30 121	**1 556 573**
Subordinated debt (Note 18)	20 000	0	0	0	0	0	0	0	0	**20 000**
Accounts payable and other financial liabilities (Note 16)	60 079	0	4	27	0	0	13	3	0	**60 126**
Financial liabilities at fair value (Note 10)	2	0	0	0	0	0	0	0	0	**2**
Total financial liabilities	**942 367**	**5 024**	**829**	**2 744**	**12 505**	**632**	**639 621**	**2 858**	**30 121**	**1 636 701**

31.12.2016	**Estonia**	**Latvia**	**Lithuania**	**Finland**	**Nether-lands**	**Germany**	**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 11)	484 578	245	31 138	512	7	46	14 508	51	676	**531 761**
Receivables from customers (Note 12)	1 689	1	6	0	0	0	3	0	0	**1 699**
Other financial assets (Note 13)	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 18)	20 000	0	0	0	0	0	0	0	0	**20 000**
Accounts payable and other financial liabilities (Note 16)	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**

Distribution of loans granted by industry (gross):	**31.12.2017**	**%**	**31.12.2016**	**%**
Individuals	141 199	19.4%	86 690	16.2%
Real estate	197 695	27.2%	149 145	27.9%
Financial services	114 888	15.8%	99 561	18.6%
Manufacturing	68 251	9.4%	43 534	8.1%
Professional, scientific and technical activities	13 948	1.9%	12 451	2.3%
Wholesale and retail	21 081	2.9%	14 719	2.7%
Other servicing activities	15 480	2.1%	15 021	2.8%
Art and entertainment	29 289	4.0%	29 143	5.4%
Transport and logistics	5 869	0.8%	12 834	2.4%
Agriculture	8 717	1.2%	8 341	1.6%
Administrative activities	33 941	4.7%	11 953	2.2%
Construction	19 414	2.7%	11 686	2.2%
Education	2 217	0.3%	1 294	0.2%
Information and communication	8 430	1.2%	9 607	1.8%
Other areas at activities	45 871	6.3%	29 517	5.6%
Total (Note 11)	**726 290**	**100%**	**535 496**	**100%**

3.6 Fair value of financial assets and financial liabilities

	Level 1	**Level 2**	**Level 3**	**31.12.2017**	**Level 1**	**Level 2**	**Level 3**	**31.12.2016**
Financial assets at fair value through profit or loss								
Shares and fund units (Note 10)	71	0	0	**71**	80	0	50	**130**
Available-for-sale financial assets (Note 9)	555	0	220	**775**	799	0	0	**799**
Debt securities at fair value through profit or loss (Note 10)	49 138	0	0	**49 138**	63 817	0	0	**63 817**
Interest rate swaps and foreign exchange forwards (Note 10)	0	30	0	**30**	0	250	0	**250**
Total financial assets	**49 764**	**30**	**220**	**50 014**	**64 696**	**250**	**50**	**64 996**
Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards (Note 10)	0	2	0	**2**	0	**209**	0	**209**
Total financial liabilities	**0**	**2**	**0**	**2**	**0**	**209**	0	**209**

The Management Board of AS LHV Pank has assessed the fair value of assets and liabilities carried at amortized 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 judgmental 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 31.12.2017 the fair value of corporate loans is EUR 135 thousand (0.03%) lower than their carrying amount (31.12.2016: EUR 2 354 thousand, 0.63% 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 31.12.2017 and 31.12.2016. 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 (2017: 3.71%, 2016: 4.54%).

(EUR thousand)	**Carrying value**	**Fair value**	**Difference**	**Level**
31.12.2017	491 141	491 277	0.03%	3
31.12.2016	374 494	372 140	-0.63%	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. As significant management judgment is required to determine fair value, mortgage loans are classified as level 3 in the fair value hierarchy. As at 31.12.2017 the fair value of mortgage loans is EUR 20 thousand (0.07%) lower than their carrying amount (31.12.2016: the fair value did not differ from carrying amount).

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 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 thousand 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 at 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 minimize 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 AS LHV Pank and to evaluate capital requirements. The analysis of cases collected into the database enables AS 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 AS LHV Pank with legislation, recommended guidelines of the Financial Supervision Authority and procedure rules of AS 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 organizational management process.

3.8. Compliance risk

Compliance risk is existing or potential risk for income and capital as a consequence of a failure to comply with laws, guidelines, standards or ethical principles. The realization of a risk may result in fines, claims, a loss in reputation, termination of contractual relationships and, in the worst case, revocation of the bank licence.

The aim of the management of compliance risk is to prevent the occurrence of compliance risk, including the imposition of fines, claims, a loss in reputation, termination of contractual relationships and revocation of the bank license.

Keeping in mind the risk assessment made by the European Central Bank, LHV still assesses regulatory changes as a high risk.

In order to manage compliance risk, the department of Compliance Control assesses changes in legislation and evaluates their potential impact, informs management of changes and participates in the implementation of the changes.

Monthly overviews to management include information gathered from different sources, including guidance from various supervisory authorities, and European Union and national legislation. During the presentation of the overviews, the members from the management bodies responsible for implementation will be appointed. In addition, the department of Compliance Control has mapped legislations, which have an impact to LHV's business operations.

Changes in regulations, which have the biggest impact on LHV's operations include the second Markets in Financial Instruments Directive (MiFiD), General Data Protection Regulation (GDPR), Payment Services Directive (PSD), IFRS 9, directive for Reporting of Analytical Credit Dataset (AnaCredit) and Money Laundering and Terrorist Financing Prevention Act.

In 2017, the department of Compliance Control has recognized changes in 72 regulations, which have an impact on LHV's operations. This number contains changes in current regulations and in new regulations. Some changes do not require significant changes in processes and systems, but still may have a significant impact on LHV. A good example is PSD and its adopting guidelines.

At the same time, implementing some of the regulations, for example MiFiD, GDPR and IFRS 9, require separate large-scale projects to be implemented, which has been done. The systematic resolution of complex issues gives the governing bodies the certainty that LHV has, to a large extent, taken into account the implication of the changes and has implemented the necessary measures to meet the requirements.

In addition to informing about the changes in the legislation, the department of Compliance Control advises the members of the management bodies and the employees of LHV in the implementation of the legislation requirements, participates in the development of new products and processes, and conducts risk-based compliance checks on activities.

LHV pays particular attention to comply with requirements of Money Laundering and Terrorist Financing Prevention Act and implementation requirements of international regulations. This is done both through control operations, as well as compliance assessment for requirements of the legislation. In order to pay enough attention to this area, there is a department of Anti-Money Laundering in LHV's structure, which functions separately from the department of Compliance Control.

3.9. Anti-money laundering

The risk of money laundering lies in the threat that the Bank's services and products are taken advantage of in order to commit money laundering and to finance terrorism. In addition, the risk may reveal itself in a situation when Bank does not apply the due diligence measures and Know Your Customer principle which are required by regulations and good banking practice. The realization of the risk of money laundering has an impact mainly to the risk of compliance or to the risk of reputation.

In order to mitigate the risk of money laundering, the Bank uses a risk-based approach, risk assessment of services and clients and risk-based monitoring of money laundering. Awareness and commitment of all employees and management about preventing money laundering is key, which are supported with appropriate information and training.

Due to the rapid increase in the number of customers and payments, the Bank has decided in 2017 to implement monitoring and screening software solutions from well-known service providers instead of using in-house developed solutions that have been used up until now. The new systems will be implemented and taken into use in 2018.

3.10. Other risks

3.10.1 Strategic and business risk

Strategic risk is expressed mainly in wrong strategic decisions. Strategic risk is mitigated through well-considered business plans and analyses. In addition, members of both AS LHV Pank's and LHV Group's management (both Management Board and Supervisory Board) have long-term experience in the banking sector and/or entrepreneurship. Prior to entering new markets and sectors, professionals in the field will always be involved and a thorough analysis will be carried out.

3.10.2 Risk on reputation

Risk on reputation is defined as a risk, which arises from a loss of reputation for clients, business partners, owners, investors or supervisors. Risk on reputation is usually a result from realization of other risks (for example operational risk or strategic risk). In order to mitigate the risk on reputation, LHV regularly carries out risk management trainings and the framework of risk management is constantly improved which will provide a strong risk culture.

3.10.3 Country risk

Similarly to the risk on reputation, the country risk is usually expressed through another risk (operational risk, credit risk, strategic risk). In addition to Estonia, LHV is operating in Lithuania and is preparing to start a business in the United Kingdom. In Lithuania, an existing and performing financial lease portfolio was purchased in 2013 as a result of a collaboration with one local well-known company.

3.11. Offsetting assets and liabilities

The group has offset the following assets and liabilities

				Related arrangements not set off in the statement of financial position		
31.12.2017	**Gross amounts before offsetting in the statement of financial position**	**Offsetting**	**Net amount of exposure presented in the statement of financial position**	**Financial instruments**	**Cash collateral received**	**Net amounts**
Assets						
Client receivables (leveraged loans, incl. repo loans) (Note 11)	7 168	0	7 168	-7 168	0	0
Due from investment companies	20 628	-20 625	3	0	0	0
Liabilities						
Payables to investment companies	20 628	-20 628	0	0	0	0
31.12.2016						
Assets						
Client receivables (leveraged loans, incl. repo loans) (Note 11)	7 387	0	7 387	-7 387	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 and 11).

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	**2017**	**2016**
Loans to companies (including retail loans)	20 784	17 593
incl. loans to related parties (Note 22)	27	36
Hire-purchase	4 182	4 431
Consumer loans	4 018	2 634
Leasing	1 845	1 600
incl. loans to related parties (Note 22)	*6*	*4*
Loans to other Group companies	919	1 167
Leveraged loans and lending of securities	147	505
From debt securities	206	365
incl. debt securities available-for-sale (Note 9)	24	27
incl. debt securities at fair value through profit or loss (Note 10)	182	*338*
Credit card loans	694	553
From balances with credit institutions and investment companies	*39*	73
Other loans	2 658	918
incl. loans to related parties (Note 22)	*30*	*12*
Total	**35 492**	**29 839**
Interest expense		
Deposits from customers and loans received	-1 218	-2 236
From balances with central bank	-1 773	-811
Subordinated debt (Note 18, 22)	-1 367	-1 240
Total	**-4 358**	**-4 287**
Net interest income	**31 134**	**25 552**

Interest income of loans by customer location (interests from bank balances and debt securities not included):	**2017**	**2016**
Estonia	34 307	28 133
Latvia	0	11
Lithuania	940	1 257
Total	**35 247**	**29 401**

Interests calculated on impaired corporate loans (incl. overdraft) in 2017 is EUR 421 thousand (2016: EUR 137 thousand).

NOTE 6 Net fee and commission income

Fee and commission income	**2017**	**2016**
Security brokerage and commission fees	3 072	3 088
Asset management and related fees	1 690	1 439
Currency exchange fees	977	1 109

Fees from cards and settlements	5 875	3 584
Other fee and commission income	1 482	540
Total	**13 096**	**9 760**
Fee and commission expense		
Security brokerage and commission fees paid	-55	-831
Fees related to bank cards paid	-2 026	-1 232
Fees related to acquiring paid	-1 982	-1 280
Fees related to consumer loans and hire-purchase paid	-485	-25
Other fee and commission expense	-853	-676
Total	**-5 401**	**-4 044**
Net fee and commission income	**7 695**	**5 716**

Fee and commission income by customer location:	**2017**	**2016**
Estonia	13 019	9 459
Latvia	0	17
Lithuania	77	284
Total	**13 096**	**9 760**

NOTE 7 Operating expenses

	2017	**2016**
Wages, salaries and bonuses	8 715	7 380
Social security and other taxes*	2 572	2 296
Total staff costs	**11 287**	**9 676**
IT expenses	1 458	1 358
Information services and bank services	513	476
Marketing expenses	1 368	951
Office expenses	414	447
Transportation and communication costs	185	181
Training and travelling expenses of employees	437	301
Other outsourced services	1 481	1 483
Other administrative expenses	1 251	1 020
Depreciation	874	812
Operating lease payments	949	793
Other operating expenses	198	139
Total other operating expenses	**9 128**	**7 961**
Total operating expenses	**20 415**	**17 637**

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

The average number of employees working for the Group in 2017 was 294 (2016: 250).

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

	31.12.2017	31.12.2016
Demand and term deposits with maturity less than 3 months*	35 177	35 244
Statutory reserve capital at central bank	15 375	7 736
Demand deposit from central bank*	905 339	257 391
Total	**955 891**	**300 371**
* cash and cash equivalents in the statement of cash flows	940 516	292 635

Distribution of receivables by countries is presented in Note 3.5.

Mandatory banking reserve as at 31.12.2017 was 1% (2016: 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 31.12.2017 that includes debt instruments in total amount of EUR 555 thousand (31.12.2016: EUR 579 thousand) and equity instruments (VISA share) in total amount of EUR 220 thousand (31.12.2016: EUR 220 thousand). The balance of other reserve in equity as at 31.12.2017 is EUR 36 thousand (31.12.2016: EUR -40 thousand).

In 2017 and 2016, 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 31.12.2015	**3 508**
Proceeds from disposal and maturities 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**
Proceeds from disposal and maturities of assets available-for-sale	-124
Interest income (Note 5)	24
Revaluation of available-for-sale assets	76
Available-for-sale financial assets 31.12.2017	**775**

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

Securities held for trading:	**31.12.2017**	**31.12.2016**
Shares and fund units	71	130
Debt securities	49 138	63 817
Foreign Exchange forwards	30	250
Total financial assets	**49 239**	**64 197**

Interest rate swaps and foreign exchange forwards	2	209
Total financial liabilities	**2**	**209**

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**
Net changes of investment securities at fair value through profit or loss	-15 099
Interest income (Note 5)	182
Revaluation	-41
Financial assets at fair value through profit or loss 31.12.2017	**49 239**

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.6). In 2017, a gain of EUR 440 thousand (2016: EUR 213 thousand) was recognized on the revaluation of bonds. No gain or loss was obtained from the revaluation of interest rate swaps in 2017 and in 2016. Interest income from bonds is recognized in interest income.

NOTE 11 Loans and advances to customers

	31.12.2017	31.12.2016
Loans to legal entities	**585 091**	**448 806**
incl. loans to other subsidiaries of the parent company	36 775	30 580
incl. corporate loans	456 748	341 358
incl. retail loans	13 656	7 088
incl. overdraft	39 192	31 333
incl. hire-purchase	269	265
incl. leveraged loans	4 547	4 383
incl. leasing	33 732	33 669
incl. credit card loans	172	130
Loans to individuals	**141 199**	**86 690**
incl. consumer loans	24 677	16 465
incl. hire-purchase	19 022	19 206
incl. leveraged loans	2 621	3 004
incl. leasing	11 320	7 694
incl. credit card loans	5 838	4 788
incl. mortgage loans	77 640	35 451
incl. overdraft	81	82
Total	**726 290**	**535 496**
Impairment provisions	-6 900	-3 735
Total	**719 390**	**531 761**

As at 31.12.2017, leveraged loans included repo loans to customers in total amount of EUR 778 thousand (31.12.2016: EUR 3 022 thousand). As at 31.12.2017, the fair value of collateral of the repo loans amounted to EUR 1 832 thousand (31.12.2016: EUR 5 439 thousand). As at 31.12.2017, loans have been issued to related parties in total amount of EUR 39 321 thousand (31.12.2016: EUR 33 290 thousand); the loans have been issued on market terms. See also Note 22.

In 2017, the average effective interest rate of new consumer loans issued to individuals was 18-20%.The average effective interest rate for hire-purchase was around 20%, credit cards 13% and leasing 3%. 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 2017	**Corporate loans, incl. overdraft**	**Retail loans**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consumer loans**	**Leasing**	**Total**
Balance as at January 1	**-2 338**	**-101**	**-143**	**-118**	**-195**	**-623**	**-217**	**-3 735**
Impairment provisions set up during the year	-2 257	-54	-100	-1	-480	-196	-562	**-3 650**
Written off during the year	1	0	0	35	440	0	9	**485**
Balance as at December 31	**-4 594**	**-155**	**-243**	**-84**	**-235**	**-819**	**-770**	**-6 900**

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

Impairment losses accumulated during the year differ from the amount of impairment losses recognized in the income statement, that have been written off earlier as uncollectible claims. These receipts were recorded among impairment losses in the income statement.

Net and gross investments on leasing's according to remaining maturity	**Gross investment**	**Unearned future interest income**	**Impairment loss provision**	**Present value of lease payments receivable**
up to 1 year	15 493	-1 274	-625	13 594
1-5 years	32 555	-1 756	-142	30 657
over 5 years	824	-20	-4	800
Total as at 31.12.2017	**48 872**	**-3 050**	**-770**	**45 052**
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**

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 12 Receivables from customers

	31.12.2017	31.12.2016
Asset management fees from customers	23	11
Other fees for providing services to customers	7 328	1 673
Payments in transit	6	15
Total	**7 357**	**1 699**

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 13 Other assets

	31.12.2017	31.12.2016
Financial assets		
Guarantee deposits of Baltic stock exchanges	9	8
Guarantee deposit of MasterCard and VISA	2 280	933
Subtotal	**2 289**	**941**
Non-financial assets		
Prepayments to Financial Supervision Authority	223	183
Other prepayments *	613	531
Subtotal	**836**	**714**
Total	**3 125**	**1 655**

* 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 14 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2015			
Cost	2 411	2 134	4 545
Accumulated depreciation and amortization	-1 805	-1 509	-3 314
Carrying amount	**606**	**625**	**1 231**
Changes in 2016:			
Purchase of non-current assets	716	649	1 365
Sold non-current assets	-13	0	-13
Accumulated depreciation/amortization of sold non-current assets	5	0	5
Write-offs	-2	0	-2
Depreciation/amortization charge	-310	-503	-813
Balance as at 31.12.2016			
Cost	3 112	2 783	5 895
Accumulated depreciation and amortization	-2 110	-2 012	-4 122
Carrying amount	**1 002**	**771**	**1 773**
Changes in 2017:			
Purchase of non-current assets	564	713	1 277

Depreciation/amortization charge	-341	-532	-873
Balance as at 31.12.2017			
Cost	3 676	3 496	7 172
Accumulated depreciation and amortization	-2 451	-2 544	-4 995
Carrying amount	**1 225**	**952**	**2 177**

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

In 2017 and 2016, there was no indication of impairment of tangible and intangible assets.

NOTE 15 Deposits from customers and loans received

	Individuals	Legal entities	Public sector	**31.12.2017 Total**	Individuals	Legal entities	Public sector	**31.12.2016 Total**
Demand deposits	278 430	1 138 590	6 203	1 423 223	202 725	420 969	8 260	631 954
Term deposits	51 075	70 221	5 816	127 112	63 749	81 945	6 469	152 163
Loans received	0	6 000	0	6 000	0	0	778	778
Accrued interest liability	144	87	7	238	209	285	20	514
Total	**329 649**	**1 214 898**	**12 026**	**1 556 573**	**266 683**	**503 199**	**15 527**	**785 409**
incl. related parties (Note 22)	*2 022*	*20 973*	*0*	*22 995*	*1 165*	*14 093*	*0*	*15 258*

In 2017, a loan received from Maaelu Edendamise Sihtasutus (Rural Development Foundation) was returned in total amount of EUR 778 thousand. AS LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) for EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2017, the loan amount taken into use by the Bank amounted to EUR 6 million.

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 16 Accounts payable and other liabilities

Financial liabilities	**31.12.2017**	**31.12.2016**
Trade payables	2 300	1 803
Other short-term financial liabilities	1 878	1 551
Accrued interest on subordinated loans (Note 18)	150	150
Payments in transit	55 661	11 063
Financial guarantee contracts issued	137	137
Subtotal	**60 126**	**14 704**
Non-financial liabilities		
Prepaid expenses	258	184
Performance guarantee contracts issued	159	228
Tax liabilities	401	584

Payables to employees	914	769
Subtotal	**1 732**	**1 765**
Total	**61 858**	**16 469**

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 recognized as current liabilities.

NOTE 17 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 2017, the operating lease payments for office premises in the amount of EUR 870 thousand (2016: EUR 723 thousand).

	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as at **31.12.2016**	747	2 741	**3 488**
Non-cancellable lease payables as at **31.12.2017**	911	1 460	**2 371**

NOTE 18 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 totaling EUR 8 000 thousand carrying a rate of interest at 7.25%. The due date of the bonds is 20.06.2024.

In June 2015, subordinated bonds were issued totaling EUR 4 000 thousand carrying a rate of interest at 6.50%. The due date of the bonds is 29.10.2025.

In August 2015, subordinated bonds were issued totaling EUR 3 000 thousand carrying a rate of interest at 6.50%. The due date of the bonds is 29.10.2025.

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 20.12.2020 and the interest rate was 7% during the first three-year period.

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

In 2017, no subordinated bonds were issued or redeemed.

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

Subordinated debt
(EUR thousand)

Subordinated debt as at 31.12.2015	**15 000**
Subordinated bonds issued	5 000
Subordinated debt as at 31.12.2016	**20 000**
Subordinated debt as at 31.12.2017	**20 000**

Accrued interest on subordinated debts
(EUR thousand)

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**
Interest calculated for 2017 (Note 5)	1 360
Paid out during 2017	-1 360
Accrued interest on subordinated debts as at 31.12.2017	**150**

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NOTE 19 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 25.1% of the voting rights and Andres Viisemann who owns 9.9% of the voting rights in AS LHV Group have significant influence over the company (31.12.2016: 25.9% and 9.8%, respectively). According to the Company’s articles of association, the minimum share capital is EUR 25 million and the maximum share capital is EUR 100 million (at 31.12.2016: EUR 25 million and EUR 100 million, respectively). The share capital is paid in full through cash contributions. In 2017, the share capital of AS LHV Pank was increased by EUR 3 million and in 2016 by EUR 5 million through a cash contribution by the sole shareholder AS LHV Group. The bank’s share capital increased to EUR 59.5 million by the year-end 2017.

As at 31.12.2017, the adjusted unconsolidated retained earnings of the Group amounted to EUR 34 956 thousand (31.12.2016: EUR 20 896 thousand). Thus, as at 31.12.2017 it is possible to pay out dividends in amount EUR 27 965 thousand (2016: EUR 16 717 thousand) and the related income tax charge would be EUR 6 991 thousand (2016: EUR 4 179 thousand). If the dividends were to be paid, the Group’s capital adequacy would remain compliant

	31.12.2017	**31.12.2016**
Share capital (EUR thousand)	59 500	56 500
Number of shares (pcs)	59 500 000	56 500 000
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 labor market that is equal to competitors and comprehensive. The share options were issued in 2016 and in 2017.

In 2017, share options were granted to six members of the Management Board of AS LHV Pank and fifty-four employees in the total amount of EUR 1 204 thousand. In 2016, share options were granted to six members of the Management Board of AS LHV Pank and thirty-six employees in the total amount of EUR 598 thousand. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options. Share options can be exercised after the expiry of a three-year period.

Share options issued in 2014 were exercised in 2017, when shares with nominal value of EUR 1 could be acquired for EUR 2 per share. In total, the former and current employees of the Group noted 278 033 shares. Share options issued in 2015 can be exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of EUR 1 can be acquired for EUR 2.4 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 EUR 1 can be acquired for EUR 3.0 per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share.

Statutory reserve capital in equity is composed of:

(EUR thousand)

Statutory reserve capital as at 31.12.2015	**416**
Transferred from 2015 net profit	469
Statutory reserve capital as at 31.12.2016	**888**
Transferred from 2016 net profit	604
Statutory reserve capital as at 31.12.2017	**1 492**

NOTE 20 Assets under management

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

	31.12.2017	31.12.2016
Cash balance of customers	10 266	11 657
Securities of customers	**1 277 535**	**1 069 151**
incl. parent company (Note 22)	*84 300*	*87 900*
incl. shareholders of the parent company and related entities (Note 22)	*168 637*	*76 803*
Total	**1 287 801**	**1 080 808**

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 recognized as off-balance sheet assets. Due to the nature of the system, the Bank has deposited these funds in personalized 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 recognized 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 21 Contingent assets and liabilities

Irrevocable transactions	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2017	10 129	5 999	51	171 528	**187 707**
Liability in contractual amount 31.12.2016	12 695	5 442	0	136 785	**154 922**

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 2016 - 2017. 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	31.12.2017	31.12.2016
Construction	7 083	7 170

Water supplies	1 237	2 062
Manufacturing	212	1 594
Professional, scientific and technical activities	708	152
Other areas at activities	889	1 718
Total	**10 129**	**12 695**

According to internal ratings	31.12.2017	31.12.2016
5 low credit risk	346	55
6 low credit risk	3 722	964
7 medium credit risk	3 938	5 591
8 medium credit risk	374	1 393
9 heightened credit risk	621	710
10 high credit risk	84	107
11 high credit risk	0	1 531
12 non-satisfactory rating	16	2 327
13 non-satisfactory rating	605	0
Non-rated*	423	17
Total	**10 129**	**12 695**

Non-rated performance guarantees are retail loan guarantees evaluated using scoring model.

Performance guarantees are over-collateralized as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2017 nor in previous period.

NOTE 22 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	2017	2016
Interest income	**5**	**982**	**1 220**
incl. management		27	17
incl. entities in the consolidation group of the parent		955	1 203
Interest expenses	**5**	**1 401**	**1 281**
incl. management		*1*	*3*
incl. parent company		*1 360*	*1 235*
incl. shareholders, related entities and close relatives that have significant influence		*40*	*43*
Fee and commission income	**6**	**8**	**5**
incl. management		*2*	*1*
incl. shareholders, related entities and close relatives that have significant influence		*6*	*4*
Other income		**17**	**72**
incl. shareholders, related entities and close relatives that have significant influence		*17*	*72*
Other expenses		***16***	***22***
incl. shareholders, related entities and close relatives that have significant influence		*16*	*22*

Balances	Note	31.12.2017	31.12.2016
Loans and receivables as at the year-end	**11**	**39 594**	**33 290**
incl. management		*1 463*	*1 314*
incl. shareholders, related entities and close relatives that have significant influence		*38 131*	*31 976*
Deposits and loans received as at the year-end		**22 995**	**15 258**
incl. management	*15*	*283*	*236*
incl. parent company	*18*	*11 018*	*7 638*
incl. shareholders, related entities and close relatives that have significant influence	*15*	*11 693*	*7 384*

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 2016, the other subsidiary of the parent company repaid loans to the Group in total amount of EUR 2.5 million. In 2017, the Group granted another loan in total amount of EUR 6.2 million to the other subsidiary of the parent company. The interest rate of the loan is dependant of financing cost and capital requirements of the Group and is changed on quarterly basis. As at 31.12.2017 the interest rate of the was 2.95% (31.12.2016: 3.51%). As at 31.12.2017, the Group has taken a commitment to grant loans up to EUR 40 million.

As at 31.12.2017 and 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.

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

In 2017, salaries and other compensations paid to the management of LHV totaled EUR 797 thousand (2016: EUR 706 thousand), including all taxes. The Management Board of the Bank had six members in 2017 and 2016. As at 31.12.2017, the remuneration for December and accrued holiday pay in the amount of EUR 46 thousand (as at 31.12.2016: EUR 58 thousand) is reported as a payable to management (Note 16). The Group did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2017 and 31.12.2016 (pension liabilities, termination benefits, etc.). In 2017 and 2016, 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 20.

NOTE 23 Subsidiary

As at 31.12.2017, the Bank has one subsidiary that has been consolidated in these financial statements:

- AS LHV Finance (ownership interest 65%)

AS LHV Pank paid EUR 325 thousand of monetary contribution for 65% of ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand 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 summarized financial information for each subsidiary that has non-controlling interests that are material to the Bank. The information disclosed is the amount before inter-company eliminations.

	AS LHV Finance	
Summarized statement of financial position	**31.12.2017**	**31.12.2016**
Loans and advances to customers and other current assets	43 209	35 454
Non-current assets	46	66
Current liabilities	2 192	1 982
Non-current liabilities	30 957	28 041
Total net assets	**10 106**	**5 497**

	AS LHV Finance	
Summarized statement of profit or loss and other comprehensive income	**2017**	**2016**
Net interest and fee & commission income	6 902	5 566
Profit before income tax	4 604	3 289
Net profit	**4 604**	**3 289**
Total comprehensive income	4 604	3 289
Profit and other comprehensive income allocated to non-controlling interests	1 612	1 151

	AS LHV Finance	
Summarized statement of cash flows	**2017**	**2016**
Cash flows from operating activities	-1 788	-5 790
Interest paid	-1 103	-1 109
Net cash from/(used in) operating activities	**-2 891**	**-6 899**
Net cash from/(used in) investing activities	-26	-18
Net cash from/(used in) financing activities	2 917	6 917
Net increase/(decrease) in cash and cash equivalents	**0**	**0**
Cash and cash equivalents at the beginning of the year	0	0
Cash and cash equivalents at the end of the year	**0**	**0**

NOTE 24 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

(EUR thousand)	**2017**	**2016**
Interest income	28 386	23 903
Interest expense	-4 358	-4 286
Net interest income	**24 028**	**19 617**
Fee and commission income	12 623	9 735
Fee and commission expense	-4 724	-3 650
Net fee and commission income	**7 899**	**6 085**
Net gains from financial assets measured at fair value	420	1 103
Foreign exchange rate gains/losses	265	-105
Net gains from financial assets	**685**	**998**
Other income	7	386
Administrative and other operating expenses	-18 749	-16 181
Operating profit	**13 870**	**10 905**
Impairment losses on loans and advances	-2 953	-947
Net profit for the year	**10 917**	**9 958**
Other comprehensive income/loss:		
Items that may be reclassified subsequently to profit or loss:		
Available-for-sale investments: Revaluation of available-for-sale financial assets	76	-17
Net profit and other comprehensive income for the year	**10 993**	**9 941**

Statement of financial position of the parent

(EUR thousand)	**31.12.2017**	**31.12.2016**
Assets		
Due from central bank	920 714	265 127
Due from credit institutions	20 991	27 171
Due from investment companies	14 186	8 073
Available-for-sale financial assets	775	799
Financial assets at fair value through profit or loss	49 239	64 197
Loans and advances to customers	707 528	524 785
Receivables from customers	7 095	1 386
Other assets	3 120	1 651
Subsidiaries	325	325
Tangible assets	1 218	990
Intangible assets	913	717
Total assets	**1 726 104**	**895 221**
Liabilities		
Deposits from customers and loans received	1 556 573	785 409
Financial liabilities at fair value through profit or loss	2	209
Accounts payable and other liabilities	59 789	14 607
Subordinated debt	20 000	20 000
Total liabilities	**1 636 364**	**820 225**
Equity		
Share capital	59 500	56 500
Statutory reserve capital	1 492	888
Other reserves	36	-40
Retained earnings	28 712	17 648
Total equity	**89 740**	**74 996**
Total liabilities and equity	**1 726 104**	**895 221**

Statement of cash flows of the parent

(EUR thousand)	**2017**	**2016**
Cash flows from operating activities		
Interest received	28 080	23 583
Interest paid	-4 634	-4 487
Fees and commissions received	12 623	9 735
Fees and commissions paid	-4 724	-3 650
Other income received	7	386
Staff costs paid	-9 599	-8 382
Administrative and other operating expenses paid	-7 470	-6 451
Cash flows from operating activities before change in operating assets and liabilities	**14 283**	**10 734**
Net increase/(decrease) in operating assets:		
Net acquisition/disposal of trading portfolio	278	-287
Loans and advances to customers	-191 100	-124 418
Mandatory reserve at central bank	- 7 639	-1 598
Security deposits	-1 348	-1
Other assets	-119	-189
Net increase/(decrease) in operating liabilities:		
Demand deposits of customers	791 270	187 136
Term deposits of customers	-25 052	-31 506
Net loans received (including loan repayments)	5 221	-14 731
Financial liabilities held for trading at fair value through profit or loss	-207	120
Other liabilities	45 081	-1 652
Net cash from/(used in) operating activities	**630 668**	**23 626**
Cash flows from investing activities		
Purchase of tangible and intangible assets	-1 251	-1 334
Proceeds from disposal and redemption of investment securities	124	3 608
Net changes of investment securities at fair value through profit or loss	15 075	35 788
Net cash from/(used in) investing activities	**13 948**	**38 044**
Cash flows from financing activities		
Paid in share capital	3 000	5 000
Proceeds from subordinated debt	0	5 000
Net cash from financing activities	**3 000**	**10 000**
Effect of exchange rate changes on cash and cash equivalents	**265**	**-105**
Net increase/(decrease) in cash and cash equivalents	**647 881**	**71 565**
Cash and cash equivalents at the beginning of the year	292 635	221 070
Cash and cash equivalents at the end of the year	**940 516**	**292 635**

Statement of changes in shareholders' equity

(EUR thousand)	Share capital	Statutory reserve capital	Other reserves	Retained earnings	Total
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**
Net profit for the year	*0*	*0*	*0*	*9 958*	***9 958***
Other comprehensive loss	*0*	*0*	*-17*	*0*	***-17***
Net profit and other 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**
Balance as at 01.01.2016	**56 500**	**888**	**-40**	**17 647**	**74 995**
Paid in statutory reserve capital	0	604	0	-604	**0**
Paid in share capital	3 000	0	0	0	**3 000**
Share options	0	0	0	752	**752**
Net profit for the year	*0*	*0*	*0*	*10 917*	***10 917***
Other comprehensive income	*0*	*0*	*76*	*0*	***76***
Net profit and other comprehensive income for 2017	0	0	76	10 917	**10 993**
Balance as at 31.12.2017	**59 500**	**1 492**	**36**	**28 712**	**89 740**
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	6 569	6 569
Adjusted unconsolidated equity as at 31.12.2017	**59 500**	**1 492**	**36**	**34 956**	**95 984**

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

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 2017. The consolidated financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

22.02.2018

Erki Kilu ______________________
Chairman of the Management Board

Andres Kitter______________________
Member of the Management Board

Indrek Nuume______________________
Member of the Management Board

Jüri Heero______________________
Member of the Management Board

Meelis Paakspuu______________________
Member of the Management Board

Martti Singi______________________
Member of the Management Board

Independent auditor's report

To the Shareholder of AS LHV Pank

(Translation of the Estonian original)*

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS LHV Pank and its subsidiary (together the Group) as at 31 December 2017, 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.

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- 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.

Independence

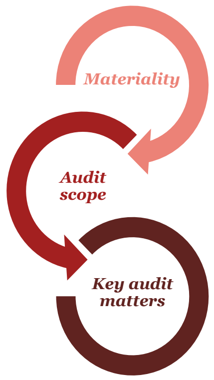
We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities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

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59[1] of the Auditors Activities Act of the Republic of Estonia.

AS PricewaterhouseCoopers, Pärnu mnt 15, 10141 Tallinn, Estonia; License No. 6; Registry code: 10142876
T: +372 614 1800, F: +372 614 1900, www.pwc.ee

Our audit approach

Overview



Materiality

Overall group materiality is EUR 775 thousand, which represents 5% of profit before tax.

Audit scope

A full scope audit was performed by PwC Estonia for Group entities covering substantially all of the Group's consolidated statements of financial position and profit or loss.

Key audit matters

- Impairment of loans and advances to customers

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall group materiality	EUR 775 thousand
How we determined it	5% of profit before tax
Rationale for the materiality benchmark applied	The use of profit before tax is considered appropriate as, in our view, profit before tax is the stakeholders' primary measurement benchmark and key performance indicator for the Management and Supervisory Board.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	*How our audit addressed the key audit matter*
Impairment of loans and advances to customers (refer to Note 2 "Summary of significant accounting policies", Note 3.2 "Credit risk" and Note 11 "Loans and advances to customers" for further details). As at 31 December 2017 loans and advances to customers amounted to EUR 719.4 million and related impairment loss for 2017 amounted to EUR 3.6 million. We focused on this area because management makes complex and subjective judgments over both timing of recognition of impairment and the estimation of the size of any such impairment. For corporate loans, a portion of impairment is individually assessed by taking into consideration the credit rating of the customer and other known heightened risk factors. Credit rating is assigned considering a combination of financial and business risks associated with the customer. Individual impairment is calculated based on the exposure and realisable value of the collateral at the balance sheet date. In addition to individual assessment and impairment calculation of corporate loans, a significant portion of their impairment is calculated on a collective basis, taking into account customer rating, historical performance, the probability of default, loss given default and other factors. Loans to individuals and loans to legal entities (other than corporate loans) are grouped for impairment calculation purposes into sub-classes on the basis of homogeneous credit risk features. The major part of impairment for those sub-classes is calculated on a collective basis, taking into account historical performance, the probability of default, loss given default and other factors.	We assessed whether the Group's accounting policies in relation to the impairment of loans and advances to customers are in compliance with IFRS. We assessed the design and operating effectiveness of the controls over impairment data and calculations. These controls included those over the identification of which loans and advances were individually impaired (overdue loans monitoring) and the calculation of the collective impairment provisions (including validation process of collective impairment model inputs). In addition, we tested the design and operating effectiveness of the credit file periodic review and rating assessment and monitoring of collateral controls for corporate loans. We determined that we could rely on these controls for the purposes of our audit. We performed detailed testing over: • the completeness and accuracy of data in the impairment model for collective impairment calculations; • the internal assignment of credit ratings for corporate loan customers; • the assumptions used for critical inputs in the collective impairment model, such as probability of default and loss given default. We have checked the calculations of probability of default and loss given default performed by management for material loan products, by evaluating the correctness of the calculation methodology and historical data used; • the correctness of information on collaterals and their values in the loan systems; and • the completeness of loans subject to individual impairment assessment and related calculations.

Areas that require the most significant judgments and estimates are:

- the identification and monitoring process of corporate customers with ratings below investment grade and other known heightened risk factors and individual impairment calculations of such loans, with special attention on the valuation of collaterals;
- the key assumptions and judgments made by management that underlie the calculation of collective impairment. Key assumptions and judgments include the probability of default calculation, the loss given default calculation and credit conversion factor calculation;
- the assessment of annual internal validation process of group-based valuation models, taking into account the repayment behavior of different customer groups; and
- the completeness of the customer accounts that are included in the impairment calculation.

In the case of some impairment provisions, we formed a different view from that of the management, but in our view the differences were within a reasonable range of outcomes in the context of the overall loans and advances and the uncertainties disclosed in the financial statements.

As a result of our work, we noted no material exceptions.

How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the financial services industry in which the Group operates.

The Group includes the subsidiary LHV Finance AS that operates in Estonia (refer to Note 23). A full scope audit was performed by PwC Estonia for all Group entities covering substantially all of the Group's consolidated statements of financial position and profit or loss.

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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of AS LHV Pank, as a public interest entity, for the financial year ended 31 December 2009. Our mandate as auditors has been renewed by tenders and shareholder resolutions in the intermediate years, representing a total period of uninterrupted engagement appointment for AS LHV Pank , as a public interest entity, of 9 years. According to the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our mandate as the auditors of AS LHV Pank can be extended until the annual period ending 31 December 2028.

AS PricewaterhouseCoopers

Ago Vilu	Verner Uibo
Certified auditor in charge, auditor's certificate no.325	Auditor's certificate no.568

27 February 2018

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

Proposal for profit distribution

The Management Board of AS LHV Pank proposes to the General meeting of shareholders to distribute the profit of the financial year 2017 as follows:

- transfer EUR 699 thousand to statutory reserve capital
- pay dividends in total amount of EUR 2 178 thousand
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 11 108 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.

22.02.2018

Madis Toomsalu__________________
Chariman 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	2017	2016
66121	Security and commodity contracts brokerage	4 762	4 527
64191	Credit institutions (banks) (granting loans)	41 981	33 472
64911	Finance lease	1 845	1 600
	Total income	**48 588**	**39 599**