AS LHV Pank
Consolidated Annual Report 2019

(Translation of the Estonian original)

Consolidated Annual Report	**01.01.2019 – 31.12.2019**
Legal name	AS LHV Pank
Commercial Registry no.	10539549
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
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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
	Kadri Kiisel
Supervisory Board	Madis Toomsalu
	Rain Lõhmus
	Andres Viisemann
	Tiina Mõis
	Raivo Hein
	Heldur Meerits
Auditor	
Auditors' legal name	AS PricewaterhouseCoopers
Auditors' Commercial Registry no.	10142876
Auditors' legal address	Pärnu mnt.15, 10141 Tallinn, Estonia

Contents

MANAGEMENT REPORT

LHV's mission is to help raise 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. LHV values: simple, supportive, effective.

LHV Pank (hereinafter the bank) is the largest Estonian domestic bank. The bank focuses on active and independent customers with an entrepreneurial mindset. For private customers, the bank provides the management of daily financial affairs, along with housing loans, and it specialises in providing the best services for growing customers' savings. For business customers, the bank offers flexible and appropriate financing, along with the management of daily financial affairs. The bank's products and services are simple, transparent and relevant. Modern electronic means of communication are used for customer relations. The resultant reduced costs are reflected in the affordable prices of our everyday banking services.

LHV Pank has representative offices in Tallinn, Tartu and London. The bank has more than 400 staff members, with more than 202 000 customers using the bank's services. LHV Pank consolidates a 65% subsidiary AS LHV Finance, which is engaged in consumer financing (hereinafter the Group).

Business activities

The bank's rapid growth continued in 2019. By the end of the year, the bank achieved a near 10% market share in Estonia, with regard to daily banking, deposits and corporate loans. With regard to daily banking and deposits, the bank is now the third largest bank in Estonia. At the beginning of the year, Eesti Pank classified LHV Pank as a provider or vital service, the fourth bank in Estonia to be classified as such.

The bank's customer numbers grew by more than 40,000 during the year. By the end of the year, customer numbers reached 202,000, having grown by 25%, year-over-year. The year saw a record-breaking growth in customer activity and business volumes. The number of customers actively using the daily banking services grew by nearly a third. The bank participated in the IPO of Coop Bank as a financial consultant, with a half of the subscribers originating from LHV Pank.

Deposit volumes grew by 87% to EUR 2,713 million. Deposits of standard customers grew by 58% to EUR 1,961 million, deposits of financial intermediaries by 94% to EUR 376 million, and deposits engaged through deposit platforms to EUR 373 million. The bank launched an active cooperation with both of the major deposit platforms in Europe (Raisin and Deposit Solutions), mainly engaging one-year term deposits. Deposits were engaged through the platforms in Q2 and Q3 with the aim of ensuring sufficient financing for purchasing the Danske Bank private customer loan portfolio.

The bank's loan volumes grew by 84% to EUR 1,687 million during the year. Corporate loans grew by 32% to EUR 851 million and retail loans by 202% to EUR 836 million. The retail loan portfolio consisted of housing loans (70%), leasing (11%) and other loans (19%). In January, the bank acquired the loan portfolio of Versobank with a total value of EUR 13 million for a price of EUR 12 million. In November, the bank acquired the private loan portfolio of Danske Bank with a total value EUR 432 million for a price of EUR 393 million. Versobank's loan portfolio contained 20 business customers and 47 private customers. Danske Bank's loan portfolio contained approximately 10,800 private customers, with home loans contributing 97%. The bank considers the credit portfolio to be strong and well-secured. As the interest rates of these housing loans were relatively close to cost price, the portfolio could only be purchased at a discount. The transaction significantly improved and diversified the entire structure of the bank's loan portfolio. The bulky corporate loan portfolio is now balanced out by the home loan portfolio.

Net profit for the year amounted to EUR 22.1 million. A quicker growth in net profit was curbed by the increase in interest expenses on both the deposits engaged from deposit platforms and the funds kept with the European Central Bank. The bank incurred interest expenses on the Danske Bank private customer loan portfolio in Q2, but only started to generate interest income at the end of the year. Net profit grew significantly after the takeover of the Danske Bank private customer loan portfolio. Net profit was negatively affected by additional loan write-downs made during the takeover of the loan portfolio, as well as the notary's fees and state fees related to re-registration of the collateral.

The quick organic growth in the bank's loan portfolio and purchase of the Danske Bank private customer loan portfolio conditioned the need to engage, in addition to deposits, a significant volume of additional capital through three different capital instruments. During the year, the bank engaged additional share capital from AS LHV Group and issued additional Tier 1 securities (AT1) and subordinated bonds.

With the aim of financing the bank's housing loan portfolio through covered bonds in the future, the bank submitted to the Financial Supervision Authority the application for additional authorisation for covered bonds. The issue of covered bonds is scheduled for 2020 and serves the purpose financing the bank's home loan portfolio via a more favourable, long-term financial instrument.

In Q4, the bank decided to continue pursuing the internal ratings-based (IRB) approach to credit risk, a project which was suspended two years ago. The decision was conditioned by the fact that the new Capital Requirements Regulation (CRR), which entered into force in the middle of the year, has not taken into account the latest Basel guidelines regarding amendment of the capital requirements for the standard approach to credit risk.

At the beginning of 2020, Moody's Investors Service re-confirmed the previous credit rating assigned to the bank: investment-grade credit rating with a stable outlook. In assigning the rating, Moody's took account of the bank's strong capitalisation and profitability, which helps to balance the bank's rapid growth.

The auditor has provided other assurance services to the bank in 2019, as required by the Credit Institutions Act and the Securities Markets Act.

Development activities

New accounts were opened more actively than in previous periods. This was facilitated by both the upgraded Mobile Bank and the expanded ATM network. The Mobile Bank was significantly improved during the year, providing the options of opening an account, ordering a bank card, making investments and applying for various loan products. In addition to Baltic shares, the upgraded Mobile Bank also provides the option of making transactions with shares of foreign stock exchanges and exchange-traded funds. Investment-making via the Mobile Bank is convenient and swift – a highly important factor in transactions. Furthermore, the Mobile Bank also provides an overview of the price information charts. More than a half of the bank's customers, who use investing services, hold foreign shares or index funds. Therefore, the creation of the new service was very important for many customers.

While at the beginning of the year, the bank installed additional ATMs, significantly expanding its pan-Estonian ATM network, the middle of the year saw the conclusion of a contract with Luminor Bank, Danske Bank and Worldline. The transaction partnered the bank with Luminor Bank in the management of a shared ATM network, replacing the former partner Danske Bank. The shared network is operated by LHV Pank. For the bank's customers, the ATM network was expanded five times, from 25 ATMs to 125 ATMs. The ATM network expansion significantly improved our customer's access to cash withdrawal.

We also launched several value-added services for our customers. At the beginning of the year, we launched real-time EUR-payments. We were the first bank to offer the Entrepreneur Account. With regard to major settlements, the state treasury's cash pool account was introduced, with accounts opened for the bank's customers in the Ministry of Finance and the Tax and Customs Board for making payments and paying taxes. A co-operation agreement was concluded with KredEx to provide housing loan surety to young people. Virtual IBAN and API services were launched for financial intermediaries. At the beginning of 2020, the bank opened real-time GBP payments to its customers engaging in financial intermediation.

As an upgrade, the bank now provides an overview of alternative investments in the summary view of the Internet Bank. We were also the first bank to provide information on EstateGuru and Coinbase investments. An overview of alternative investments, i.e. investments in crowd-funding and crypto-assets, provides the customer with convenient access to information on both stock exchange investments and OTC investments, as well as a quick and comprehensive overview of the investment portfolio. Customers can also view the funds available on the platform. We are working towards adding the overview of the accounts opened in other major alternative investment platforms.

The new Payment Services Directive entered into force in the middle of September, with the bank allowing third parties access to customer accounts for making and accepting payments, provided that the customer has previously agreed to the same. The first service providers have already interfaced with the bank. The Directive also established restrictions for contactless payments. The new regulation allows to make either five contactless payments or contactless payments in the total amount of up to EUR 150 without strong authentication.

Two internationally acknowledged and widely used IT systems were implemented for preventing money laundering and terrorist financing: Fico-Tonbeller for KYC in account opening and payment monitoring, and Accuity for payment screening. The bank actively supported the development of the new IT system Salv, and its adoption as one of Salv's first customers.

Organisation

The bank's organisational structure is divided into six areas, each with their own departments. Business areas include retail banking, corporate banking and financial intermediation, supporting areas include IT, financial management and support services, and risk management. Human resource management, marketing and communication, and compliance are activities covering the entire bank. The bank's UK branch is covered by the financial intermediation area. Management of the compliance function and department was transferred from the area of risk management to the sphere of responsibility of the Chairman of the Management Board in the middle of the year.

The Risk and Capital Committee and the Nomination Committee were established at the end of the year on the level of the Supervisory Board. The purpose of the Risk and Capital Committee is to advise and support the Supervisory Board with regard to supervision of the general, actual and future risk appetite and strategy, considering all types of risk and ensuring their compliance with the business strategy, objectives, business practice and values. The purpose of the Nomination Committee is to support the Supervisory Board in issues concerning the selection process and fit-and-proper requirements.

The Money Laundering and Terrorist Financing Prevention Committee was established on the Management Board level, and the Risk and Capital Committee was renamed Assets and Liabilities Management Committee. The purpose of the Money Laundering and Terrorist Financing Prevention Committee is to advise and support the Management Board in issues concerning the prevention of money laundering and terrorist financing and implementation of international sanctions. Within the framework of performance of its duties, the committee analyses the information regarding the services provided by the bank, as well as the dynamics in the market, legal and supervisory environment. Based on the information gathered, the committee assesses compliance of the bank's activities with its strategy and risk appetite, as well as the relevance of the planned audit procedures, and gives instructions regarding additional actions to be taken.

In connection with the United Kingdom's exit from the European Union, the Financial Supervision Authority provided the bank with the authorisation for the UK branch as a third-country branch. However, the authorisation process was delayed by the UK supervisory authority in connection with the postponement of the Brexit date and lack of clarity, and will be continued at the beginning of 2020.

Year-over-year, the bank's employee numbers grew by 57 to 434 (including passive and part-time staff members), including 31 staff members of LHV Finance. In full time equivalents, the number of active employees amounts to 396.

The bank received several recognitions during the year. Once again, the bank was elected the bank with the best customer service in Estonia. The bank's marketing team was elected Estonia's marketing team of the year. The staff satisfaction survey conducted within the bank showed high satisfaction with both the employer and the job. The bank won the Estonian Banking Association's innovation prize for the third year in a row, this time for the Entrepreneur Account. The bank also received the golden award of the Family-friendly Employer, issued by the Ministry of Social Affairs. For the second year in a row, Euromoney declared LHV Pank the best bank in Estonia. At the end of the year, the Banker magazine of the Financial Times elected LHV Pank the best bank in Estonia.

Sponsorship

The bank takes its 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, the bank prefers long-term dedication and cooperation. The bank stands ready to contribute to the pursuit of innovative ideas which help to advance Estonian life.

The bank's long-term partners include Estonian Football Association, Estonian Optimist Class Association, Estonian Gazelle Movement, Estonian Entrepreneur of the Year competition, Estonian Music Days and the Enn Soosaar Foundation.

At the end of the year, the bank extended its cooperation agreement with the Estonian Football Association for the next five-year period. The scale of the sponsorship for the next five years amounts to a total of one million euros, subject to further expansion, depending on the active use of the Football Card and the national team making it to the finals.

Financial results

In 2019, the net profit of the Group increased by 20% compared to the previous year, amounting to EUR 22.1 million (2018: EUR 18.4 million). Net interest income increased by 23% and net fee and commission income increased by 15%. Financial income decreased by 56% compared to the previous year.

The increase of the net interest income is attributable to the increase in of the lending and regular customer 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 26% year-on-year, which was expected given the current phase of high growth and new business development.

Loan losses were 34% lower compared to the previous year.

The total volume of the Bank's loan portfolios at the end of December amounted to EUR 1 687 million (31.12.2018: EUR 919 million). The portfolio volume grew by 84% year-on-year. The majority of the loan portfolio consists of loans for companies, which grew by 33% year-on-year to EUR 880 million (31.12.2018: EUR 664 million). The portfolio of loans issued to private individuals increased by 207% to EUR 813 million (2018: EUR 265 million).

The volume of deposits of the Bank increased by 87% year-on-year and reached EUR 2 713 million by year-end (31.12.2018: EUR 1 448 million).

The proportion of demand deposits decreased a bit, accounting for 81% of all deposits as at the end of December (31.12.2018: 92%).

Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Bank, calculated according to the definitions of the Basel Committee, was 143% at the end of December (31.12.2018: 144%). The Bank includes cash and bond portfolios, accounting for 43% of the balance sheet total, among its liquidity buffer (31.12.2018: 44%). The Bank’s loan-to-deposit ratio at the end of 2019 was 62% (31.12.2018: 63%).

The debt security portfolio decreased by 16% during 2019 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 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 26 million.

The Bank's level of own funds as at 31.12.2019 was EUR 158.5 million (31.12.2018: EUR 113.8 million). The Bank is well capitalized as at the end of the reporting period with a capital adequacy level of 17.61% (31.12.2018: 17.14%).

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 31.12.2019 was 5.70% (31.12.2018: 6.56%). 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)*	**2019**	**2018**	**change**
Net interest income	47.91	39.02	23%
Net fee and commission income	12.81	11.10	15%
Other financial income	0.21	0.47	-56%
Total net operating revenues	60.93	50.59	20%
Other income	0.18	0.95	-81%
Operating expenses	-32.52	-25.74	26%
Income tax expense	-3.28	-2.51	30%
Loan losses	-3.22	-4.88	-34%
Net profit	22.10	18.41	20%

Key figures, *(EUR million)*	**2019**	**2018**	**change**
Net profit	22.1	18.4	20%

Volumes, *(EUR million)*	**31.12.2019**	**31.12.2018**	**change**
Loan portfolio	1 687.0	918.8	84%
Bond portfolio	32.9	39.0	-16%
Deposits	2 713.0	1 448.0	87%
Equity	171.7	125.6	37%
Number of customers holding assets in bank	202 186	161 357	25%

Net profit attributable to owners of the parent	19.8	16.6	19%
Average equity	148.7	112.5	32%
Return on equity (ROE) %*	13.8	15.3	-1.5
Average assets	2 327	1 693	37%
Return on assets (ROA) %	0.9	1.1	-0.2
Net interest income	47.9	39.0	23%
Average assets exposed to interest risk	2 320	1 688	37%
Net interest margin (NIM) %	2.1	2.31	-0.24
Spread %	2.02	2.29	-0.27
Cost / Income ratio %	53%	50%	3

* 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

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)*	**31.12.2019**	**31.12.2018**
Paid-in share capital	95 500	69 500
Statutory reserves paid in from net profit	3 237	2 269
Accumulated profit/deficit	45 619	31 442
Intangible assets (subtracted)	-685	-1 286
Net profit for accounting period (COREP)	14 863	12 046
Deductions	-33	-193
Tier 1 capital	**158 501**	**113 778**
Additional Tier 1 capital	23 000	0
Total Tier 1 capital	**181 501**	**113 778**
Subordinated debt	47 500	30 000
Total Tier 2 capital	**47 500**	**30 000**
Net own funds for capital adequacy calculation	**229 001**	**143 778**
Capital requirements		
Central governments and central banks under standard method	920	939
Credit institutions and investment companies under standard method	4 043	5 213
Companies under standard method	819 052	579 886
Retail claims under standard method	167 115	133 053
Public sector under standard method	2	124
Housing real estate under standard method	208 693	39 903
Overdue claims under standard method	5 387	10 381
Other assets under standard method	16 879	9 065
Total capital requirements for covering the credit risk and counterparty credit risk	**1 222 091**	**778 555**
Capital requirement against foreign currency risk	476	305
Capital requirement against interest position risk	0	32
Capital requirement against equity portfolio risks	960	704
Capital requirement against credit valuation adjustment risks under standard method	22	41
Capital requirement for operational risk under base method	76 766	59 434
Total capital requirements for adequacy calculation	**1 300 315**	**839 071**
Capital adequacy (%)	**17.61**	**17.14**
Tier 1 Capital Ratio (%)	**13.96**	**13.56**

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 23.7% and Andres Viisemann and persons related to him with 9.8%.

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 seven members. The Management Board is comprised of Erki Kilu, Andres Kitter, Indrek Nuume, Jüri Heero, Meelis Paakspuu, Kadri Kiisel and Martti Singi.

Committees

The Supervisory Board of AS LHV Group, the sole shareholder of LHV Pank, has formed four 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.

During 2019, the extenral auditors have provided to the Group translation services, tax advisory services and other assurance services, which are required to be performed by auditors according to Credit Institutions Act and Securities Markets Act.

Risk and Capital Committee

The purpose of the Risk and Capital Committee is to advise and support the Supervisory Board with regard to supervision of the general, actual and future risk appetite and strategy, considering all types of risk and ensuring their compliance with the business strategy, objectives, business practice and values.

Nomination Committee

The purpose of the Nomination Committee is to support the Supervisory Board in issues concerning the selection process and fit-and-proper requirements.

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, in 2017, in 2018 and in 2019. In 2017, the options issued in 2014 were fully exercised and in 2018, the options issued in 2015 were fully exercised. In 2019, the options issued in 2016 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 2019, share options were granted to seven members of the Management Board of AS LHV Pank and seventy-one employees in the total amount of EUR 1 786 thousand. In the beginning of 2018, share options were granted to seven members of the Management Board of AS LHV Pank and fifty-six employees in the total amount of EUR 1 166 thousand. 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 were exercised in 2018, when shares with nominal value of EUR 1 could be acquired for EUR 2.4 per share. Share options issued in 2016 were exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of EUR 1 were acquired for EUR 3.0 per share. Share options issued in 2017 can be exercised between the period of 01.04.2020-30.04.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share. Share options issued in 2018 can be exercised between the period of 01.04.2020-30.04.2020 and shares with nominal value of EUR 1 can be acquired for EUR 5.33 per share. Share options issued in 2019 can be exercised between the period of 01.04.2021-30.04.2021 and shares with nominal value of EUR 1 can be acquired for EUR 4.90 per share. Similarly to previous years, share options are most probably issued also in 2020.

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	3 423	0	3 423	187
Private and corporate banking	1 749	0	1 749	42
Support services	3 710	0	3 710	136
Information technology	2 858	0	2 858	95
Total	**11 740**	**0**	**11 740**	**460**

Business environment

Similarly to the beginning of the year, second half was a pleasant surprise in most of the world's regions. In many places, economic output outperformed the analyst expectations; there were fewer unpleasant surprises. Both in the US and Europe, private consumption was the driver behind the economic growth, with trade remaining in a slump. Of the major economic regions, only China's growth fell short of expectations, and even there it was only marginally subpar. Economic growth in China was curtailed by the trade war and the months of unrest in Hong Kong.

At the end of the year, the growth rate slowed, at least in Europe. The main brakes on growth continue to be the decline in industrial output in Germany and the battle of wills between China and US on protective tariffs and the resulting uncertainty in shaping decisions regarding the future. December's preliminary agreement on the agricultural purchases and use of technology and intellectual property led to the US slightly easing the existing tariffs and holding off on implementing new ones. That sent an immediate positive signal to the markets, but next year will show whether the truce holds and what the actual consequences will be.

The dark clouds surrounding the departure of the United Kingdom from the European Union have not been dispelled, either. The Conservatives' victory in the December general elections is highly likely to mean that Brexit will become a reality by the end of January, however. A minimum of 1-2 years of negotiations on new trade agreements and other understandings will follow. The UK will also have to devote more attention to Scotland and Northern Ireland's strengthening bids for independence. For businesses, it will mean more chaos and a more complicated environment for development.

Economic growth in the Eurozone has remained at the same level for the whole year (1.2% y-o-y growth in Q3). The powerhouse of the European economy, Germany, surprised in Q3 with 1% economic growth, at a time when many analysts expected it to slip into technical recession. In Germany, which has historically relied on exports, the economy has been kept afloat by consumer spending been stimulated by various government subsidies and tax incentives. Looking ahead, there is nevertheless little reason for optimism – survey data show that order books (particularly for export orders) are deteriorating and that the lack of confidence in the industrial sector is now spreading to the services sector. In the longer perspective, a determining factor will be how Europe's car industry embraces new trends in the sector (electric cars, self-driving cars), trends in which it has been in more of an onlooker's role so far.

Although wage growth remained quite brisk in the Eurozone compared to years past (2.5-3%), it was not able to generate enough pressure on inflation. Inflation in the Eurozone fell to 0.7% in the early part of the Q4, but bounced again to higher than 1% in the year end.

To contend with low inflation, the European Central Bank is continuing a dovish monetary policy – the ECB's deposit facility rate is at a historic low of -0.5% and asset purchases are also continuing in order to increase the money supply. Low interest rates have undoubtedly stimulated the economy over the last years, but it is becoming harder and harder to obtain a lasting effect. Negative rates on deposits have delivered a blow to banks' profitability but only in very rare cases has the effect been passed on to end depositors. The new President of the ECB, Christine Lagarde, has mentioned the need to review the whole monetary policy strategy, and this should start in the first half of 2020. She does not see the need for a dramatic change of direction, however, being a supporter of a dovish monetary policy herself.

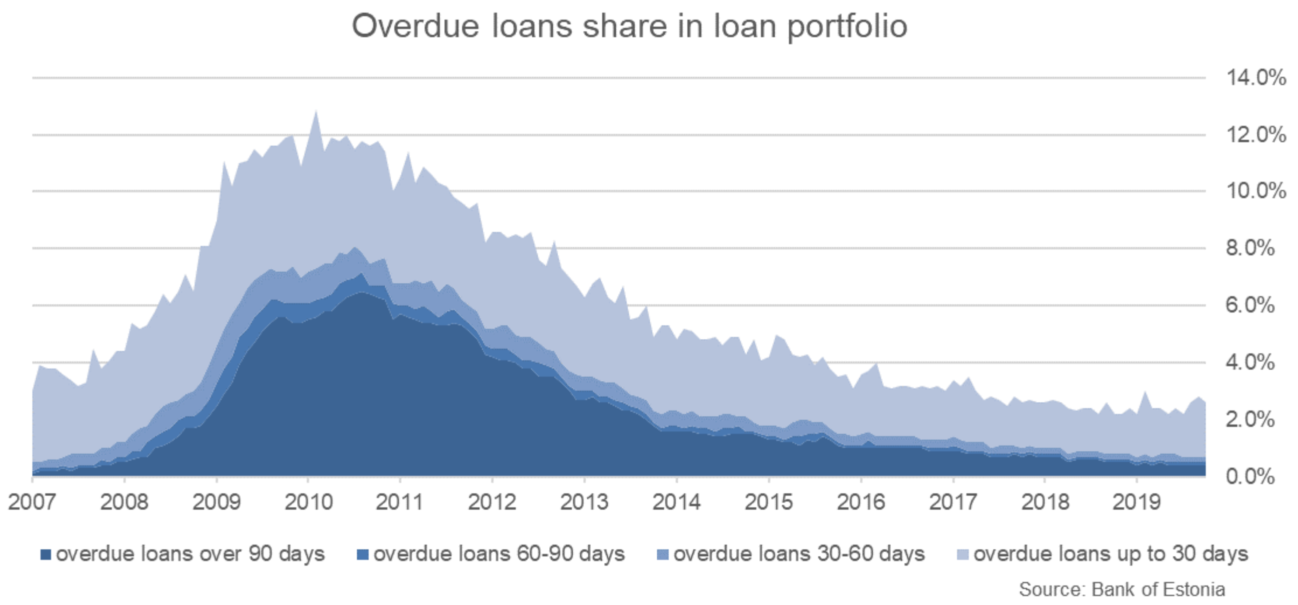
The Estonian economy grew by 4.2% in Q3, which clearly exceeded expectations. Growth was driven by the services sector (information and communications, retail and business services) and the influence of the agriculture and industry sectors was also noteworthy. In spite of the weakening external environment, Estonia's export sector has stood up well and export volumes were up 7% in Q3. True, some of the growth can be attributed to last year's relatively low comparison base. Approximately one-quarter of the economic growth came from net taxes on products, which is directly the outcome of government tax policy. The lowering of the alcohol excise duty in July made businesses postpone replenishing their warehouse stocks until the last minute and thus excise duty receipts in July and all through Q3 were very high. The actual growth in value-added generated in the economy was 3%, and slower compared to previous quarters, which is a logical trend considering the backdrop of uncertainty and lower confidence.

The growth of industrial output slowed in the beginning of the year and even reached the zero mark in April. This was caused mainly by the concentration of production in the energy sector, which is grappling with high CO2 allowance prices. Until the end of the summer, the processing industry was able to gradually increase its output, but it nevertheless fell to near zero in the end of Q3. The drop in machinery and equipment production output played a major role. The clothing and paper industry and the production of metal products also stood out on the negative side. The chemical and oil industry fared better.

Overall for the year 2019, economic growth in Estonia should be around 3.5%. In the years ahead, growth will slow, because external demand is softening and the economy is already performing at the maximum level with its existing resources and has little capacity for additional rapid growth. The shortage of available resources means that businesses' ability to adapt and success in increasing productivity are increasingly important, so there will have to be an energetic commitment to continuing smart investments. Above all, it will be important to achieve long-term sustainable economic growth balanced between different sectors. By economic sector, the risks are higher than average in the construction sector, where the market will be saturated for some time, and in low-productivity branches of the processing industry, where businesses find it increasingly hard to keep up with rapidly growing wages. LHV maintains a conservative outlook on the real estate market, keeping an eye on the local and Scandinavian market and devoting increased attention to developments in Sweden. As to rental cash flow projects, there is a danger that there may not be enough demand for absorbing the volume being developed and that there may be corrections in rent prices or vacancy rates. A positive that can be highlighted is that the financing environment remains favourable, allowing loan balances to enjoy reasonable growth. Household demand for loans remains strong, driven by housing loans and car leasing. The average interest rate on new home loans issued has started rising, which is a sign of lower confidence in society but also of low competition on the loan market. Interest rates are at historic lows, which for local businesses represent opportunities that they should seize more actively in thinking about the future. LHV is looking to be actively involved in finding and supporting new sources of growth, offering businesses a long-term partnership and value-generating advisory services.

							Bank of Estonia forecast		
Key economic indicators of Estonia*	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Nominal GDP (EUR billion)	18.89	19.76	20.25	21.10	23.62	26.04	27.98	29.54	30.93
GDP volume**	1.4%	2.8%	1.4%	2.1%	4.9%	4.8%	3.4%	2.3%	2.0%
Private consumption expenditures***	3.8%	3.3%	4.7%	4.4%	2.6%	4.3%	3.2%	4.3%	3.9%
Government consumption expenditures	1.9%	2.7%	3.4%	1.9%	0.6%	0.9%	1.3%	-0.5%	-0.6%
Fixed capital formation	-2.8%	-8.1%	-3.3%	-1.2%	12.5%	1.7%	15.5%	0.2%	1.6%
Exports	2.3%	3.1%	-0.6%	4.1%	3.5%	4.3%	3.8%	1.3%	2.5%
Imports	3.2%	2.2%	-1.4%	5.3%	3.6%	5.7%	4.2%	2.0%	3.0%
CPI	2.8%	-0.1%	-0.5%	0.1%	3.4%	3.4%	2.4%	2.2%	1.8%
Unemployment rate (% of the labour force)	8.6%	7.4%	6.2%	6.8%	5.8%	5.4%	4.7%	5.7%	6.2%
Current account (% of GDP)	-0.4%	0.9%	2.2%	1.9%	3.3%	1.8%	1.2%	1.1%	0.6%
Budget balance (% of GDP)****	-0.2%	0.7%	0.1%	-0.3%	-0.4%	-0.5%	-0.2%	-0.2%	-0.2%

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



Overdue loans share in loan portfolio
14.0%
12.0%
10.0%
8.0%
6.0%
4.0%
2.0%
0.0%
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
overdue loans over 90 days
overdue loans 60-90 days
overdue loans 30-60 days
overdue loans up to 30 days
Source: Bank of Estonia

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of profit or loss and other comprehensive income

(EUR thousand)	Note	2019	2018
Interest income		61 413	45 622
incl interest income based on EIR		57 804	43 047
Interest expense		-13 498	-6 601
Net interest income	5	**47 915**	**39 021**
Fee and commission income		24 157	18 902
Fee and commission expense		-11 349	-7 799
Net fee and commission income	6	**12 808**	**11 103**
Net gains from financial assets measured at fair value	10	126	404
Foreign exchange rate gains/losses		79	64
Net gains from financial assets		**205**	**468**
Other income		176	951
Staff costs	7	-17 042	-13 878
Administrative and other operating expenses	7	-15 475	-11 865
Profit before credit losses		**28 587**	**25 800**
Impairment losses on loans and advances	11	-3 210	-4 879
Profit before income tax		**25 377**	**20 921**
Income tax expense		-3 277	-2 514
Profit for the year		**22 100**	**18 407**
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Net gains on investments in equity instruments designated at FVOCI	9	134	42
Total profit and other comprehensive income for the year		**22 234**	**18 449**
Total profit attributable to:			
Owners of the parent		19 804	16 642
Non-controlling interest		2 296	1 765
Total profit for the year		**22 100**	**18 407**
Total profit and other comprehensive income attributable to:			
Owners of the parent		19 938	16 684
Non-controlling interest		2 296	1 765
Total profit and other comprehensive income for the year		**22 234**	**18 449**

Notes on pages 19 to 105 are an integral part of the consolidated financial statements.

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Initials I.S. Date 27.02.2020

Consolidated statement of financial position

(EUR thousand)	**Note**	**31.12.2019**	**31.12.2018**
Assets			
Due from central bank	8	1 232 733	639 862
Due from credit institutions	8	32 247	24 979
Due from investment companies	8	5 473	17 005
Equity instruments at fair value through other comprehensive income	9	432	298
Financial assets at fair value through profit or loss	10	32 499	38 913
Loans and advances to customers	11	1 687 034	918 761
Receivables from customers	12	2 745	2 509
Other financial assets	13	2 246	2 936
Other assets	13	1 857	1 341
Tangible assets	14	1 903	1 122
Right-of-use assets	14	4 777	0
Intangible assets	14	685	1 286
Total assets		**3 004 631**	**1 649 012**
Liabilities			
Deposits from customers and loans received	15	2 738 601	1 469 561
Financial liabilities at fair value through profit or loss	10	8	11
Accounts payable and other liabilities	16	23 774	23 861
Subordinated debt	18	70 500	30 000
Total liabilities		**2 832 883**	**1 523 433**
Equity			
Share capital	19	95 500	69 500
Statutory reserve capital	19	3 025	2 191
Other reserves	9	212	78
Retained earnings		67 793	49 687
Total equity attributable to owners of the parent		**166 530**	**121 456**
Non-controlling interest		5 218	4 123
Total equity		**171 748**	**125 579**
Total liabilities and equity		**3 004 631**	**1 649 012**

Notes on pages 19 to 105 are an integral part of the consolidated financial statements.

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

LHV

Consolidated statement of cash flows

(EUR thousand)	Note	2019	2018
Cash flows from operating activities			
Interest received		60 045	45 574
Interest paid		-10 609	-6 621
Fees and commissions received		24 157	18 902
Fees and commissions paid		-11 349	-7 799
Other income received		171	950
Staff costs paid		-16 072	-13 077
Administrative and other operating expenses paid		-11 122	-10 700
Income tax paid		-3 236	-1 970
Cash flows from operating activities before change in operating assets and liabilities		**31 985**	**25 259**
Net increase/(decrease) in operating assets:			
Net increase/(decrease) in financial assets held for trading at fair value through profit or loss		49	-115
Loans and advances to customers		-770 388	-199 259
Mandatory reserve at central bank	8	-12 146	1 094
Security deposits	13	690	-647
Other assets		-481	-449
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers	15	871 616	-93 323
Term deposits of customers	15	390 754	-9 316
Loans received	15	10 000	16 250
Repayments of loans received	15	-5 886	-722
Financial liabilities held for trading at fair value through profit or loss		-3	8
Other liabilities		-6 300	-38 414
Net cash from/(used in) operating activities		**509 890**	**-299 634**
Cash flows from investing activities			
Purchase of tangible and intangible assets	14	-2 071	-1 395
Disposal of tangible assets		5	0
Proceeds from disposal and redemption of investment securities at fair value through other comprehensive income	9	0	520
Net changes of investment securities at fair value through profit or loss	10	6 492	10 845
Net cash from/(used in) investing activities		**4 426**	**9 970**
Cash flows from financing activities			
Paid in share capital	19	26 000	10 000
Proceeds from subordinated debt	18	48 500	10 000
Subordinated loans redeemed		-8 000	0
Dividends paid		-3 431	-3 350
Repayment of principal of lease liabilities		-1 003	0
Net cash from financing activities		**62 066**	**16 650**
Effect of exchange rate changes on cash and cash equivalents		**79**	**64**
Net increase/(decrease) in cash and cash equivalents		**576 461**	**-272 950**
Cash and cash equivalents at the beginning of the year	8	667 566	940 516
Cash and cash equivalents at the end of the year	**8**	**1 244 027**	**667 566**

Notes on pages 19 to 105 are an integral part of the consolidated financial statements.

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Initials I.S. Date 27.02.2020

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
Balance as at 01.01.2018	**56 500**	**1 492**	**36**	**34 963**	**95 991**	**3 530**	**99 521**
Transfer to statutory reserve capital (Note 19)	0	699	0	-699	**0**	0	**0**
Paid in share capital (Note 19)	10 000	0	0	0	**10 000**	0	**10 000**
Dividends paid	0	0	0	-2 178	**-2 178**	-1 172	**-3 350**
Share options (Note 19)	0	0	0	959	**959**	0	**959**
Profit of the year	*0*	*0*	*0*	16 642	**16 642**	1 765	**18 407**
including changes on initial application of IFRS 9	*0*	*0*	*0*	-712	**-712**	0	**-712**
Other comprehensive income	*0*	*0*	*42*	0	**42**	0	**42**
Total profit and other comprehensive income for 2018	0	0	42	16 642	**16 684**	1 765	**18 449**
Balance as at 31.12.2018	**69 500**	**2 191**	**78**	**49 687**	**121 456**	**4 123**	**125 579**
Balance as at 01.01.2019	**69 500**	**2 191**	**78**	**49 687**	**121 456**	**4 123**	**125 579**
Transfer to statutory reserve capital (Note 19)	0	834	0	-834	0	0	**0**
Paid in share capital (Note 19)	26 000	0	0	0	26 000	0	**26 000**
Dividends paid	0	0	0	-2 230	-2 230	-1 201	**-3 431**
Share options (Note 19)	0	0	0	1 366	1 366	0	**1 366**
Profit of the year	*0*	*0*	*0*	19 804	19 804	2 296	**22 100**
Other comprehensive income	*0*	*0*	*134*	0	134	0	**134**
Total profit and other comprehensive income for 2019	0	0	134	19 804	19 938	2 296	**22 234**
Balance as at 31.12.2019	**95 500**	**3 025**	**212**	**67 793**	**166 530**	**5 218**	**171 748**

Additional information on equity is provided in Note 19.

Notes on pages 19 to 105 are an integral part of the consolidated financial statements.

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Initials I.S. Date 27.02.2020

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 2019 for AS LHV Pank (hereinafter the Bank) and its subsidiary AS LHV Finance (together hereinafter: the Group or LHV). AS LHV Pank holds 65% interest in AS LHV Finance.

AS LHV Pank (Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia and in UK. There are offices for client servicing in Tallinn, Tartu and also London branch was opened in 2018. LHV is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt. 2, Tallinn. As at 31.12.2019, the Group employed 420 people, including 25 non-active employees (31.12.2018: 377 people, 32 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 27 February 2020. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 23.7% of the voting rights and Andres Viisemann, who owns 9.8% 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 authorised for approval by the Supervisory Board and shareholders. The shareholders have the right not to approve the consolidated annual report while the Supervisory Board does not have that right.

NOTE 2 Summary of significant accounting policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2019 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 held at fair value through OCI.

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

The financial year started at 1 January 2019 and ended at 31 December 2019. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new IFRS amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements, which became mandatory for the Group's reporting periods beginning on or after 1 January 2019. The overview of these standards and 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 2019.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees are required to recognise: (a) assets and liabilities for all leases with

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Initials I.S. Date 27.02.2020

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. Starting from 1 January 2019, the Group recognised EUR 4 042 thousand on the Group's statement of financial position as right-of-use assets and lease liabilities, thus increasing the total of the statement of financial position of the Group. More information on the right-of-use assets is provided in the Note 14, for lease liabilities in the Note 16. The full accounting policy in disclosed in Note 2.18.

(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 2020, and which the Group has not early adopted.

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

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

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

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

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

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The Group is currently assessing the impact of the new amendment.

IFRS 17, Insurance Contracts (effective for annual periods beginning on or after 1 January 2021; not yet adopted by the EU).

IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare the financial performance of similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. The Group is currently assessing the impact of the standard to it's financial statements.

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

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Initials I.S. Date 27.02.2020

2.2 Consolidation

The 2019 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 recognised at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

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

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

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

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

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company, the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for accounting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27 "Separate Financial Statements". In the parent separate primary financial statements, disclosed in these consolidated financial statements (see Note 24), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognised

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. 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 translation

(a) Functional and presentation currency

The functional and presentation currency of entities in the Group is euro except the branch in UK which has pound as functional currency As the branch had limited activities and transactions in 2019, the effect to Group financial statements is immaterial.

(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 end of the reporting period. Non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the fair value measurement date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of profit or loss under the

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Initials i.S. Date 27.02.2020

line "Foreign exchange rate gains/losses". Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the statement of profit or loss under the line "Net gains from financial assets measured at fair value".

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

Initial recognition and derecognition

Financial assets are recognised on the statement of financial position when the Group becomes a party to the contractual provisions of the instrument and are measured at fair value on initial recognition. Transaction costs are included in the fair value on initial recognition except for financial assets at fair value through profit or loss where transaction costs are expensed in profit or loss. Financial assets at fair value are recognised on the statement of financial position on trade date. Financial assets measured at amortised cost are recognised on trade date.

Financial assets are derecognised when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control.

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

Subsequent measurement

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

Debt instruments (Loans and debt securities)

The classification is based on a combination of assessing the business model for managing the financial assets and whether the contractual cash flows consist of solely payments of principal and interest ('SPPI'). The business model assessment is performed for homogenous portfolios/products identified based on how the business is managed in the divisions of the Group. The assessment is based on reasonable scenarios taking into consideration how the portfolio is evaluated and reported to management; the risks affecting the performance of the portfolio and how these risks are managed; how managers are compensated; and the frequency, value and timing of sales including the reasons for the sales. In determining if the cash flows consist solely of principal and interest, the principal is defined as the fair value of the debt instrument at initial recognition, which can change over the life if there are repayments or capitalisation of interest. Interest cash flows are consistent with components per a basic lending arrangement including consideration for time value of money, credit risk, liquidity risk as well as administrative costs and profit margin. If there are contractual features introducing an exposure to other risks or volatility, it is not considered to consist of solely payments of principal and interest. SPPI tests are performed as a part of new product approval tests. In implementation of IFRS 9 in 2018 SPPI was applied to 22 larger products carried at amortised cost.

Debt instruments are presented in the statement of financial position line items: Due from central banks, credit institutions and investment companies; Loans and advances to customers; Financial assets at fair value through other comprehensive income; Financial assets at fair value through profit or loss; Receivables from customers and Other financial assets, and include instruments in the following measurement categories.

Fair value through profit or loss: Debt instruments are classified in this category if not meeting the criteria for amortised cost or fair value through other comprehensive income. This is the case if the business model is held for trading; where financial assets are considered held for trading if they are held with the intention to be sold in the short-term and for the purpose of generating profits. Debt instruments are mandatorily measured at fair value through profit or loss if the assets are managed and evaluated on a fair value basis or the assets are held with an intention to sell, or alternatively, if the cash flows do not consist of solely payments of principal and interest.

Fair value through other comprehensive income: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to both hold assets to collect contractual cash flows and to sell the assets (b) the contractual cash flows consist of solely payments of principal and interest. The assets are measured at fair value and gains and losses arising from changes in fair value are reported in other comprehensive income and accumulated in equity. The cumulative gain or loss is reclassified from equity to profit or loss upon derecognition of the debt instrument. Interest is calculated by applying the effective interest method on interest-bearing financial assets and expected credit losses are recognised in profit or loss.

Amortised cost: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to hold assets to collect contractual cash flows and (b) the contractual cash flow characteristics consist of solely

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Initials i.S. Date 27.02.2020

payments of principal and interest. The gross carrying amount of these assets is measured using the effective interest method and adjusted for expected credit losses.

Equity instruments

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

Derivatives

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

Modification

The Group may renegotiate loans and modify contractual terms. If the new terms are substantially different from the original terms, the Group derecognises the original financial asset and recognises a new asset. The Group also assesses whether the new financial asset is credit-impaired at initial recognition. If the terms are not substantially different, the modification does not result in derecognition and the Group recalculates the gross carrying amount based on the new cash flows using the original effective interest rate of the financial asset and recognises a modification gain or loss.

Reclassification

In rare circumstances debt instruments (financial assets) excluding those designated at fair value through profit or loss on initial recognition, can be reclassified if there has been a change in the business model for managing the financial asset.

Write-off

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a dercognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognised as income.

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

IFRS 9 category		Class (applied by the Group)		31.12.2019	31.12.2018
Financial assets	Amortised cost	Due from banks and investment companies		1 270 453	681 846
		Loans and advances to customers	Loans to legal entities	950 541	705 186
			Loans to individuals	736 493	213 575
		Receivables from customers		2 745	2 509
		Other financial assets		2 246	2 936
	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	Shares and fund units	164	157
			Listed bonds	32 331	38 697
			Derivatives	4	59
	Equity instruments at fair value through other comprehensive income	Investment securities	Unlisted shares	432	298

2.6 Impairment of financial assets carried at amortised cost

Measurement

The impairment requirements are based on an expected credit loss (ECL) model. The guiding principle of the ECL model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments.

All debt financial assets measured at amortised cost and fair value through other comprehensive income, as well as lease receivables, financial guarantees contracts, contract assets and certain loan commitments are in scope for expected credit loss.

ECLs on financial assets measured at amortised cost and lease receivables are presented as allowances, i.e., as an integral part of the measurement of those assets in the statement of financial position. The allowance reduces the gross carrying amount. ECLs on loan commitments and financial guarantee contracts are presented as provisions, i.e., as a liability, in the statement of financial position. Adjustment to the loss allowance and provision due to changes in ECLs is recognised in the statement of profit or loss as net expected credit losses.

The assessment of credit risk, and the estimation of ECL, shall be unbiased and probability-weighted, and shall incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. LHV uses both models and expert based individual assesments for calculating ECLs.

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Initials I.S. Date 27.02.2020

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

Significant increase in credit risk

At the end of each reporting period the Group performs an assessment of whether credit risk has increased significantly since initial recognition. The assessment of whether there has been a significant change in credit risk is based on quantitative and qualitative indicators. Indicators include payments that are past due >30 days and <90 days and financial assets that have been classified as watch-list or with forbearance measures (loans whose contractual terms have been revised due to the customer's financial difficulties). A quantitative indicator is calculated based on the change in lifetime probability of default (PD) by comparing the scenario-weighted lifetime PD at the reporting date with the scenario-weighted lifetime PD at initial recognition. In case there has been a significant increase in credit risk since initial recognition, an allowance for lifetime ECL shall be recognised and the financial instrument is transferred to Stage 2. The approach is symmetrical, meaning that in subsequent reporting periods, if the credit quality of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the financial asset moves back to Stage 1.

Definition of default

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments has been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %
- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. Financial instruments in default are in Stage 3. All financial assets in Stage 3 are considered credit-impaired.

Modelling

The ECL is calculated as a function of the probability of default (PD), the exposure at default (EAD) and the loss given default (LGD), as well as the timing of the loss. The Group's IFRS 9 methodology for ECL measurement is based on existing internal scoring and rating models.

PD represents the likelihood that a loan will not be repaid and will go into default in either a 12-month or lifetime horizon. The expected PD for each individual instrument incorporates a consideration of past events, current market conditions and reasonable and supportable information about future economic conditions. LHV uses existing scoring and rating models that are adjusted according to specific IFRS 9 requirements. The models are calibrated based on a combination of asset class and product type.

EAD represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default. LGD takes into consideration the amount and quality of any collateral held. LHV uses existing LGD models adjusted to meet IFRS 9 requirements. When measuring ECL, LHV uses the maximum contractual period during which LHV is exposed to risk.

Forward-looking information

The Group uses internally developed macroeconomic forecasts as the basis for the forward-looking information incorporated in the ECL measurement. In order to ensure an unbiased estimation of credit losses under IFRS 9, at least three scenarios shall be used. One of the scenarios shall be the base case scenario, representing the most likely outcome, which is also applied in the regular financial planning and budgeting process, while other case scenarios shall represent more optimistic or pessimistic outcomes.

Forecasts are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business and finance. As available without undue cost, external experts and externally developed 'benchmark forecasts' should be consulted. The referred benchmark forecasts include but are not limited to World Economic Outlook by the IMF, European Economic Forecasts by the European Commission and Economic Forecasts by Bank of Estonia. The scenarios shall be approved by the Risk and Capital Committee.

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Initials i.S. Date 27.02.2020

Scenarios are be developed for a time horizon over which reliable projections can be made, typically for a time horizon of 3 years. At minimum, selected macro indicators have to be forecasted for a period of two years following the current year. In general, scenarios are reviewed on a quarterly basis. In case of significant changes in the macroeconomic environment and outlook, the scenarios shall be updated.

Individual assesments and Management´s judgement

The Group uses both models and expert based judgement in order to determine ECLs. The degree of judgement that is required to estimate ECL depends on the model outcome, materiality and the availability of detailed information. The model provides guidance and transparency as to how economic events could affect the impairment of financial assets. Expert based judgement may be applied to the modelled outcome to incorporate an estimated impact of factors not captured by the model. Such individual ECL assesments may be applied to significant exposures at a counterparty level. These assesments are decided by the Credit Committee. In addition there may be a need for adjustments at a portfolio level, which is decided by the Risk and Capital Committee.

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

An item of tangible fixed assets is carried in the statement of financial position at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers, furniture and fixtures is 33%, for improvements of rental space either 20% p.a. or amortization throughout the rental period, depending on which is shorter. Depreciation is calculated starting from the month of acquisition until the carrying amount reaches the residual value of the asset. In case the residual value is greater than the carrying amount of the asset, no further depreciation expense is calculated.

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. The Group performs an impairment test when there are circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell or its value in use), it is written down immediately to its recoverable amount recognising an impairment loss in the statement of profit or loss for the reporting period.

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

2.8 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis, except client agreements (see below). The annual amortisation rate for purchased licenses is 33%.

Sales costs for the acquisition of new clients are capitalised. The amortisation method for client agreements is the diminishing balance method. The annual amortisation rate for purchased client agreements is 12% of the residual value of those assets. At the end of each reporting period, the appropriateness of amortization rates, methods and residual values is assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset’s fair value less costs to sell and value in use.

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 recognised for the amount by which the asset’s carrying amount exceeds its recoverable amount. The

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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 recognised in statement of profit or loss.

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

2.10 Loan commitments, Financial guarantees and performance guarantees

The Group issues commitments to provide loans. These commitments are irrevocable or revocable only in response to material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Group cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

The Group issues financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the financial guarantee. At the end of each reporting period, the financial guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

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

2.11 Financial liabilities

The Group classifies financial liabilities either:

a) financial liabilities measured at fair value through profit or loss
b) financial liabilities measured at amortised cost
c) financial guarantee contracts and loan commitments

Recognition of a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.6. All other financial liabilities are subsequently measured at amortised cost using the effective interest method. Transaction costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the statement of profit or loss during the term of the instrument, using the effective interest rate. Interest costs are included in the statement of profit or loss line "Interest expenses".

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

Loans received, debt securities issued and similar subordinated debts are initially recognised at fair value, less transaction costs

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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

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

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 end of the reporting period. The liability related to the payment of a vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the statement of financial position and as staff costs in the statement of profit or loss.

Social security tax includes payments to the state pension fund. The Group has neither 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 company receives services from group employees as consideration for equity instruments (options) of LHV Group. The fair value of the employee services received in exchange for the grant of the options is recognised during the shared-based compensation program as group's staff expense and as an increase in the equity (other reserves). The total amount to be expensed is determined by the fair value at the time of issuing the options. The fair value of the options granted:

- including any market performance conditions influencing the share price (e.g. LHV Group share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period).

At the end of each reporting period, the bank revises its estimates of the number of options that are expected to vest based on the vesting conditions (other than market conditions). It recognises the impact of the revision to original estimates, if any, in the statement of profit or loss, with a corresponding adjustment to equity.

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

2.14 Provisions and contingent liabilities

Liabilities arising from an obligating event before the end of the reporting period that have either a legal basis or that have arisen from the Group's current operating practice (legal or constructive obligation) that require probable outflow of resources, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the statement of financial position. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the statement of financial position in the amount which according to the management is necessary as at the end of the reporting period for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and an expense from the change in the carrying amount of provisions are included within expenses in the reporting period. Provisions are not set up to cover future operating losses.

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

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

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

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

Assets from which resources are expected to flow to the Group within 12 months are recognised as current assets. The portion of assets with expected inflows later than 12 months after the end of the reporting period is recognised as non-current assets (see Note 3.4).

Liabilities are classified as current when they are due within twelve months after the end of the reporting period or if the Group does not have an unconditional right to defer the payment for later than 12 months after the end of the reporting period. Loans received with due date within 12 months after the end of the reporting period which are refinanced as non-current after the end of the reporting period but before the financial statements are authorised for issue, are recognised as current. Loans received that the lender has the right to recall at the end of the reporting period due to breaches of contractual terms are also classified as current.

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

2.16 Revenues and expenses

The effective interest method is applied to recognise interest income and interest expenses in profit or loss for financial assets and financial liabilities measured at amortised cost or debt investments at fair value through other comprehensive income.

The effective interest method is a method of calculating the gross carrying amount of a financial asset or the amortised cost of a financial liability and of allocating interest income and interest expenses. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial instrument. When calculating future payments, all payments included in the terms and conditions of the contracts, such as advance payments, are taken into consideration. The calculation of the effective interest rate includes fees that are an integral part of the effective interest rate. However, expected credit losses are not taken into account.

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

Fee and commission income

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

Fees that are included in the calculation of the effective interest rate of a financial instrument measured at amortised cost, such as loan origination fees, are allocated over the expected tenor of the instrument applying the effective interest method and presented in Net interest income.

Fee and commission income is recognised to depict the transfer of promised services to the customers in an amount that reflects the consideration to which LHV expects to be entitled in exchange for the service.

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Group's performance. Variable fees are recognised only to the extent that management determines that it is highly probable that a significant reversal will not occur.

Other fee and commission income is recognised at a point in time when the Group satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations.

The major types of fees are described below.

Fee and commission income for asset custody and asset management to customers is recognised as revenue over the period in which the services are provided. Performance based fees are recognised when it is highly probable that a significant reversal of recognised revenue will not occur, which is most often when the performance criteria are fulfilled.

Brokerage fees, commission and fees from negotiating a transaction for a third party, such as arrangement of acquisitions or purchase or sale of a business, are recognised on completion of the transaction.

Expenses that are directly related to the generation of fee and commission income are recognised as fee and commission expense.

Net financial income

Gains and losses arising from changes in fair value of financial assets and liabilities measured at fair value through profit or loss are reported under the item Net gains from financial assets. For financial liabilities designated at fair value through profit or loss the change in fair value relating to change in own credit risk is accounted for in other comprehensive income.

Dividend income

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

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Initials I.S. Date 27.02.2020

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

Since 1 January 2019 the IFRS 16 Leases are recognised in the Group's financial reporting.

Lessees are required to recognise:

(a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and

(b) depreciation of lease assets separately from interest on lease liabilities in the income statement.

The group has adopted IFRS 16 Leases retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period as permitted under the specific transition provisions in the standard.

On adoption of IFRS 16, the group recognised tangible assets and lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17 Leases.

The Group leases various properties. Rental contracts are typically made for fixed periods of up to 5 years but as a rule, include extension and termination options. Lease terms are negotiated on an individual basis and may contain a wide range of different terms and conditions.

The Group recognises leases as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use.

Lease liabilities were recognised as present value of lease payments. The right-of use assets were measured at the amount equal to the lease liability, as no adjustments to right of use assets were necessary. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life or the lease term on a straight-line basis.

Lease liabilities include the net present value of the following lease payments:

• fixed payments, less any lease incentives receivable.

• variable lease payment that are based on some kind an index (for example inflation, Euribor).

• amounts expected to be payable by the lessee under residual value guarantees.

• the exercise price of a purchase option if the lessee is reasonably certain to exercise that option.

The lease payments are discounted using the interest rate implicit in the lease, if it is readily determinable, or the Group's incremental borrowing rate. The alternative interest rate is the rate of interest that a lessee would have to pay to borrow, over a similar term and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Short-term leases are leases with a lease term of 12 months or less. Low value assets comprise IT-equipment and small items of office furniture. In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option or not to exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The management reviews the assessment if a significant event or a significant change in circumstances occurs which affects the probability of using options and that is within the control of the management. Alternatively, the extension period of the contract has changed (for example, Group has exercised an option, which initially was considered reasonably uncertain or has not exercised an option, which was initially considered reasonably certain).

According to the contracts, Group has not granted any residual value guaratees in the end of the contract.

On applying the standard as at 01.01.2019, the lease payments were discounted at the Group's incremental borrowing rate of 3.75% on average.

The Group has used the following practical expedients permitted by the standard:

• the accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases.

• lease agreements for low value assets are excluded.

• the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application.

As the result of application, the Group's total assets in the statement of financial position as at 01.01.2019 increased 4 042 thousand euros and liabilities increased 4 042 thousand euros. During the year 2019 EUR 1 634 thousand was additionally recorded as lease liability which was related to the new lease properties.

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Initials I.S. Date 27.02.2020

2.19 Taxation and deferred income tax

Corporate income tax in Estonia

Estonian companies generally do not pay corporate income tax on profits on a current basis. Tax is paid on distributions of profit, either formal (dividends, other payments from equity) or deemed (non-business expenses, transfer pricing adjustments, certain payments to tax havens, etc.). Dividends and other profit distributions are subject to corporate income tax at the rate of 20/80 on the net amount. Starting from 2019, regular dividend payments will be subject to corporate income tax at the reduced rate of 14/86 to the extent of the average dividend distribution of three preceding years. The first year to be taken into account is 2018. Corporate income tax arising from dividend distributions is recorded as a liability and income tax expense when the dividends are declared. The tax becomes due to the tax authorities on the 10th day of the month following the dividend payment.

Starting from second quarter of 2018 credit institutions are obliged to pay advance income tax of 14% on quarterly profits under IFRS (Note 24). The tax becomes due to the tax authorities on the 10th day of the third month following the quarter. Advance income tax paid is non-refundable and thus recorded as expense, but can be used to reduce income tax payable on future dividend distributions.

Corporate income tax in other countries

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

Corporate income tax rates	2019	2018
United Kingdom	19%	19%

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

A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the statement of financial position. The maximum amount of income tax payable, which would arise from paying out the retained earnings as dividends, is disclosed in the Note 19 to the financial statements.

2.20 Offsetting

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

2.21 Statutory reserve capital

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

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

NOTE 3 Risk management

Risk is defined as a potential negative deviation from expected financial results. The Group encounters several risks in its day-to-day operations. The objective of risk management at the Group is to recognise these risks, to measure them appropriately, to manage and to report them. More broadly, the aim of risk management is to increase the value of the Group by minimising losses and reducing the volatility of results. Risk management at the Group is based on a strong risk culture and is built on the principle of three lines of defence where the first line of defence, the business units, are responsible for taking risk and for day-to-day management. The second line of defence, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of defence, the internal audit, conducts independent supervision over the entire group. Risk management principles, requirements and areas of responsibility are described in risk management policy. The principles and objectives of capital management processes are described in the policies of the respective field.

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 Group considers net own funds valid according to capital adequacy regulation as capital. The amount of capital that the Group managed as at 31.12.2019, was EUR 229 001 thousand (31.12.2018: EUR 143 778 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	**31.12.2019**	**31.12.2018**
(in thousands of euros)		
Paid-in share capital	95 500	69 500
Statutory reserves transferred from net profit	3 237	2 269
Accumulated profit/(deficit)	45 619	31 442
Intangible assets (subtracted)	-685	-1 286
Net profit for accounting period (COREP)	14 863	12 046
Deductions	-33	-193
Tier 1 own funds	**158 501**	**113 778**
Additional Tier 1 capital	23 000	0
Total Tier 1 capital	**181 501**	**113 778**
Subordinated debt	47 500	30 000
Total Tier 2 own funds	**47 500**	**30 000**
Total net own funds	**229 001**	**143 778**

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

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). Started from 2014, the capital of banks and investment firms in the European Union became subject to a legal framework (CRD IV/CRR), largely based on the Basel III framework that was agreed in the Basel Committee on Banking Supervision. The objective of the framework is to strengthen the resilience of the financial sector to adverse economic shocks and thereby ensure an adequate and sustainable financing of the economy. Significant changes implemented by the new requirements include the requirement for credit institutions to maintain a higher level and quality of capital than before and a unified framework for designing liquidity buffers. The capital requirements directive also define measures for macro-financial supervision that member states can use to control the behaviour of credit institutions in amplifying the cycles and to alleviate risks arising from market structure. Every year additional smaller changes have been implemented in the regulations and completely updated regulation will be valid started from 2022.

The regulation, which is directly applicable in the member states, obligates all credit institutions operating in the European Union (including their consolidating holding companies) and investment firms to maintain 4.5% of Common Equity Tier 1 (CET 1) and 6.0% of Tier 1 Capital against risk assets. The overall Capital Adequacy Requirement (CAD), including both Tier 1 and Tier 2 capital, remains at the existing 8.0% level.

In addition to the main requirements based on uniform rules, the directive defines the principles for forming capital buffers. In Estonia, in addition to the baseline capital requirements, credit institutions have been subjected to capital maintenance and systemic risk buffers, which are 2.5% (imposed by the Financial Supervisory Authority), 1.0% (imposed by Bank of Estonia) and systematically importance buffer (imposed by Financial Supervisory Authority), respectively. In 2018 the grouping of capital requirements changed and SREP buffers were moved to higher capital buffers, meaning that first bank will breach other buffers before SREP buffers. Breaching each buffer triggers different actions from regulators side and first one in list is set by Estonian Central Bank triggering limitation of ECB transactions..

The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions. An overview of capital requirements as of 31.12.2019 is provided in the table below:

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

Capital requirements valid until October 2018 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	0.92%	0.92%	0.92%
Capital requirements total	**7.92%**	**9.42%**	**11.42%**

Capitalization levels have been increased not due to riskiness of the bank, but because of the increasing market share of the bank. In 2018 LHV was considered as one of four systematically important bank in Estonia. This decision has increased capital buffers by 0.5% from 1st of July 2018 and by another 0.5% from 1st of January 2019. LHV has been keeping conservative approach in capital management and keeps additional internal buffers compared to regulatory ones.
LHV has received the new SREP report only in January 2020, according to which capitalization requirements in 2020 will remain almost the same. The new internal targets will be set by supervisory board in next regular meeting in February.

Each year, the Bank's supervisory board confirms the goals of capitalization and the target level of capital adequacy to cover potential risks arising from fast growth. Each year, an internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential internal capital needs in addition to regulatory capital requirements.
Estonian FSA informed LHV in January 2020 that MREL requirement will change from end of Q2 2021 to the level of 10.15%, as LHV is treated as systematic bank and will and bank has to keep sizable amount of suitable liabilities which could be converted to own funds in case of resolution process.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. 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 risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises from cash and cash equivalents, derivatives and deposits with banks and other financial institutions, debt securities, but mainly from credit exposures to customers, including outstanding loans, given guarantees, other receivables and commitments.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Credit risk is one of the largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. In order to evaluate credit risk, Group analyses the operations and financial position of its customers and business partners. After approving the credit, the solvency of the customer and the value of the collateral are regularly monitored. The credit risk management and control are centralised in a credit risk management unit which reports regularly to the Management Board and Supervisory Board.

3.2.1 Distribution of credit risks

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

a) due from central bank and credit institutions (referred to as "banks" in the tables) and investment companies

b) debt securities and derivatives

c) leveraged loans (loans secured by debt or equity securities)

d) corporate credit portfolio, including
   - loans and overdrafts
   - financial guarantees
   - warehouse financing
   - factoring
   - leasing
   - unused loan commitments

e) retail credit portfolio, including
   - mortgage loans (home and private loans)
   - real estate leasing
   - consumer loans without collateral
   - hire-purchase
   - credit cards and overdrafts to individuals
   - leasing
   - retail loans and overdrafts to SMEs
   - financial guarantees to SMEs
   - unused loan commitments

Maximum exposure to credit risk *(in thousands of euros)*	**31.12.2019**	**31.12.2018**
Due from banks and investment companies (Note 8)	1 270 453	681 846
Financial assets at fair value (debt securities) (Note 10)	32 499	38 913
Loans and advances to customers (Note 11)	1 687 034	918 761
Receivables from customers (Note 12)	2 745	2 509
Other financial assets (Note 13)	2 246	2 936
Total financial assets	**2 995 409**	**1 645 263**
Exposures related to off-balance sheet items (Note 21), excluding performance guarantees	373 379	198 210
Total maximum exposure to credit risk	**3 368 788**	**1 843 473**

3.2.2 Credit risk measurement

For all loan products, except leverage loans, LHV uses either rating or scoring systems to assess customer credit risk, as outlined in the table below. In retail, for credit decisions, application PD models are used, while portfolio scoring PD models are developed for existing contracts. There are also separate models to cover the dimensions of Loss Given Default (LGD) and Credit Conversion Factor (CCF).

Portfolio	Segment	Definition	PD	LGD	CCF/EAD
Corporate	Corporate exposures	Loans to companies with total exposure to LHV >= EUR 500 000 (2018: EUR 250 000)	Rating models	Model	Model
Retail	SME, incl. micro enterprises	Loans to companies with total exposure to LHV < EUR 500 000 (2018: EUR 250 000)	Scoring models		
	Private mortgage	All mortgage loans to private individuals	Scoring models		
	Private non-mortgage	All consumer financing products and car leasing to private individuals	Scoring models		

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

(a) Due from banks and investment companies

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. Loans and advances to central bank, credit institutions and investments companies are not overdue, and are also unsecured. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating). In case there are ratings available from more than one rating agency, the average, or the most conservative rating is used. The positions are held as follows:

Rating *(in thousands of euros)*	**Credit institutions**	**Investment companies**	**Total 31.12.2019**	**Credit institutions**	**Investment companies**	**Total 31.12.2018**
Central bank (The Bank of Estonia, The Bank of England)	1 232 733	0	1 232 733	639 862	0	639 862
AA- to AA+	312	0	312	195	0	195
A- to A+	7 293	0	7 293	10 554	0	10 554
BBB to BBB+	4 091	4 917	9 008	5 661	16 505	22 166
B to B+	0	556	556	0	500	500
Non-rated	20 551	0	20 551	8 569	0	8 569
Total (Note 8)	**1 264 980**	**5 473**	**1 270 453**	**664 841**	**17 005**	**681 846**

Non-rated credit institutions are banks or financial institutions without external credit rating, however management considers their credit quality to be good based on available market information. If credit institutions do not have the external rating and they are subsidiaries of large EU banks, then the rating of the parent company is used. Management has assessed that the ECL from credit institutions and investment companies exposures is immaterial due to the strong ratings of corresponding parties, their financial position and also due to the positive economic outlook in short-term perspective, as the Group holds only very liquid positions with the counterparties. See also note 3.2.4.1 for additional information.

(b) Debt securities and derivatives

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

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

The Group´s derivatives, debt securities at fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVOCI) according to ratings given by Standard & Poor's or equivalent:

Ratings distribution	**Mandatory FVTPL**				
(in thousands of euros)	**Investment portfolio**	**Liquidity portfolio**	**Trading portfolio**	**Foreign exchange forwards**	**Total 31.12.2019**
AAA	11 627	0	0	0	11 627
A- to A+	2 890	17 814	0	0	20 704
Non-rated	0	0	0	4	4
Total (Note 9,10)	**14 517**	**17 814**	**0**	**4**	**32 335**

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Initials I.S. Date 27.02.2020

Ratings distribution (in thousands of euros)	Mandatory FVTPL Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	Total 31.12.2018
AAA	0	18 439	0	0	18 439
A- to A+	18 006	0	0	0	18 006
AA- to AA+	0	1 229		0	1 229
Non-rated	0	0	1 023	59	1 082
Total (Note 9,10)	**18 006**	**19 668**	**1 023**	**59**	**38 756**

Debt securities classified as FVTPL is based on the management assessment of the instrument's business model and how management monitor these investments. Therefore, fair value through profit or loss measurement basis was applied at the application of IFRS 9 as at 1 January 2018.

(c) Other receivables

Credit quality of other receivables *(in thousands of euros)*	31.12.2019	31.12.2018
Receivables (not overdue)	2 634	2 286
Receivables (overdue)	111	223
incl. receivables from individuals	101	196
incl. receivables from legal entities	10	27
Total (Note 12)	**2 745**	**2 509**

As at 20 February 2020, other receivables of EUR 205 thousand euros are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 13) in amount EUR 2 246 thousand (31.12.2018: EUR 2 936 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.

(d) 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 but not higher than 500 thousand assumes an analysis of the overall financial situation of the client and the portfolio offered as collateral by the customer and the decision is within the competence of the Chief Financial Officer and Head of Brokerage. Loans higher than EUR 500 thousand require a further analysis of the overall financial situation of the client and the portfolio offered as collateral by the customer and the decision is within the competence of the Credit Committee. The Group has set sufficiently conservative limits to the ratio of the loan and the collateral assets value. 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.

(e) Corporate credit portfolio

Corporate credit portfolio customers are evaluated on individual basis. Each customer is assigned a credit rating between 1 and 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.

The specific financial ratios and business risk aspects considered depend on the rating model used: corporate, commercial real estate, residential development, and commodity. Credit rating is assigned by credit analyst and confirmed by Head of Credit Analysis Department, but final decision of risk taking is the unanimous decision by the Credit Committee.

After issuing the loan, follow-up monitoring is performed at least quarterly for each customer's financial position. At least annually all client ratings are reviewed. Clients with significant increase in credit risks are listed in watchlist.The financial position, liquidity and collateral value of watchlist clients is thoroughly monitored more frequently. See Note 3.2.4. for more detailed information on the credit quality of loans.

(f) Retail loans to SME's

In 2016, the Group started offering micro loans. The loan is aimed to micro enterprises in the growth stage and the maximum loan amount is up to EUR 25 000.

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

In addition to micro loans, the retail banking segment also includes other corporate credit commitments in the amount of up to EUR 500 thousand (until May 2019 upto 250 EUR thousand). Credits below EUR 500 thousand are analysed with a more cost-efficient scoring process. The scoring process is carried out at the time of loan application and it is one of the criteria for issuing the loan.

Financial data and information on payment behaviour of the company is used when calculating the probability of default (PD). The structure of assets and liabilities are taken into account, also the profitability and cash flow ratios.

Retail loans of legal entities are included in the retail loans financial statement line item.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(g) Consumer loans without collateral and hire-purchase

Group offers consumer loans and hire-purchase through its subsidiary LHV Finance in Estonia. The maximum loan amount is up to EUR 20 thousand and hire purchase for private individuals up to EUR 10 thousand and for enterprises up to EUR 20 thousand. Hire purchase service is offered through merchant partners. Scoring model are used to assess the customer's credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a credit.

The Group has entered into agreements where most overdue consumer loans and hire purchase agreements are sold – usually when loans reaching overdue at least of 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(h) Credit cards

The Bank issues credit cards and Partner credit cards in cooperation with Tallinna Kaubamaja. Similarly to consumer loans and hire purchase most overdue loans are sold when overdues breach 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(i) Student loans

In 2018, the Group started offering student loans. The loan is aimed to students to cover costs during their studies. The maximum amount of state secured student loan is EUR 2 000 per academic year.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(j) Mortgage loans

In 2013, Group started to offer on a limited basis mortgage loans (private loans) to customers in the Tallinn and Tartu region only. In autumn 2016, Group started offering the mortgage loan (home loans) to a large scale of retail clients without regional limits within Estonia. In November 2019 Danske Bank Estonian Branche's private individual mortgage loan portfolio was acquired by LHV. The maximum loan amount is in line with the regulations set by Central Bank of Estonia.

See Note 3.2.4. for more detailed information on the credit quality of loans.

(k) Leasing

The Bank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using a rating model for clients with exposure of more than EUR 500 thousand and scoring models for clients with exposure of less than EUR 500 thousand. Rating model is the same which used for assessment of creditworthiness of corporate credit portfolio customers.

See Note 3.2.4. for more detailed information on the credit quality of loans.

Risk concentration

Several tolerance limits that are regularly monitored and reported have been introduced in LHV Pank's Credit Policy to control and hedge concentration risk. These limits are set for overall credit portfolio and separately for the largest – corporate credit portfolio. The most significant metrics and limits measured at the last day of each quarter are as follows:

a) The share of small financing in the LHV Pank's total credit portfolio
b) The share of financing non-domicile customers in the LHV Pank's total credit portfolio
c) The share of shadow banking financing compared to net owned funds
d) The share of ten largest credit customers compared to net owned funds
e) The share of financing the higher risk rating classes compared to the total corporate credit portfolio

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

f) The share of financing the catering and construction sector compared to the total corporate credit portfolio
g) Th share of financing outside of Estonia (incl. financing in EU countries and UK).

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2019, the loans issued to 12 customers (2018: total 14) had a large risk exposure, i.e. more than 10% of the net own funds (NOF) of Group either individually or via group risk, totalling 190% of NOF (2018: 199%).

The LHV Pank has not invested in the debt securities with a large risk exposure (2018: 2 debt securities; 25% of NOF). Of customer deposits, the deposits of 4 (2018: 5) customers have a high risk concentration, which amounts to 213% (2018: 132%) of NOF. There are 4 clients holding more than 1% of all deposits (2018: 6). Their total deposits amount was EUR 487 million (2018: 189). Share of Top 20 depositors was 25.3% as of 31.12.2019 compared to more than 20% as end of 2018.

31.12.2019 *(in thousands of euros)*	**Estonia**	**Latvia**	**Lithuania**	**Finland**	**Ger-many**	**Other EU**	**USA**	**UK**	**Other**	**Total**
Due from banks and investment companies (Note 8)	1 228 469	0	0	0	0	10 972	4 929	23 041	3 042	**1 270 453**
Financial assets at fair value (Note 9,10)	453	760	19 951	0	9 840	1 907	4	0	16	**32 931**
Loans and advances to customers (Note 11)	1 656 373	445	287	5 574	840	19 951	379	0	3 185	**1 687 034**
Receivables from customers (Note 12)	2 745	0	0	0	0	0	0	0	0	**2 745**
Other financial assets (Note 13)	110	0	0	0	0	0	2 136	0	0	**2 246**
Total financial assets	**2 888 150**	**1 205**	**20 238**	**5 574**	**10 680**	**32 830**	**7 448**	**23 041**	**6 243**	**2 995 409**
Deposits from customers and loans received (Note 15)	1 882 514	12 725	1 503	19 564	372 390	394 310	1 241	0	54 354	**2 738 601**
Subordinated debt (Note 18)	70 500	0	0	0	0	0	0	0	0	**70 500**
Accounts payable and other financial liabilities (Note 16)	20 563	0	4	27	0	13	3	3	0	**20 613**
Financial liabilities at fair value (Note 10)	8	0	0	0	0	0	0	0	0	**8**
Total financial liabilities	**1 973 585**	**12 725**	**1 507**	**19 591**	**372 390**	**394 323**	**1 244**	**3**	**54 354**	**2 829 722**

31.12.2018 *(in thousands of euros)*	**Estonia**	**Latvia**	**Lithuania**	**Finland**	**Ger-many**	**Other EU**	**USA**	**UK**	**Other**	**Total**
Due from banks and investment companies (Note 8)	649 509	0	0	0	0	13 599	16 541	0	2 197	**681 846**
Financial assets at fair value (Note 9,10)	449	772	17 242	0	1	20 704	43	0	0	**39 211**
Loans and advances to customers (Note 11)	886 881	52	10 561	1 524	6	18 433	175	0	1 129	**918 761**
Receivables from customers (Note 12)	2 494	1	5	0	0	0	0	0	9	**2 509**
Other financial assets (Note 13)	111	0	0	0	0	0	2 825	0	0	**2 936**
Total financial assets	**1 539 444**	**825**	**27 808**	**1 524**	**7**	**52 736**	**19 584**	**0**	**3 335**	**1 645 263**
Deposits from customers and loans received (Note 15)	1 179 791	10 041	951	3 414	13 274	220 749	3 085	0	38 256	**1 469 561**
Subordinated debt (Note 18)	30 000	0	0	0	0	0	0	0	0	**30 000**
Accounts payable and other financial liabilities (Note 16)	20 901	0	4	27	0	13	3	0	0	**20 948**
Financial liabilities at fair value (Note 10)	11	0	0	0	0	0	0	0	0	**11**
Total financial liabilities	**1 230 703**	**10 041**	**955**	**3 441**	**13 274**	**220 762**	**3 088**	**0**	**38 256**	**1 520 520**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Distribution of loans granted by industry (gross):	31.12.2019	%	31.12.2018	%
(in thousands of euros)				
Individuals	738 152	43.6%	214 702	23.1%
Real estate	353 405	20.9%	246 930	26.6%
Financial services	71 690	4.2%	95 697	10.3%
Manufacturing	114 104	6.7%	98 073	10.6%
Professional, scientific and technical activities	47 368	2.8%	18 779	2.0%
Wholesale and retail	80 767	4.8%	24 378	2.6%
Other servicing activities	7 290	0.4%	25 669	2.8%
Art and entertainment	42 638	2.5%	34 582	3.7%
Transport and logistics	15 337	0.9%	11 076	1.2%
Agriculture	59 657	3.5%	20 231	2.2%
Administrative activities	67 064	4.0%	39 808	4.3%
Construction	38 951	2.3%	35 808	3.9%
Education	1 976	0.1%	2 391	0.3%
Information and communication	7 017	0.4%	4 115	0.4%
Other areas at activities	47 722	2.8%	56 798	6.1%
Total (Note 11)	**1 693 138**	**100%**	**929 037**	**100%**

Loans and advances (incl. loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 3.3.2 for more details.

Credit risk grading

The Group uses internal credit risk grading that reflect the assessment of the probability of default of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between rating grade 4 and 5 is lower than the difference in the PD between a 7 and 8.

The following are additional considerations for each type of portfolio held by the Group:

Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on a periodic basis to develop a behavioural score. Any other known information about the borrower which impacts their creditworthiness – such as unemployment and previous delinquency history – is also incorporated into the behavioural score. This score is mapped to a PD.

Corporate

For corporate business, the rating is determined at the borrower level. A credit analyst will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the analyst will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and PD.

Treasury

For debt securities in the Treasury portfolio, the credit standing of the security is determined on the basis of the ratings of external rating agencies. These ratings are continuously monitored and updated. The PD's associated with each rating are mapped to LHV's rating scale.

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Initials I.S. Date 27.02.2020

Liquidity Risk

As LHV keeps its liquid assets mainly in cash in ECB then concentration risk in liquidity risk concerns mostly funding risks. 98% of LHV funding is in the form of deposits and therefore the most important metrics to measure concentration risk concerning liquidity is deposit concentration (Note 3.2.2. Risk concentration).

Credit Risk

The Group's rating method used for evaluating the PD of corporate loans consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk (default). Ratings 1 and 2 are attributed only based on average ratings of rating agencies Fitch, Moody's and Standard & Poor's, and are subject to the Group's financial analysis as necessary.

Thus, ratings 1 and 2 are attributed only to international enterprises, organisations, local governments and countries whose solvency has been confirmed by the rating agencies with their investment grade rating. Also rating classes 3 -13 are partly based on the evaluation of rating agencies, although this category includes mainly Estonian enterprises that do not have an international rating.

The group's internal rating scale for corporate loans and mapping of external ratings:

LHV rating	LHV description	PD%	S&P	Moody's
1		0.03	AAA	Aaa
2		0.05	AA+	Aa1
3		0.10	AA, AA-	Aa2, Aa3
4		0.20	A+,A,A-	A1,A2,A3
5	Investment grade	0.30	BBB+	Baa1
6		0.40	BBB	Baa2
7		0.50	BBB-	Baa3
8		1.00	BB+,BB	Ba1,Ba2
9		2.50	BB-	Ba3
10		5.00	B+	B1
11	Non-investment grade (including special monitoring)	10.00	B,B-	B2,B3
12		30.00	CCC/C	Caa
13	Default	100.00	D	C

The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

All retail loans have a behavioural score. This score is mapped to a PD. Retail loans are divided into three groups: investment grade, special monitoring and default. Investment grade is allocated when the loan is not overdue as at end of the reporting period. Special monitoring status is allocated when the loan has overdue status more than 31 days and default status is based on the definition of default principle.

3.2.3 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.2.3.1 for a description of how the Group determines when a significant increase in credit risk has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.2.3.2 for a description of how the Group defines credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.2.3.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 3.2.3.4 includes an explanation of how the Group has incorporated this in its ECL models.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	Stage 2	Stage 3
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below.

3.2.3.1 Significant increase in credit risk

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

Quantitative criteria

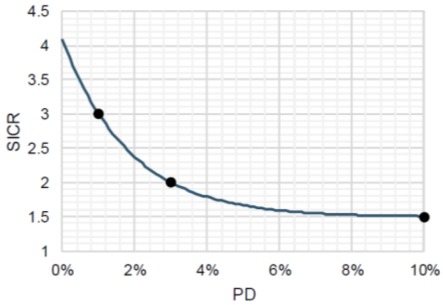
Quantitative criteria is applied to all credit contracts initiated in2018 in the current portfolio and Wholesale legacy portfolio, for which a rating based Lifetime PD is used.

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

Current portfolio – contracts initiated from 1st January 2018

Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
X%	≥100 bps
And	Current PD_life/Initial PD_life > 1.4885+exp(0,9549-54,173*Initial PD_life)

To illustrate the formula, see SICR curve graphic below. In addition to the curve, the PD increase has to be at least 100 bps.



SICR curve: Relation between the Origination PD and the significance threshold (PD increase in number of times) for identifying significant increase in default risk

To illustrate the application of these thresholds, take for example a 3-year retail business loan agreement initiated on 13th February 2018 which at initial recognition had a Lifetime PD of 3.36 % and was expected to have a residual Lifetime PD of 2.76% ten months later at the current reporting date. If at the current reporting date the loan has a current lifetime PD of 8.86% then this exceeds the expected PD of 2.76% by more than the threshold shown above. Therefore a significant increase in credit risk has occurred.

Legacy portfolio – corporate contracts initiated before 1st January 2018

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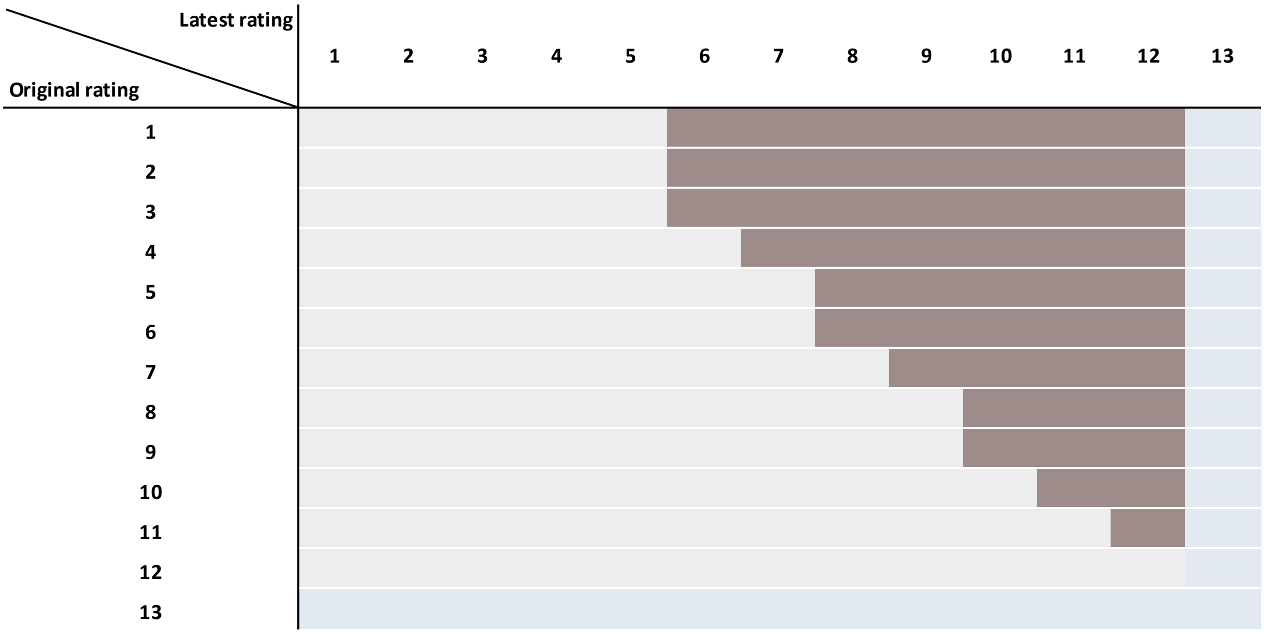
Initials i.S. Date 27.02.2020



These thresholds have been determined by assessing how the Lifetime PD moves prior to an instrument becoming delinquent. The Lifetime PD movements on instruments which do not subsequently become delinquent have also been assessed, to identify the „natural“ movement in Lifetime PD, which is not considered indicative of a significant increase in credit risk. The average maturity of the corporate portfolio is short, namely 2.5 years.

Qualitative criteria

Qualitative criteria is applied in SICR calculation to legacy retail portfolio that was initiated before 2018. For the current portfolio, the qualitative criteria is included in the PD calculation and therefore included in the SICR calculation through Lifetime PD.

Due to the average short maturity of the legacy portfolio (1.75 years) it was not practical to go back to history to predict initial PDs for the contracts initiated before the of 1st December, 2017 and therefore the application PD or rating PD were used as initial PDs for legacy portfolio.

Retail legacy portfolio – private person contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or
- The customer has had more than one payment alert or tax debt over the last 12 months
- In case of home or private loan the contract LTV >100% is also considered.

Retail legacy portfolio – business contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or
- The customer has had more than one payment alert or has had at least four incidents of tax debt in the amount of over 640 euros over the last 12 months.

The assessment of SICR incorporates forward-looking information (see note 3.2.3.4. for further information) and is performed on a quarterly basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent member of Credit Risk team.

Backstop

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

The Group has used the low credit risk exemption for cash and nostro accounts fulfilling the liquidity portfolio criteria in the year ended 31 December 2019 and 31 December 2018.

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The following tables show the impact on the 31 December 2019 and 31 December 2018 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognised.

Product 2019 *(in thousands of euros)*	**+10% Change in SICR**	**-10% Change in SICR**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	-1	0
Consumer loans	-4	5
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	-8	7
Private loans	-2	1
Leasing	-5	1

Product 2018 *(in thousands of euros)*	**+10% Change in SICR**	**-10% Change in SICR**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	-3	3
Hire-purchase	0	0
Credit cards	0	1
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

Product 2019 *(in thousands of euros)*	**SICR with 0.5% threshold**	**SICR with 1.5% threshold**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

Product 2018 *(in thousands of euros)*	**SICR with 0.5% threshold**	**SICR with 1.5% threshold**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

As evidenced by above tables, changing SICR by +/- 10% or changing the 100bps threshold to 50bps or 150bps have limited impact to the overall ECL of the Group.

3.2.3.2 Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

Qualitative criteria

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Initials I.S. Date 27.02.2020

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments have been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %
- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

For applying the default status a customer based approach is used for wholesale and contract based approach is used for the retail portfolio.

An instrument is considered to no longer be in default when it no longer meets any of the default criteria for the probation period of corresponding to the reason of default. The shortest probation period of three months is applied to the contracts that defaulted due to filling the quantitative criteria from the date the criteria is no longer met.

Loans under distressed restructuring are considered to require particular attention in the reclassification to non-defaulted status because the assessment of days past due is based on the modified payment arrangement and the exposure cannot stop being restructured by the time it is fully repaid. Therefore the probation period for these loans is defined as at least 1 year from the latter of:

- the moment of extending the restructuring measures;
- the moment when the exposure has been classified as defaulted; or
- the end of grace period included in the restructuring arrangements.

3.2.3.3 Measuring ECL - Explanation of inputs, assumptions and estimation techniques

The aim of the ECL model is to calculate the 12-month and lifetime expected credit losses that:

- are unbiased, i.e. do not include any conservatism or optimism;
- are probability-weighted amounts that are determined by evaluating three provisioning scenarios (base scenario, upside scenario and downside scenario);
- reflect the time value of money;
- use reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.

The Group's ECL model follows widely accepted sum of marginal losses approach, whereby ECLs are calculated as the sum of the marginal losses occurring in each time period (month) from the reporting date. The marginal losses are derived from individual risk parameters (PD, LGD, EAD) that estimate exposures and losses in the case of default and the marginal probability of default for each period (the probability of a default between time periods t and t+1).

ECL calculations are based on four components:

Probability of Default (PD) is an estimate of the likelihood of default over a given time horizon.

Exposure at Default (EAD) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

Loss Given Default (LGD) is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that LHV would expect to receive, including from any collateral. LGD is expressed as a percentage of the EAD.

Discount factor is used to discount an expected loss to a present value at the reporting date.

Mathematically, the ECL amount for prediction horizon T (12 months or lifetime, depending on whether 12-month or lifetime ECL estimates are concerned) is expressed as follows:

$$ECL_T = \sum_{t=1}^{T} PD_t * LGD_t * EAD_t * d_t$$

Where:

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Initials i.S. Date 27.02.2020

t = 0,…,T – *a one month period within the prediction horizon T; for a 12-month ECL estimate, T = 12 months; for a lifetime ECL estimate, T = expected life of the lending exposure;*

PDt – *marginal PD for month t;*

LGDt – *LGD as estimated for month t;*

EADt – *exposure amount, incl. expected drawdowns of undrawn commitments, at month t;*

dt – *discount factor for month t.*

The discount rate represents the effective interest rate ("EIR") for the financial instrument or an approximation thereof.

A simplified example of the calculation logic is illustrated in table below. Note that in this example for secured loans, LGD is directly derived from the collateral value and as a simplification, fair value is assumed to be constant. However, ECL model takes into account the possible decrease of collateral fair value over time through different scenarios.

	31.01.2019	28.02.2019	31.03.2019	30.04.2019	31.05.2019	30.06.2019	31.07.2019	31.08.2019	30.09.2019
(1) Exposure (EAD)	4000	3500	3000	2500	2000	1500	1000	500	0
(2) Marginal PD	0.40%	0.38%	0.36%	0.34%	0.32%	0.30%	0.28%	0.26%	0.24%
(3) Collateral value	2000	2000	2000	2000	2000	2000	2000	2000	2000
(4) Potential loss amount [Max (0;1-3)}	2000	1500	1000	500	0	0	0	0	0
(5) Expected marginal loss [2*4]	8	5.7	3.6	1.7	0	0	0	0	0
(6) Expected marginal loss, discounted	7.97	5.65	3.56	1.67	0	0	0	0	0
Lifetime ECL at 31.12.2018 [Sum(6)]	18.85								

Note. Discounting is done, assuming current reporting date 31.12.2018 and a 5% discount rate.

For the defaulted exposures, ECL is computed as:

$$ECL_T \sum_{t=1}^{T} LGD_t * Exposure_t * d_t$$

Each of the risk dimensions (PD, LGD, EAD) is covered with the internally developed rating- and scoring models. These models have been developed for the business- and credit management.

As can be concluded, the key issue in ECL modelling is to transform the available risk parameter values into forward looking PiT estimates and 'feed' them into the expected credit loss calculation formula.

	IFRS 9 parameters
Definition of Default	• 90 days past due • Unlikely to pay without the bank turning to recourses such as selling collateral
PD	• 12-month PD; lifetime PD broken down further into marginal probabilities for sub-periods • Forward looking PiT estimate, reflecting assessment of current and future economic conditions, and a range of possible future outcomes • No regulatory floors or margins of conservatism applied
LGD	• Neutral PiT projections • Consider current and future economic conditions, and a range of possible future outcomes • Recoveries discounted, using EIR as discount rate • No regulatory floors or margins of conservatism applied
CCF/EAD	• Reflects expected changes in the balance outstanding over the lifetime of the lending exposure, incl. scheduled loan payments and prepayments
ECL	• PV of cash shortfalls. For Stage 1 exposures, 12-month PD is used. For stage 2 exposures, lifetime PD is used. For Stage 3 exposures, PD = 100%[1]

The following paragraphs outline how the existing underlying models are leveraged off for the ECL measurement. Each risk dimension in detail is discussed in the following chapters.

3.2.3.3.1 'Feeding' PDs from underlying rating and scoring models into ECL model

Instead of the historically based or long run average 12-month PDs (model PDs), forward looking 12-month and lifetime PiT estimates and marginal PDs are required for the IFRS 9 expected credit loss calculation.

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

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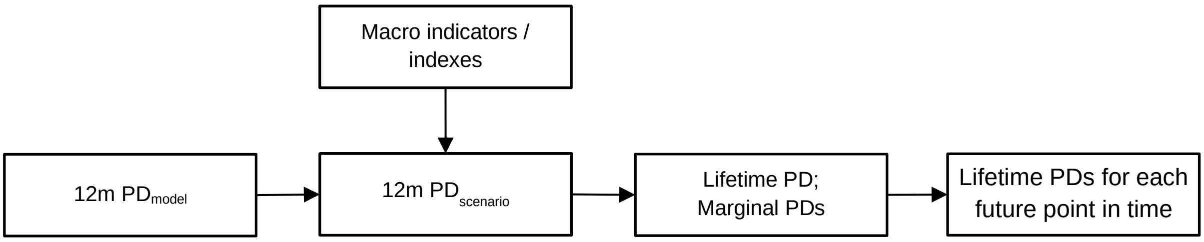

Firstly, model PD is re-calibrated to the forward looking 12-month PiT estimate, given the defined macro scenario (12m PDscenario). Selected macro indicators, transformed into macro indexes, serve as inputs for this purpose.

Next, forward looking 12-month PiT estimate is converted to lifetime PD and marginal PDs. This is done using the segment-specific standard default curve which gives the timing of the expected defaults for the remaining life of an exposure.

Lastly, lifetime PDs for each of the future points in time till the end of the expected life of the exposure are calculated.

3.2.3.3.2 'Feeding' LGDs from underlying models into ECL model

In LGD dimension, the use of the underlying LGD models differs for secured and unsecured lending exposures.

As IFRS 9 parameter should take into account the expected drop in the exposure amount over time, LGD for the secured part of the secured loans is directly calculated from the estimated fire-sale price of the collateral; no input from the underlying LGD models is used.

LGDs from the underlying LGD models 'feed' into the ECL calculation for the unsecured exposures and unsecured parts of the secured exposures.

Further, macroeconomic scenarios are incorporated into both secured and unsecured LGDs as applicable for the defined provisioning scenarios.

3.2.3.3.3 'Feeding' CCF estimates from underlying models into ECL model

Internal CCF estimates feed directly to the ECL model and are used in the EAD. No further adjustments are needed for the CCF as the internal estimates do not include margins of conservatism, or through the cycle (TtC) or downturn adjustments.

3.2.3.4 Forward-looking information incorporated in the ECL model

In order to incorporate forward looking information into the ECL measurements and capture a range of possible outcomes for the future conditions, probability-weighted ECL amounts based on the three provisioning scenarios (base, upside and downside) are calculated. Among others, this approach enables to reflect non-linear relationships between alternative scenarios and the ECL.

Mathematically:

$$ECL = p_{base} * ECL_{base} + p_{up} * ECL_{up} + p_{down} * ECL_{down}$$

Where:

pbase, pup, pdown – probabilities of the base, upside and downside scenarios respectively;

ECLbase, ECLup, ECLdown – expected credit loss amounts calculated for each of the defined scenarios.

ECLs for each of the defined scenarios are derived based on the general formula, using scenario specific risk parameter values. Probability-weighted lifetime PD estimates for the purpose of assessing significant increase in credit risk are calculated in the same way:

$$PD = p_{base} * PD_{base} + p_{up} * PD_{up} + p_{down} * PD_{down}$$

Where:

PDbase, PDup, PDdown – lifetime PD estimates corresponding to each of the defined scenarios.

3.2.3.4.1 Selected indicators for private person credit portfolios

Selected macro indicators for private person credit portfolios and relative importance of each of the indicators are shown in table below:

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	Mortgage	Consumer financing, fixed rate	Consumer financing, floating (incl. leasing)
Wage growth, %	17%	22%	18%
Unemployment rate, %	33%	44%	36%
House price index growth, %	8%	0%	0%
Inflation rate, %	8%	11%	9%
Euribor, 6m	17%	0%	18%
Bank lending margins	17%	22%	18%
TOTAL	**100%**	**100%**	**100%**

Note. Relative importance of each of the indicators is calculated based on the indicator 'weights'

3.2.3.4.2 Selected indicators for companies

A wide range of macroeconomic and industry sector-specific indicators was considered for companies. The analysis was conducted based on the two industry breakdowns:

1) broad industry sector level based on letter codes / alphabetical branch of the NACE Rev.2 classification, and
2) sub-sectors based on lower level numerical codes of the NACE Rev.2 classification.

The following conclusions were drawn from the analysis:

All sectors have been affected by the same credit cycle and have experienced major sector-wide financial difficulties at the same time. Despite of that, there are certain idiosyncratic differences between the industry sub-sectors e.g. in manufacturing

There are only a few variables that 'work'; the variables that have explanatory power, tend to 'work' similarly for most of the industry sectors:

GDP growth which explains the general state of economy,

Change in turnover,

Change in number of persons employed.

Change in an industry sector's profit/loss was also tested, but tends to be too volatile for drawing conclusions on substantial change in default risk.

A few macro indicators are significant to certain industry sectors, sub-sectors and/or groupings of sub-sectors even if correlations are difficult to show due to low numbers of observations and/or because of relatively short observation period. E.g.:

Export conditions for export-oriented industries such as: metal products, chemical products and electrical equipment;

Population growth and income growth for residential real estate;

Household consumption growth for industries that are oriented to internal consumption such as retail trade.

In conclusion, gross value added by industry sectors was selected as the indicator for companies, this given several considerations:

Observed correlation with the considered proxies for default rates;

GDP, which is close indicator to the gross value added, is the preferred approach for the industry;

It is easier to project for a macro economist than alternative indicators.

Economic variable assumptions

Macoreconomic scenarios (forecasts) and its indicators (incl. corporate portfolio PD and LGD estimates) are developed at least once a year and which are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business, finance and external experts.

Macro developments are monitored on a quarterly basis as new macroeconomic data becomes available. Forecasts are updated as necessary in order to ensure timely inclusion of new forward-looking information into the ECL estimates.

Developed provisioning scenarios and significant updates to the scenarios are approved in the Risk and Capital Committee.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

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Valid at 31.12.2019	Base scenario		Downside scenario		Upside scenario	
General macro-financial indicators	**2020E**	**2021E**	**2020E**	**2021E**	**2020E**	**2021E**
Real GDP growth, %	2.2%	2.6%	0.2%	0.6%	2.7%	3.1%
Household consumption, %	3.6%	2.8%	1.6%	0.8%	4.1%	3.3%
Government consumption, %	0.1%	-0.2%	-2.0%	-2.2%	0.6%	0.3%
Gross fixed capital formation, %	0.6%	2.7%	-1.5%	0.7%	1.1%	3.2%
Exports of goods and services, %	1.6%	3.1%	-0.4%	1.1%	2.1%	3.6%
Imports of goods and services, %	2.1%	3.1%	0.1%	1.1%	2.6%	3.6%
Nominal GDP, EURm	29 472	31 010	27 791	28 111	30 048	31 924
GDP deflator, % change	3.0%	2.6%	1.0%	0.6%	3.5%	3.1%
Consumer price growth, %	2.1%	2.0%	2.0%	2.0%	2.6%	2.5%
Unemployment rate, %	5.6%	5.9%	7.6%	7.9%	5.1%	5.4%
Change in employment, %	0.2%	-0.1%	-0.3%	-0.8%	0.7%	0.5%
Net monthly wage growth, % (nominal)	5.5%	5.1%	3.4%	3.1%	5.9%	5.6%
House price index growth, %	4.0%	4.1%	-4.8%	-4.4%	5.5%	5.1%
Euribor 6m	-0.6%	-0.5%	-0.6%	-0.6%	-0.5%	-0.3%
Bank lending margins on new loans	2.3%	2.5%	2.5%	2.7%	2.0%	2.0%

Nominal growth	Base scenario		Downside scenario		Upside scenario	
Gross value added by sectors, y-o-y growth rates	**2020E**	**2021E**	**2020E**	**2021E**	**2020E**	**2021E**
Total - all NACE activities	**5.3%**	**5.2%**	**1.2%**	**1.2%**	**6.2%**	**6.2%**
Agriculture, forestry and fishing	5.0%	5.0%	0.6%	0.5%	9.3%	6.0%
Industry (except construction)	4.9%	5.0%	-0.2%	0.3%	6.2%	5.7%
Industry, except construction and manufacturing (mostly energy related)	5.0%	5.0%	-0.5%	-0.6%	6.0%	6.0%
Manufacturing	5.0%	5.0%	-0.1%	0.5%	6.3%	5.7%
Construction	3.6%	5.0%	-8.5%	0.5%	6.0%	7.4%
Wholesale and retail trade, transport, accomodation and food service activities	4.5%	4.5%	0.1%	0.1%	5.5%	6.9%
Information and communication	8.5%	8.4%	8.5%	8.4%	9.5%	9.4%
Financial and insurance activities	7.2%	5.0%	2.7%	-2.6%	7.1%	6.0%
Real estate activities	4.0%	4.1%	-4.8%	-4.4%	5.5%	5.1%
Professional, scientific and technical activities; administrative and support service activities	5.0%	5.0%	0.6%	0.5%	6.0%	6.0%
Public administration, defence, education, human health and social work activities	5.0%	5.0%	6.1%	5.5%	6.0%	6.0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	0.8%	0.6%	-1.5%	-3.7%	1.7%	1.6%

The weightings assigned to each economic scenario at 31 December 2019 were as follows:

Valid at 31.12.2019	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

The weightings assigned to each economic scenario at 31 December 2018 were as follows:

Valid at 31.12.2018	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 31.12.2018	Base scenario	Downside scenario	Upside scenario

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pwc
Initials I.S. Date 27.02.2020

General macro-financial indicators	2019E	2020E	2019E	2020E	2019E	2020E
Real GDP growth, %	3.0%	2.9%	1.0%	0.9%	4.0%	3.9%
Household consumption, %	3.9%	3.0%	2.0%	1.0%	4.5%	3.5%
Government consumption, %	0.8%	0.7%	0.7%	0.6%	1.2%	1.0%
Gross fixed capital formation, %	4.4%	4.2%	2.0%	1.9%	8.0%	8.0%
Exports of goods and services, %	3.8%	3.8%	0.5%	0.3%	4.3%	4.3%
Imports of goods and services, %	4.0%	3.9%	1.0%	0.7%	4.8%	4.8%
Nominal GDP, EURm	27 051	28 614	26 161	26 919	27 722	29 875
GDP deflator, % change	3.2%	2.8%	2.5%	2.0%	3.9%	3.7%
Consumer price growth, %	3.0%	2.6%	2.1%	1.7%	3.5%	3.5%
Unemployment rate, %	4.6%	4.5%	5.5%	5.9%	4.5%	4.5%
Change in employment, %	0.8%	-0.1%	0.0%	-0.3%	1.1%	0.3%
Net monthly wage growth, % (nominal)	6.0%	5.2%	3.0%	2.5%	7.5%	6.0%
House price index growth, %	3.4%	3.2%	-4.0%	-4.1%	4.4%	4.2%
Euribor 6m	-0.2%	0.2%	-0.2%	0.2%	-0.1%	0.3%
Bank lending margins on new loans	2.0%	2.0%	2.3%	2.5%	2.0%	2.0%

Nominal growth	**Base scenario**		**Downside scenario**		**Upside scenario**	
Gross value added by sectors, y-o-y growth rates	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Total - all NACE activities	**6.3%**	**5.7%**	**3.5%**	**3.1%**	**8.0%**	**7.8%**
Agriculture, forestry and fishing	10.0%	10.0%	5.0%	5.0%	14.0%	14.0%
Industry (except construction)	5.0%	4.3%	2.8%	2.2%	6.2%	5.5%
Industry, except construction and manufacturing (mostly energy related)	5.0%	3.0%	4.8%	2.8%	6.0%	4.0%
Manufacturing	5.0%	4.7%	2.1%	2.0%	6.3%	6.0%
Construction	9.0%	5.0%	-6.0%	-4.0%	12.0%	11.0%
Wholesale and retail trade, transport, accomodation and food service activities	5.0%	4.8%	1.5%	0.5%	6.5%	6.5%
Information and communication	14.1%	14.0%	14.1%	14.0%	15.8%	15.8%
Financial and insurance activities	6.0%	6.0%	3.5%	3.5%	9.0%	9.0%
Real estate activities	3.3%	3.3%	-1.0%	-5.0%	3.8%	3.8%
Professional, scientific and technical activities; administrative and support service activities	7.0%	6.0%	5.0%	4.0%	9.0%	8.0%
Public administration, defence, education, human health and social work activities	6.0%	6.0%	9.0%	9.0%	8.0%	8.0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	7.0%	6.5%	4.5%	4.0%	9.0%	8.5%

Sensitivity analysis

The most significant assumptions affecting the ECL allowance are as follows:

Retail portfolio

- Unemployment rate
- Wage growth
- Euribor
- Bank lending margins
- GDP

Corporate portfolio

- Estimated portfolio PiT PD values for each scenario
- Estimated LGD impact on downside scenario

The table below illustrates the impact of changing scenario weights of positive and negative scenarios to the portfolio as it was at 31 December 2018 and 31 December 2019.

(in thousands of euros) 31.12.2019	**65-5-30** (base/up/down)	**65-15-20** (base/up/down)
Change in scenario weights	293	-284

(in thousands of euros) 31.12.2018	**65-5-30** (base/up/down)	**65-15-20** (base/up/down)
Change in scenario weights	265	-265

Set out below are the changes to the ECL as at 31 December 2019 and 31 December 2018 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions (for example, the impact on ECL of increasing the estimated unemployment rate by X% in each of the base, upside, downside scenarios):

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Initials I.S. Date 27.02.2020

(in thousands of euros) 31.12.2019	Impact of increase	Impact of decrease
Unemployment rate +/-1%	114	-93
Wage growth +/- 5%	-113	92
Euribor +/-0.5%	17	-11
Bank lending margins +/-0.5%	159	-167
Consumer price growth +/-1%	-37	30
House price index +/- 2%	-4	4
Gross value added by sectors, yoy growth rates +/- 5%	-37	34

(in thousands of euros) 31.12.2018	Impact of increase	Impact of decrease
Unemployment rate +/-1%	37	-24
Wage growth +/- 5%	-35	27
Euribor +/-0.5%	1	-1
Bank lending margins +/-0.5%	62	-50
Consumer price growth +/-1%	-13	8
House price index +/- 2%	0	0
Gross value added by sectors, yoy growth rates +/- 5%	-24	27

The Group has performed stress test scenarios when PD and LGD estimations will both increase by 0.5. The impact of the described stress test to impairments is aggregated in the table below. The table includes loans, which have collective impairment and which have material balances and potential impact.

(in thousands of euros) 2019	Impact on loss allowances
LGD negative 0.9	136
LGD negative 1.0	29
Average PiT PD -0.5%	-898
Average PiT PD +0.5%	875

(in thousands of euros) 2018	Impact on loss allowances
LGD negative 0.88	260
LGD negative 1.0	-246
Average PiT PD -0.5%	-843
Average PiT PD +0.5%	814

3.2.4 Credit risk exposure

3.2.4.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 3.2.3. „Expected credit loss measurement".

Corporate Credit portfolio

As at 31.12.2019, the group-based impairment reserve makes up 0.44% of corporate loans and overdraft and the related interest receivables (31.12.2018: 1.4%).

Distribution of corporate loans, overdraft and trade financing by internal ratings

(in thousands of euros)	31.12.2019	31.12.2018	Grading
4 low credit risk	40	1 162	
5 low credit risk	14 984	31 936	
6 low credit risk	133 538	103 019	
7 medium credit risk	215 853	155 855	
8 medium credit risk	263 626	180 376	
9 heightened credit risk	151 446	116 164	Investment grade
10 high credit risk	49 375	38 407	Non-investment grade (incl. special monitoring)
11 high credit risk	4 559	3 121	
12 non-satisfactory rating	4 268	5 807	
13 insolvent	1 036	12 425	Default
Total	**838 725**	**648 271**	

LHV

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Initials I.S. Date 27.02.2020

Corporate loans

2019

ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	744 985	11 795	0	0	**756 780**
Non-investment grade (incl. special monitoring)	21 521	26 627	0	0	**48 148**
Default	0	0	1 036	0	**1 036**
Gross carrying amount	**766 506**	**38 422**	**1 036**	**0**	**805 964**
Loss allowances	2 410	1 128	0	0	**3 538**
Carrying amount	**764 096**	**37 294**	**1 036**	**0**	**802 426**

Corporate loans

2018

ECL staging

(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	471 744	603	0	0	**472 348**
Non-investment grade (incl. special monitoring)	135 723	27 775	0	0	**163 498**
Default	0	0	12 045	380	**12 425**
Gross carrying amount	**607 468**	**28 378**	**12 045**	**380**	**648 271**
Loss allowances	1 973	1 107	5 486	186	**8 751**
Carrying amount	**605 495**	**27 272**	**6 560**	**194**	**639 520**

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Initials I.S. Date 27.02.2020

As at 31.12.2019 stage 3 includes 3 loans which are well collateralised taking into consideration all three scenarios and, therefore, the related ECL is considered to be 0 EUR. For off-balance sheet exposures related with corporate credit portfolio, a provision of EUR 178 thousand was recorded as of 31.12.2019 (31.12.2018: EUR 128 thousand).

Trade financing

As at 31.12.2019, the group-based impairment reserve makes up 0.38% of trade financing portfolio and the related interest receivables.

Trade financing					
2019					
ECL staging					
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	22 707	0	0	0	**22 707**
Non-investment grade (special monitooring)	10 055	0	0	0	**10 055**
Default	0	0	0	0	**0**
Gross carrying amount	**32 761**	**0**	**0**	**0**	**32 761**
Loss allowances	123	0	0	0	**123**
Carrying amount	**32 638**	**0**	**0**	**0**	**32 638**

The size of the trade finance portfolio was negligible as at 31.12.2018 and it was recorded as part of the corporate loan portfolio.

Retail loans

As at 31.12.2019, the group-based impairment reserve makes up 0.1% of retail loans to SME and related claims (31.12.2018: 0.4%). Credit decision is done by the majority decision of the Retail Banking Credit Committee.

Retail loans to SMEs					
2019					
ECL staging					
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	36 275	0	0	0	**36 275**
Special monitoring	0	4 528	0	0	**4 528**
Default	0	0	164	0	**164**
Gross carrying amount	**36 275**	**4 528**	**164**	**0**	**40 967**
Loss allowances	36	45	72	0	**153**
Carrying amount	**36 239**	**4 483**	**92**	**0**	**40 813**

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Initials I.S. Date 27.02.2020

Retail loans to SMEs

	2018				
	ECL staging				
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	14 966	0	0	0	**14 966**
Special monitoring	0	1 043	0	0	**1 043**
Default	0	0	191	0	**191**
Gross carrying amount	**14 966**	**1 043**	**191**	**0**	**16 200**
Loss allowances	31	54	98	0	**184**
Carrying amount	**14 935**	**988**	**93**	**0**	**16 016**

For off-balance sheet exposures related with retail credit portfolio, a provision of EUR 1 thousand was recorded as of 31.12.2019 (2018: EUR 19 thousand).

Private loans

	2019				
	ECL staging				
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	39 860	0	0	0	**39 860**
Special monitoring	0	4 806	0	0	**4 806**
Default	0	0	50	93	**143**
Gross carrying amount	**39 860**	**4 806**	**50**	**93**	**44 810**
Loss allowances	24	49	1	14	**89**
Carrying amount	**39 836**	**4 757**	**49**	**79**	**44 721**

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Initials I.S. Date 27.02.2020

Private loans					
2019					
ECL staging					
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	35 248	0	0	0	**35 248**
Special monitoring	0	2 516	0	0	**2 516**
Default	0	0	146	16	**163**
Gross carrying amount	**35 248**	**2 516**	**146**	**16**	**37 927**
Loss allowances	8	0	1	0	**10**
Carrying amount	**35 239**	**2 516**	**145**	**16**	**37 917**

Consumer loans

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. The gross amount of consumer loans written off and recorded as off-balance sheet EUR 68 thousand as at 31 December 2019 (2018: 26)

As at 31.12.2019, the group-based impairment reserve makes up 1.26% of consumer loans and the related interest receivables (31.12.2018: 1.7%).

Consumer loans					
2019					
ECL staging					
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	44 235	0	0	0	**44 235**
Special monitoring	0	5 076	0	0	**5 076**
Default	0	0	98	3	**101**
Gross carrying amount	**44 235**	**5 076**	**98**	**3**	**49 412**
Loss allowances	290	276	55	3	**624**
Carrying amount	**43 945**	**4 800**	**43**	**0**	**48 788**

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Initials i.S. Date 27.02.2020

(in thousands of euros) Credit grade	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
	2018				
	ECL staging				
Investment grade	29 427	0	0	0	**29 427**
Special monitoring	0	4 372	0	0	**4 372**
Default	0	0	190	0	**190**
Gross carrying amount	**29 427**	**4 372**	**190**	**0**	**33 989**
Loss allowances	213	267	88	0	**568**
Carrying amount	**29 214**	**4 105**	**102**	**0**	**33 421**

For off-balance sheet exposures related with consumer credit portfolio, a provision of EUR 0 thousand was recorded as of 31.12.2019 and 31.12.2018.

Mortgage loans

The provisions are made based on the same framework as for consumer loans. As of 31 December 2019, the group-based impairment amounted to 0.13% of mortgage portfolio (31.12.2018: 0.3%).

Mortgage loans

(thousands of euros) Credit grade	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
	2019				
	ECL staging				
Investment grade	548 054	0	0	0	**548 054**
Special monitoring	0	37 916	0	0	**37 916**
Default	0	0	78	1 808	**1 886**
Gross carrying amount	**548 054**	**37 916**	**78**	**1 808**	**587 855**
Loss allowances	193	496	2	54	**745**
Carrying amount	**547 861**	**37 419**	**75**	**1 754**	**587 110**

(thousands of euros) Credit grade	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
	2018				
	ECL staging				
Investment grade	93 158	0	0	0	**93 158**
Special monitoring	0	7 851	0	0	**7 851**
Default	0	0	0	0	**0**
Gross carrying amount	93 158	7 851	0	0	**101 009**
Loss allowances	19	7	0	0	**26**
Carrying amount	93 139	7 844	0	0	**100 983**

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Initials I.S. Date 27.02.2020

Leasing

The leasing provisioning is done based on Leasing scoring models. The provisions are made based on the same framework as for consumer loans. As of 31 December 2019, the group-based impairment reserve amounted to 0.71% of leasing portfolio (31.12.2018: 0.8%).

Leasing

2019

	ECL staging				
(in thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	77 742	8 957	0	0	**86 700**
Special monitoring	0	2 708	0	0	**2 708**
Default	0	0	81	0	**81**
Gross carrying amount	**77 742**	**11 665**	**81**	**0**	**89 488**
Loss allowances	147	477	15	0	**639**
Carrying amount	**77 596**	**11 188**	**66**	**0**	**88 850**

2018

	ECL staging				
(thousands of euros)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	53 810	3 874	0	0	**57 684**
Special monitoring	0	2 198	0	0	**2 198**
Default	0	0	284	0	**284**
Gross carrying amount	**53 810**	**6 071**	**284**	**0**	**60 165**
Loss allowances	92	312	63	0	**467**
Carrying amount	**53 717**	**5 760**	**221**	**0**	**59 698**

Corporate factoring

As at 31.12.2019, the group-based impairment reserve makes up 0.1% of corporate factoring portfolio and the related interest receivables. As at 31.12.2019 the balance of corporate factoring portfolio was EUR 5 389 (31.12.2018: 0) thousand and the related loss allowance was EUR 5 (31.12.2018: 0) thousand. Majority of the loans were recorded in stage 1.

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Initials I.S. Date 27.02.2020

Hire purchase

Similarly, to other homogenous portfolios, provisions are made based on the same framework as consumer loans. As of 31 December 2019, the group-based impairment reserve amounted to 0.68% of hire-purchase portfolio (31.12.2018: 0.8%). As at 31.12.2019 the balance of hire purchase portfolio was EUR 16 410 (31.12.2018: 17 750) thousand and the related loss allowance was EUR 112 (31.12.2018: 140) thousand. Majority of the loans were recorded in stage 1.

Leveraged loans

The Bank had no impaired leveraged loans as at 31.12.2019 and 31.12.2018.

The impairment reserve amounted to 0.11% of the leveraged loans portfolio.

As at 31.12.2019 the balance of leverage loan portfolio was EUR 5 988 (31.12.2018: 3 730) thousand and the related loss allowance was EUR 6 (31.12.2018: 3) thousand.

Credit cards

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. As of 31 December 2019, the group-based impairment reserve amounted to 0.7% of credit card loans and related receivables (31.12.2018: 0.4%).

For off-balance sheet exposures related with credit cards portfolio, a provision of EUR 2.5 thousand was recorded as of 31.12.2019 (31.12 2018: EUR 1 thousand).

As at 31.12.2019 the balance of credit cards loan portfolio was EUR 7 665 (31.12.2018: 6 853) thousand and the related loss allowance was EUR 53 (31.12.2018: 27) thousand. Majority of the loans were recorded in stage 1.

3.2.4.2 Maximum exposure to credit risk – Financial instruments not subject to impairment

Financial assets kept in fair value are by definition not subject to impairment, their changes in credit risk is automatically accounted through market value changes.

In addition some accounts carrying smaller credit risk are not part of impairment calculation:

- **Cash and balances with central bank**
- **Nostro accounts**

Both of these account types carry very limited amount of credit risk and maturity tenor in general is just 1 day. Cash and central bank balances are limited per currencies – only currencies bank is active are allowed. Nostro accounts are subject to credit risk limits, all counterparts have to minimally have investment grade rating. In case counterparts rating is lowered below investment grade, the nostro account will not qualify for having balances by the end of banking day.

3.2.4.3 Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The valuations of the market value of collaterals are based on the principle of conservatism, which takes into account the type of collateral, the location, the likelihood of realisation 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.

The principal collateral types for loans and advances are:

- Mortgage
- Guarantee of KredEx Fund or Rural Development Foundation
- Deposit
- Marketable securities
- Rights of claims
- Commercial pledge
- Commodity pledge
- Credit Insurance
- Unlisted Securities
- Letter of credit
- Pledge of claim
- Surety of private person or legal entity
- Machinery and equipment

The preferred collateral is where there is no strong correlation between the client's default risk and value of the collateral. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance.

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Initials i.S. Date 27.02.2020

Unsecured loan can be issued to private customers up to a specified amount. For corporate customers this is only allowed when cash flow forecast shows stable and significantly strong cash flows and/or customer's credit risk is valued to be low.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

Mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in low loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is EUR 587 855 thousand as at 31 December 2019.

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

31.12.2019 *(in thousands of euros)*	**Gross exposure**	**Impairment allowance**	**Carrying amount**	**Fair value of collateral held**
Credit-impaired assets				
Loans to corporate entities:				
- Large corporate customers	1 036	0	1 036	2 800
Loans to private individuals:				
- Mortgage loans	1 808	54	1 754	2 243
Total credit-impaired assets	**2 844**	**54**	**2 790**	**5 043**

31.12.2018 *(in thousands of euros)*	**Gross exposure**	**Impairment allowance**	**Carrying amount**	**Fair value of collateral held**
Credit-impaired assets				
Loans to corporate entities:				
- Large corporate customers	380	(186)	194	194
Total credit-impaired assets	**380**	**(186)**	**194**	**194**

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

Loans against collateral as at 31.12.2019 *(in thousands of euros)*	**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	5 988	0	0	0	0	**5 988**
Unlisted equity securities	35 396	0	1 066	0	0	0	**36 462**
Mortgages, real estate	581 750	0	41 663	0	0	584 685	**1 208 098**
Guarantee of KredEx and Rural Development Foundation	30 377	0	7	0	0	2 612	**32 996**
Pledges of rights of claim	84 365	0	0	0	0	0	**84 365**
Deposits	3 141	0	2 001	0	0	0	**5 142**
Leased assets	0	0	0	76 407	0	0	**76 407**
Others	51 174	0	674	0	0	0	**51 848**
Unsecured loans	98 878	0	57 226	13 081	16 410	6 237	**191 832**
Total	**885 081**	**5 988**	**102 637**	**89 488**	**16 410**	**593 534**	**1 693 138**

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Initials i.S. Date 27.02.2020

Loans against collateral as at 31.12.2018 *(in thousands of euros)*	**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	3 730	0	0	0	0	3 730
Unlisted equity securities	21 257	0	673	0	0	0	21 930
Mortgages, real estate	333 498	0	28 224	0	0	100 281	462 003
Guarantee of KredEx and Rural Development Foundation	4 395	0	0	0	0	0	4 395
Pledges of rights of claim	35 250	0	0	0	0	0	35 250
Deposits	3 168	0	1 654	0	0	0	4 822
Leased assets	53 309	0	0	41 033	0	0	94 342
Others	25 136	0	7 390	0	0	0	32 526
Unsecured loans	191 525	0	40 904	19 132	17 750	728	270 039
Total	**667 538**	**3 730**	**78 845**	**60 165**	**17 750**	**101 009**	**929 037**

Collaterals for leveraged loans are monitored on a daily basis and if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31.12.2019 and as of 31.12.2018, all leveraged loans are over-collateralized. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing and mortgage loans are all over-collateralized. The Group monitors customers in arrears of leasing, hire purchase, mortgage loans and overdraft to private individuals on regular basis.

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

Under-collateralized loans include contracts with more than 90 days overdue totaling EUR 322 thousand (2018: EUR 13 592 thousand) with a collateral value of EUR 131 thousand (2018: EUR 7 172 thousand).

	Over-collateralized loans		**Under-collateralized loans**	
(in thousands of euros)	**Carrying value**	**Fair value of collateral**	**Carrying value**	**Fair value of collateral**
As at 31.12.2019	**826 643**	**1 523 286**	**866 495**	**674 663**
Corporate and retail loans (including overdraft)	211 756	294 565	673 325	574 448
Leveraged loans	5 988	137 767	0	0
Credit cards, consumer loans, overdraft to private individuals	37 119	57 802	65 518	8 291
Leasing	76 407	76 407	13 081	0
Hire-purchase	0	0	16 410	0
Mortgage loans	495 373	956 745	98 161	91 924
As at 31.12.2018	**364 598**	**616 532**	**564 439**	**294 379**
Corporate and retail loans (including overdraft)	236 687	397 060	430 851	239 326
Leveraged loans	3 730	6 293	0	0
Credit cards, consumer loans, overdraft to private individuals	37 846	100 820	40 999	74
Leasing	0	0	60 165	41 033
Hire-purchase	0	0	17 750	0
Mortgage loans	86 335	112 359	14 674	13 946

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Initials i.S. Date 27.02.2020

3.2.5 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent „step up“ (or „step down“) between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular update of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period (see note 3.2.6.).

The following tables explain the changes in the loss allowances between the beginning and the end of the annual period due to these factors.

	Stage 1	Stage 2	Stage 3		
Corporate loans and overdraft					
(in thousands of euros)	**12-month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Purchased Credit Impaired**	**Total**
Loss allowance as at 1 January 2019	**2 272**	**1 122**	**5 299**	**186**	**8 879**
Movements with P&L impact	-123	123	0	0	0
Transfers:					
From Stage 1 to Stage 2	-145	145	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	22	-22	NA	0	0
New financial assets originated or purchased	667	721	0	0	1 388
Changes in PDs/LGDs/EADs	-75	-35	0	0	-110
Changes to model assumptions and methodologies	-2	-1	0	0	-3
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	-329	-802	0	0	-1 131
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**138**	**6**	**0**	**0**	**144**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	-5 299	-186	**-5 485**
Loss allowance as at 31 December 2019	**2 410**	**1 128**	**0**	**0**	**3 538**

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Initials I.S. Date 27.02.2020

Corporate loans and overdraft	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
(in thousands of euros)					
Loss allowance as at 1 January 2018	**1 112**	**1 241**	**2 199**	**0**	**4 552**
Movements with P&L impact	-226	226	0	0	**0**
Transfers:					
From Stage 1 to Stage 2	-227	227	NA	0	**0**
From Stage 1 to Stage 3	0	NA	0	0	**0**
From Stage 2 to Stage 1	1	-1	NA	0	**0**
New financial assets originated or purchased	1 165	86	0	186	**1 437**
Changes in PDs/LGDs/EADs	192	-455	3 091	0	**2 828**
Changes to model assumptions and methodologies	28	24	0	0	**52**
Modifications of contractual cash flows of financial assets	0	0	0	0	**0**
Unwind of discount	0	0	10	0	**10**
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**1 159**	**-119**	**3 101**	**186**	**4 327**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	115	0	**115**
Loss allowance as at 31 December 2018	**2 271**	**1 122**	**5 299**	**186**	**8 879**

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Initials I.S. Date 27.02.2020

Trade financing *(in thousands of euros)*	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Purchased Credit Impaired**	**Total**
Loss allowance as at 1 January 2019	**5**	**0**	**0**	**0**	**5**
Movements with P&L impact	0	0	0	0	0
Transfers:				0	0
From Stage 1 to Stage 2	0	0	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	123	0	0	0	123
Changes in PDs/LGDs/EADs	0	0	0	0	0
Changes to model assumptions and methodologies	-3	0	0	0	-3
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	-2	0	0	0	-2
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**118**	**0**	**0**	**0**	**118**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2019	**123**	**0**	**0**	**0**	**123**

The size of the trade finance portfolio was negligible as at 31.12.2018 and it was recorded as part of the corporate loan portfolio.

Retail loans to SMEs *(in thousands of euros)*	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Purchased Credit Impaired**	**Total**
Loss allowance as at 1 January 2019	**31**	**54**	**99**	**0**	**184**
Movements with P&L impact	-24	11	13	0	0
Transfers:					
From Stage 1 to Stage 2	-12	12	NA	0	0
From Stage 1 to Stage 3	-13	NA	13	0	0
From Stage 2 to Stage 1	1	-1	NA	0	0
New financial assets originated or purchased	19	11	0	0	30
Changes in PDs/LGDs/EADs	-1	-1	-2	0	-4
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	11	-30	-38		-57
FX and other movements	0	0	0		**0**
Total net P&L charge during the period	**5**	**-9**	**-27**	**0**	**-31**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	-35	35	0	0
From Stage 3 to Stage 2	NA	2	-2	0	0
Financial assets derecognised during the period					
Write-offs	0	0	13	0	**13**
Loss allowance as at 31 December 2019	**36**	**45**	**72**	**0**	**153**

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Initials I.S. Date 27.02.2020

Retail loans to SMEs	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(in thousands of euros)					
Loss allowance as at 1 January 2018	**131**	**0**	**0**	**0**	**131**
Movements with P&L impact	-148	49	99	0	0
Transfers:					
From Stage 1 to Stage 2	-49	49	NA	0	0
From Stage 1 to Stage 3	-99	NA	99	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	20	1	0	0	21
Changes in PDs/LGDs/EADs	46	3	-1	0	48
Changes to model assumptions and methodologies	1	1	0	0	2
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	-19	0	1	0	-18
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-100**	**54**	**99**	**0**	**53**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	25	0	**25**
Loss allowance as at 31 December 2018	**31**	**54**	**99**	**0**	**184**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Consumer loans *(in thousands of euros)*	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	**212**	**267**	**89**	**0**	**568**
Movements with P&L impact	-63	54	9	0	0
Transfers:					
From Stage 1 to Stage 2	-61	61	NA	0	0
From Stage 1 to Stage 3	-9	NA	9	0	0
From Stage 2 to Stage 1	7	-7	NA	0	0
New financial assets originated or purchased	234	643	10	3	890
Changes in PDs/LGDs/EADs	-25	-24	-5	0	-54
Changes to model assumptions and methodologies	7	7	1	0	15
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	-75	0	-30	0	-105
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**78**	**680**	**-15**	**3**	**746**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	-671	-19	0	**-690**
Loss allowance as at 31 December 2019	**290**	**276**	**55**	**3**	**624**

Consumer loans (in thousands of euros)	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	**442**	**0**	**0**	**0**	**442**
Movements with P&L impact	-219	133	86	0	0
Transfers:					
From Stage 1 to Stage 2	-133	133	NA	0	0
From Stage 1 to Stage 3	-86	NA	86	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	212	32	1	0	245
Changes in PDs/LGDs/EADs	-223	102	2	0	119
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-230**	**267**	**89**	**0**	**126**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**212**	**267**	**89**	**0**	**568**

Private loans	**Stage 1**	**Stage 2**	**Stage 3**		
	12-month ECL	**Lifetime ECL**	**Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(in thousands of euros)					
Loss allowance as at 1 January 2019	**9**	**0**	**1**	**0**	**10**
Movements with P&L impact	-23	22	1	0	0
Transfers:					
From Stage 1 to Stage 2	-22	22	NA	0	0
From Stage 1 to Stage 3	-1	NA	1	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	12	18	0	14	44
Changes in PDs/LGDs/EADs	1	2	1	0	4
Changes to model assumptions and methodologies	16	33	10	0	59
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	10	-26	-12	0	-28
FX and other movements	0	0	0	0	0
Total net P&L charge during the period	**16**	**49**	**0**	**14**	**78**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	3	-3	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
Loss allowance as at 31 December 2019	**25**	**49**	**1**	**14**	**89**

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Initials I.S. Date 27.02.2020

Mortgage loans *(in thousands of euros)*	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2019	**17**	**9**	**0**	**0**	**26**
Movements with P&L impact	-21	21	0	0	0
Transfers:					
From Stage 1 to Stage 2	-22	22	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	1	-1	NA	0	0
New financial assets originated or purchased	174	474	0	54	702
Changes in PDs/LGDs/EADs	-4	-11	-1	0	-16
Changes to model assumptions and methodologies	139	358	41	0	538
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[(a)]	-112	-355	-38	0	-505
FX and other movements	0	0	0	0	0
Total net P&L charge during the period	**176**	**487**	**2**	**54**	**719**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	3	-3	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
Loss allowance as at 31 December 2019	**193**	**496**	**2**	**54**	**745**

Mortgage loans (in thousands of euros)	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
Loss allowance as at 1 January 2018	**32**	**0**	**0**	**0**	**32**
Movements with P&L impact	0	0	0	0	0
Transfers:					
From Stage 1 to Stage 2	0	0	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	42	3	0	0	45
Changes in PDs/LGDs/EADs	-58	5	0	0	-53
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-16**	**9**	**0**	**0**	**-7**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**17**	**9**	**0**	**0**	**26**

Leasing *(in thousands of euros)*	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Purchased Credit Impaired**	**Total**
Loss allowance as at 1 January 2019	**92**	**312**	**63**	**0**	**467**
Movements with P&L impact	-140	140	0	0	0
Transfers:					
From Stage 1 to Stage 2	-148	148	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	8	-8	NA	0	0
New financial assets originated or purchased	64	156	0	0	220
Changes in PDs/LGDs/EADs	-5	-17	-1	0	-23
Changes to model assumptions and methodologies	-2	-8	0	0	-10
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[a]	138	-106	-47	0	-15
FX and other movements	0	0	0	0	0
Total net P&L charge during the period	**55**	**165**	**-48**	**0**	**172**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	3	-3	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	8	0	8
Loss allowance as at 31 December 2019	**147**	**477**	**15**	**0**	**639**

Leasing	**Stage 1** **12-month ECL**	**Stage 2** **Lifetime ECL**	**Stage 3** **Lifetime ECL**	**Purchased Credit Impaired**	**Total**

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Initials I.S. Date 27.02.2020

(in thousands of euros)					
Loss allowance as at 1 January 2018	**233**	**0**	**0**	**0**	**233**
Movements with P&L impact	-268	238	30	0	0
Transfers:					
From Stage 1 to Stage 2	-238	238	NA	0	0
From Stage 1 to Stage 3	-30	NA	30	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	43	7	0	0	50
Changes in PDs/LGDs/EADs	85	67	33	0	185
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-140**	**312**	**63**	**0**	**235**
Other movements with no P&L impact					
Transfers:					
From Stage 1 to Stage 3	NA	0	0	0	0
From Stage 2 to Stage 1	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**92**	**312**	**63**	**0**	**467**

Other loan portfolios and changes in the impairments between the beginning and the end of the annual period are disclosed in the Note 11. ECL allowance related information is disclosed in the Note 3.2.4.1.

Significant changes in the gross carrying amount of financial assets that contributed to changes in the loss allowance were as follows:

- Changes in loss allowances of corporate loan portfolio explained in detail in table below

The following table further explains changes in the gross carrying amount of the portfolio to help explain their significance to the changes in the loss allowance for the same portfolio as discussed above:

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Initials I.S. Date 27.02.2020

Corporate loans	Stage 1	Stage 2	Stage 3		
(in thousands of euros)	12-month ECL	Lifetime ECL	Lifetime ECL	Purchased Credit Impaired	Total
Gross carrying amount as at 1 January 2019	**607 468**	**28 378**	**12 045**	**380**	**648 271**
Movements with P&L impact					
Transfers:					
From Stage 1 to Stage 2	-16 784	16 784	NA	NA	0
From Stage 1 to Stage 3	0	NA	0	NA	0
From Stage 2 to Stage 3	NA	-46	46	NA	0
From Stage 3 to Stage 2	NA	0	0	0	0
From Stage 2 to Stage 1	3 318	-3 318	NA	NA	0
Financial assets derecognised during the period	-110 503	-14 242	-24 048	-379	-149 172
New financial assets originated or purchased	283 300	10 788	0	0	294 088
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Changes in interest accrual	-293	78	-35	-1	-251
Write-offs	0	0	13 028	0	13 028
FX and other movements	0	0	0	0	0
Gross carrying amount as at 31 December 2019	**766 506**	**38 422**	**1 036**	**0**	**805 964**

Corporate loans and overdraft	Stage 1	Stage 2	Stage 3		
	12-month ECL	Lifetime ECL	Lifetime ECL	Purchased Credit Impaired	Total
(in thousands of euros)					
Gross carrying amount as at 1 January 2018	**456 747**	**25 150**	**14 043**	**0**	**495 940**
Movements with P&L impact					
Transfers:					
From Stage 1 to Stage 2	-11 244	11 244	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 3	NA	-3 415	3 415	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
From Stage 2 to Stage 1	2 208	-2 208	NA	0	0
Financial assets derecognised during the period	-45 325	-4 479	-5 528	0	-55 332
New financial assets originated or purchased	204 715	2 066	0	380	207 161
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Changes in interest accrual	367	20	0	0	387
Write-offs	0	0	115	0	115
FX and other movements	0	0	0	0	0
Gross carrying amount as at 31 December 2018	**607 468**	**28 378**	**12 045**	**380**	**648 271**

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Initials I.S. Date 27.02.2020

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 realisation 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 2019, the Group provisioned corporate loans in the total amount of EUR 3 431 thousand (2018: EUR 4 303 thousand).

Loan customers with ratings of 10-13 are subject to more frequent monitoring during which the solvency of the borrower is evaluated. In case of a deterioration of payment behaviour, the requirement for individual provisioning is evaluated, considering, among other factors, the collateral of the loan, therefore some loans are not individually impaired, because they are sufficiently secured. 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 359 230 thousand euros at 31.12.2019 (31.12.2018: 188 841 thousand euros).

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2019 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans to individuals in total amount of EUR 69 898 thousand (31.12.2018: EUR 41 430 thousand). All uncommissioned loans available to individuals have at least investment grade scoring as at the end of each reporting period.

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

(in thousands of euros)	**31.12.2019**	**31.12.2018**
3 very low risk	100 000	0
5 low credit risk	615	5 302
6 low credit risk	42 265	17 202
7 medium credit risk	29 462	25 997
8 medium credit risk	86 923	71 244
9 heightened credit risk	41 016	25 142
10 high credit risk	15 743	10 534
11 high credit risk	16	17
12 payments are delayed	77	604
Non-rated (retail clients)	2 730	737
Total	**318 847**	**156 780**

The total amount of undiscounted expected credit losses at initial recognition for purchased or originated credit-impaired financial assets recognised during the period was EUR 71 thousand.

3.2.6. Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognised as income.

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

Credit cards and hire purchase

There has been no significant contribution in 12 months since the client's insolvency (default) and the court proceedings relating to arrears have terminated to the Group's detriment or the client fails to comply with the court decision

A bankruptcy has been announced to the client or the client has been declared insolvent

The court confirms the debt restructuring plan (the claim recognised in the plan is less and the actual claim)

Criminal proceedings have been initiated in relation to issued credit or fraud has been used to obtain credit

The customer is dead and after the inventory of the estate bankruptcy is declared

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

The client forwarded to the bailiff has a foreign address or none at all.

Leasing, private and business loans

The client does not voluntarily reimburse the Group's claim risen from the difference of original claim and the realisation of the collateral.

3.2.7. Modifications of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset (refer to note 2.6). The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. The gross carrying amount of such assets held as at 31 December 2019 was EUR 0 (2018: 0).

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

There were no such financial assets with lifetime ECL whose cash flows were modified during the period.

3.3 Market risk

Market risk arises from the Group's positions which are exposed to changes in interest rates, foreign exchange rates and securities prices. Such positions arise from the Group's trading, market making and investment activities as well as from the Bank's lending and funding activities (banking book). The Bank has set very conservative limits for the trading, liquidity and investment portfolios and open foreign currency exposures.

3.3.1 Foreign currency risk

Foreign currency risk arises from the potential mis-match of the Bank's foreign currency assets and liabilities. Treasury is responsible for daily monitoring of net open foreign currency positions. The Group's management of foreign currency risk is governed by risk policies, risk metrics, limits and internal procedures. The internal limits for net open foreign currency positions are proposed by the Risk Control unit and Treasury and the limits are set internally by the Risk and Capital Committee. The limits set by the Committee are maximum nominal limits in euro equivalent for each currency. The nominal limits are calibrated to ensure that the total potential loss from foreign currency risk would remain within a specified percentage with respect to the Group's net own funds. 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 spot, forwards or futures).

A sensitivity analysis has been performed for the effect of possible changes attributable to net open currency positions on statement of profit or loss, with the assumption of other conditions remaining constant.

Impact on statement of profit or loss *(in thousands of euros)*	**2019**	**2018**
USD exchange rate +/- 10%	+/-3	+/-13
SEK exchange rate +/- 10%	+/-3	+/-0
GBP exchange rate +/- 10%	+/-1	+/-10
CHF exchange rate +/- 10%	+/-2	+/-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 end of the reporting period. Derivatives reported at fair value in the statement of financial position have been included at contractual amounts under off-balance sheet assets and liabilities. Open currency exposure and the volume of financial assets and liabilities of the Group at the end of the reporting period do not significantly differ from the average exposure during the year. 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.

31.12.2019

(in thousands of euros)	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk							
Due from banks and investment companies (Note 8)	1 231 088	514	27 690	1 053	1 362	8 745	**1 270 453**
Investments in debt and equity securities (Note 9,10)	16 683	0	0	1	16 241	5	**32 931**
Loans and advances to customers (Note 11)	1 685 519	4	62	584	788	77	**1 687 034**
Receivables from customers (Note 12)	1 742	10	601	56	0	335	**2 745**
Other financial assets (Note 13)	110	0	0	0	2 136	0	**2 246**
Total assets bearing currency risk	**2 935 142**	**528**	**28 353**	**1 695**	**20 528**	**9 163**	**2 995 409**
Liabilities bearing currency risk							
Deposits from customers and loans received (Note 15)	2 667 370	4 538	27 138	8 139	20 356	11 061	**2 738 601**
Financial liabilities at fair value (Note 10)	5	0	0	1	1	1	**8**
Accounts payable and other financial liabilities (Note 16)	16 934	62	1 201	345	245	1 826	**20 613**
Subordinated debt (Note 18)	70 500	0	0	0	0	0	**70 500**
Total liabilities bearing currency risk	**2 754 809**	**4 601**	**28 339**	**8 485**	**20 602**	**12 888**	**2 829 722**
Open gross position derivative assets at contractual value	615	4 054	0	6 816	713	3 359	15 557
Open gross position derivative liabilities at contractual value	14 942	0	0	0	615	0	15 557
Open foreign currency position	**166 006**	**-19**	**14**	**26**	**25**	**-366**	**165 687**

31.12.2018

(in thousands of euros)	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk							
Due from banks and investment companies (Note 8)	650 363	2 224	18 319	2 536	1 430	6 973	**681 846**
Financial assets at fair value (Note 9,10)	14 807	0	1 174	1	23 230	0	**39 211**
Loans and advances to customers (Note 11)	902 843	0	14 707	220	957	34	**918 761**
Receivables from customers (Note 12)	1 590	0	374	42	0	503	**2 509**
Other financial assets (Note 13)	840	0	0	0	2 096	0	**2 936**
Total assets bearing currency risk	**1 570 443**	**2 224**	**34 574**	**2 799**	**27 713**	**7 511**	**1 645 263**
Liabilities bearing currency risk							
Deposits from customers and loans received (Note 15)	1 382 450	2 194	41 600	6 363	29 297	7 657	**1 469 561**
Financial liabilities at fair value (Note 10)	0	0	0	0	3	8	**11**
Accounts payable and other financial liabilities (Note 16)	14 819	50	2 238	410	120	3 311	**20 948**
Subordinated debt (Note 18)	30 000	0	0	0	0	0	**30 000**
Total liabilities bearing currency risk	**1 427 269**	**2 244**	**43 838**	**6 773**	**29 420**	**10 976**	**1 520 520**
Open gross position derivative assets at contractual value	610	0	9 166	3 973	2 186	3 234	19 169
Open gross position derivative liabilities at contractual value	18 559	0	0	0	610	0	19 169
Open foreign currency position	**125 225**	**-20**	**-98**	**-2**	**-130**	**-232**	**124 743**

3.3.2 Price risk

Financial instruments bearing price risk at Group are securities held in the liquidity portfolio, trading portfolio and investment portfolio (Note 9, 10). Limits have been set for the size of the trading and investment portfolios. There are criteria in place for acceptable credit ratings as well as other parameters of the debt securities that can be held by the Group. The Risk Control unit monitors the compliance with limits.

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Initials I.S. Date 27.02.2020

The Bank does not hold significant amounts of equity securities in its position (see Note 10), due to which the sensitivity to change in the market price of these positions is marginal.

Bank's debt securities portfolio recognised at the market price is short-term and of high quality, therefore, the effect of the changes in market risk premiums on the market value of the debt security portfolio should remain at around 1.0% (2018: 1.0%).

The following table presents the results of a sensitivity analysis(the impact from the risk exposures to the net result of the Group's largest entity AS LHV Pank from a reasonably possible change in thousands euros):

Impact on statement of profit or loss (profit after tax) *(in thousands of euros)*	**2019**	**2018**
Equity securities and fund units +/-10%	+/-50	+/-51
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-323	+/-387
Impact on other comprehensive income		
(in thousands of euros)	**2019**	**2018**
Equity securities (FVOCI) +/-10%	+/- 43	+/- 30

3.3.3 Interest rate risk

Interest rate risk arises from the mismatch of interest rate types, refixing periods or base rates of assets and liabilities (both balance sheet and off-balance sheet items). The Group's interest rate risk management is based on risk policies, limits and internal procedures which identify all significant sources of interest rate risk and provide for balanced risk taking.

Interest rate risk is measured by conducting gap and duration analysis under different scenarios. The goal of the analysis is to determine the maximum potential loss in case of an adverse change in interest rates.

Duration analysis (change in the economic value of equity) aims to assess the change in the economic value of the assets, liabilities and equity in different interest rate scenarios. Gap analysis assesses the impact of interest rate changes on net interest income in the next 12-month period.

Both duration analysis and gap analysis are regularly conducted for two scenarios including an increase as well as decrease of interest rates. The key scenario is parallel upward or downward shift in interest rates of 200 bps.

The statement of financial position and margins on assets and deposits are assumed to be constant over time. Internal limits for interest rate risk management are set by AS LHV Pank's Risk and Capital Committee. Limits on interest rate risk are set in relation to net own funds. Treasury is responsible for managing interest rate risk on an ongoing basis.The deposits interest rates did not change in 2019 remaining at the level of up to 1.0% (up to 1.0% in 2018).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2019, the interest rate on loans received for specific purposes was around 1.0% (2018: 1.0%). The effective interest rate of subordinated debts entered into in 2015 was 6.5%, the effective interest rate of subordinated debts entered into in 2018 was 6.0% and the effective interest rate of subordinated debts entered into in 2019 was 8%. The information about subordinated debt contractual interest rates is provided in Note 18.

As at 31.12.2019, an increase of 1 percentage point in interest rates would affect the Group's annual net interest income and profit by EUR +9 362 thousand (2018: EUR +10 263 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 127 thousand (2018: EUR -1 657 thousand). A 1 percentage point increase in market interest rates would raise the Group's economical value, i.e. equity, by EUR 16 946 thousand (2018: EUR 11 437 thousand). A 1 percentage point decrease in market interest rates would decrease the Group's economical value (equity) by EUR 74 229 thousand (2018: EUR 25 265 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.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Demand deposits have a duration of 2 years due to their behavioural 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 LHV Group 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.

31.12.2019 *(in thousands of euros)*	**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)	1 270 453	0	0	0	**1 270 453**	0	0	**1 270 453**
Financial assets at fair value (debt securities) (Note 9, 10)	10 682	0	12 950	7 925	**31 557**	774	0	**32 331**
Loans and advances to customers (Note 11)	729 768	851 657	84 798	22 988	**1 689 211**	3 927	-6 104	**1 687 034**
Total	**2 010 903**	**864 607**	**92 723**	**22 988**	**2 991 221**	**4 701**	**-6 104**	**2 989 818**
Financial liabilities								
Deposits from customers and loans received (Note 15)	375 862	491 080	1 868 767	1	**2 735 710**	2 891	0	**2 738 601**
Subordinated debt* (Note 18)	0	0	0	70 500	**70 500**	429	0	**70 929**
Total	**375 862**	**491 080**	**1 868 767**	**70 501**	**2 806 219**	**3 320**	**0**	**2 809 530**
Net interest sensitivity gap	**1 635 041**	**373 527**	**-1 776 044**	**-47 513**	**185 011**			

31.12.2018 *(in thousands of euros)*	**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)	681 846	0	0	0	**681 846**	0	0	**681 846**
Financial assets at fair value (debt securities) (Note 9, 10)	20 546	0	15 031	2 000	**37 577**	1 120	0	**38 697**
Loans and advances to customers (Note 11)	382 251	465 063	62 286	16 770	**926 370**	2667	-10 276	**918 6761**
Total	**1 084 643**	**465 063**	**77 317**	**18 770**	**1 645 793**	**3 787**	**-10 276**	**1 639 304**
Financial liabilities								
Deposits from customers and loans received (Note 15)	136 498	111 503	1 221 205	18	**1 469 224**	337	0	**1 469 561**
Subordinated debt* (Note 18)	0	0	0	30 000	**30 000**	150	0	**30 150**
Total	**136 498**	**111 503**	**1 221 205**	**30 018**	**1 499 224**	**487**	**0**	**1 499 711**
Net interest sensitivity gap	**948 145**	**353 560**	**-1 143 888**	**-11 248**	**146 569**			

* The contractual term of subordinated debts received in 2018 is 10 years and the interest rate is fixed at 6.0%. The contractual term of subordinated debts received in 2015 is 10 years and the interest is fixed at 6.5%. The contractual term of subordinated debts received in 2019 is 10 years and the interest rate is fixed at 8.0%.

3.4 Liquidity risk

Liquidity risk relates to the ability 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 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

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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 31.12.2019 and 31.12.2018. 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 31.12.2019 was 143% (2018: 144%).

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 31.12.2019 was 157% (31.12.2018: 153%). The net stable funding ratio was imposed as minimum requirement in 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 31.12.2019 and 31.12.2018, 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 3.5.

31.12.2019 *(in thousands of euros)*	**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)	2 201 704	41 522	476 248	18 721	2 906	**2 741 101**	**2 738 601**
Subordinated debt (Note 18)	0	1 318	3 954	21 090	81 745	**108 107**	**70 500**
Accounts payable and other financial liabilities (Note 16)	0	20 613	0	0	0	**20 613**	**20 613**
Unused loan commitments (Note 21)	0	359 230	0	0	0	**359 230**	**0**
Financial guarantees by contractual amounts (Note 21)	0	14 139	0	0	0	**14 139**	**0**
Foreign exchange derivatives (gross settled)	0	14 942	0	615	0	**15 557**	**0**
Financial liabilities at fair value (Note 10)	0	8	0	0	0	**8**	**8**
Total liabilities	**2 201 704**	**451 772**	**480 202**	**40 426**	**84 651**	**3 258 755**	**2 829 722**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	1 270 453	0	0	0	0	**1 270 453**	**1 270 453**
Financial assets at fair value (debt securities) (Note 9,10)	0	10 883	13 018	8 429	0	**32 330**	**32 331**
Loans and advances to customers (Note 11)	0	113 590	251 806	1 029 520	582 889	**1 977 805**	**1 687 034**
Receivables from customers (Note 12)	0	2 745	0	0	0	**2 745**	**2 745**
Foreign exchange derivatives (gross settled)	0	14 942	0	615	0	**15 557**	**0**
Other financial assets (Note 13)	2 246	0	0	0	0	**2 246**	**2 246**
Total assets held for managing liquidity risk	**1 272 699**	**142 160**	**264 824**	**1 038 564**	**582 889**	**3 301 136**	**2 994 809**
Maturity gap from assets and liabilities	**-929 005**	**-309 612**	**-215 378**	**998 138**	**498 238**	**42 381**	**165 087**

Initialled for identification purposes only
Initials i.S. Date 27.02.2020

31.12.2018 *(in thousands of euros)*	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)	1 330 018	24 949	94 113	16 780	4 390	**1 470 250**	**1 469 561**
Subordinated debt (Note 18)	0	504	1 510	8 055	35 333	**45 402**	**30 000**
Accounts payable and other financial liabilities (Note 16)	0	20 948	0	0	0	**20 948**	**20 948**
Unused loan commitments (Note 21)	32 259	156 582	0	0	0	**188 841**	**0**
Financial guarantees by contractual amounts (Note 21)	0	9 314	0	0	0	**9 314**	**0**
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	**19 169**	**0**
Financial liabilities at fair value (Note 10)	0	11	0	0	0	**11**	**11**
Total liabilities	**1 362 277**	**230 867**	**95 623**	**25 445**	**39 723**	**1 753 935**	**1 520 520**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	681 846	0	0	0	0	**681 846**	**681 846**
Financial assets at fair value (debt securities) (Note 9,10)	0	20 690	0	15 845	2 161	**38 696**	**38 697**
Loans and advances to customers (Note 11)	0	63 584	198 293	634 077	154 853	**1 050 807**	**918 761**
Receivables from customers (Note 12)	0	2 509	0	0	0	**2 509**	**2 509**
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	**19 169**	**0**
Other financial assets (Note 13)	2 936	0	0	0	0	**2 936**	**2 936**
Total assets held for managing liquidity risk	**684 782**	**105 342**	**198 293**	**650 532**	**157 014**	**1 795 963**	**1 644 749**
Maturity gap from assets and liabilities	**-677 495**	**-125 525**	**102 670**	**625 087**	**117 291**	**42 028**	**124 229**

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

(in thousands of euros)	31.12.2019	31.12.2018
Current assets		
Due from central banks (Note 8)	1 232 733	639 862
Due from credit institutions (Note 8)	32 247	24 979
Due from investment companies (Note 8)	5 473	17 005
Financial assets at fair value through profit or loss (Note 10)	32 499	38 913
Loans and advances to customers (Note 11)	301 327	225 036
Receivables from customers (Note 12)	2 745	2 509
Other assets (Note 13)	1 857	1 341
Total current assets	**1 608 881**	**949 645**
Non-current assets		
Equity instruments at FVOCI (Note 9)	432	298
Other financial assets (Note 13)	2 246	2 936
Loans and advances to customers (Note 11)	1 385 707	693 725
Tangible assets (Note 14)	6 680	1 122
Intangible assets (Note 14)	685	1 286
Total non-current assets	**1 395 750**	**699 367**
Total assets	**3 004 631**	**1 649 012**

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Initials I.S. Date 27.02.2020

LHV

Liabilities		
Current liabilities		
Deposits from customers and loans received (Note 15)	2 716 974	1 448 767
Financial liabilities at fair value through profit or loss (Note 10)	8	11
Accounts payable and other liabilities (Note 16)	23 774	23 861
Total current liabilities	**2 740 756**	**1 472 639**
Non-current liabilities		
Deposits from customers and loans received (Note 15)	21 627	20 794
Subordinated debt (Note 18)	70 500	30 000
Total non-current liabilities	**92 127**	**50 794**
Total liabilities	**2 832 883**	**1 523 433**

3.5 Fair value of financial assets and financial liabilities

(in thousands of euros)	**Note**	**Level 1**	**Level 2**	**Level 3**	**Valuation explanation**	**Total fair value 31.12.2019**	**Carrying value 31.12.2019**	**Diffe-rence**
Financial assets at fair value through profit or loss								
Shares	10	164	0	0	Level 1 – quotes from active market	**164**	**164**	**0**
Equity instruments at fair value through other comprehensive income	9	0	0	432	The shares of Visa are not traded on an active market, therefore their value is based on market information on similar transactions and management estimates.	**432**	**432**	**0**
Debt securities at fair value through profit or loss	10	32 331	0	0	Quotes from active market	**32 331**	**32 331**	**0**
Interest rate swaps and foreign exchange forwards	10	0	4	0	Mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. 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.	**4**	**4**	**0**
Total financial assets at fair value throught profit or loss		**33 495**	**4**	**432**		**32 931**	**32 931**	**0**

Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards	10	0	8	0		**8**	**8**	**0**
Total financial liabilities at fair value throught profit or loss		**0**	**8**	0		**8**	**8**	**0**
Financial assets at amortised cost								
Due from other banks	8	0	1 232 733	0	Very liquid and short-term	**1 232 733**	**1 232 733**	**0**
Due from credit institutions	8	0	32 247	0	Very liquid and short-term	**32 247**	**32 247**	**0**
Due from investment companies	8	0	5 473	0	Very liquid and short-term	**5 473**	**5 473**	**0**
Loans and advances to customers	13	0	0	1 707 842	Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest rate of past 6 months prior to end of the reporting period.	**1 707 842**	**1 687 034**	**20 808**
Receivables from customers	14	0	2 745	0	Short-term receivables	**2 745**	**2 745**	**0**
Other financial assets	15	0	2 246	0	Short-term deposits	**2 246**	**2 246**	**0**
Total financial assets at amortised cost		**0**	**1 275 444**	**1 707 842**		**2 983 286**	**2 962 478**	**6 064**
Financial liabilities at amortised cost								
Deposits from customers and loans received	15	0	2 204 495	537 577	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.	**2 742 072**	**2 738 601**	**3 471**
Subordinated debt	18	0	0	73 010	Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade.	**73 010**	**70 500**	**2 510**
Accounts payable and other liabilities	16	0	20 613	0	Short-term payables	**20 613**	**20 613**	**0**
Total financial liabilities at amortised cost		**0**	**2 225 108**	**610 587**		**2 835 695**	**2 829 714**	**5 981**

Total net gain recognised in OCI for level 3 financial assets amounted to EUR 134 thousand.

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Initials I.S. Date 27.02.2020

(in thousands of euros)	**Note**	**Level 1**	**Level 2**	**Level 3**	**Valuation explanation**	**Total fair value 31.12.2018**	**Carrying value 31.12.2018**	**Diffe-rence**
Financial assets at fair value through profit or loss								
Shares	10	157	0	0	Level 1 – quotes from active market	**157**	**157**	**0**
Equity instruments at fair value through other comprehensive income	9	0	0	298	The shares of Visa are not traded on an active market, therefore their value is based on market information on similar transactions and management estimates.	**298**	**298**	**0**
Debt securities at fair value through profit or loss	10	38 697	0	0	Quotes from active market	**38 697**	**38 697**	**0**
Interest rate swaps and foreign exchange forwards	10	0	59	0	Mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. 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.	**59**	**59**	**0**
Total financial assets at fair value throught profit or loss		**38 854**	**59**	**298**		**39 211**	**39 211**	**0**
Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards	10	0	11	0		**11**	**11**	**0**
Total financial liabilities at fair value throught profit or loss		**0**	**11**	0		**11**	**11**	**0**
Financial assets at amortised cost								
Due from other banks	8	0	639 862	0	Very liquid and short-term	**639 862**	**639 862**	**0**
Due from credit institutions	8	0	24 979	0	Very liquid and short-term	**24 979**	**24 979**	**0**
Due from investment companies	8	0	17 005	0	Very liquid and short-term	**17 005**	**17 005**	**0**
Loans and advances to customers	11	0	0	924 825	Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest	**924 825**	**918 761**	**6 064**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

					rate of past 6 months prior to end of the reporting period.			
Receivables from customers	12	0	2 509	0	Short-term receivables	**2 509**	**2 509**	**0**
Other financial assets	13	0	2 936	0	Short-term deposits	**2 936**	**2 936**	**0**
Total financial assets at amortised cost		**0**	**687 291**	**924 825**		**1 612 116**	**1 606 052**	**6 064**
Financial liabilities at amortised cost								
Deposits from customers and loans received	15	0	0	1 469 708	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.	**1 469 708**	**1 469 561**	**147**
Subordinated debt	18	0	0	30 491	Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade.	**30 491**	**30 150**	**341**
Accounts payable and other liabilities	16	20 977	0	0	Short-term payables	**20 977**	**20 977**	**0**
Total financial liabilities at amortised cost		**20 977**	**0**	**1 500 199**		**1 521 176**	**1 520 688**	**488**

Total net gain recognised in OCI for level 3 financial assets amounted to EUR 42 thousand.

The management board of the Group has assessed the fair value of assets and liabilities carried at amortised cost in the statement of financial position. For estimating fair value, the future cash flows are discounted based on 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 (a)Quantitative information about the significant unobservable inputs used in fair value measurement (if developed and available for the entity); b)a narrative description of the sensitivity of FV measurement to changes in unobservable inputs (if the change might result in a significant change in FV measurement); c)effect of reasonable possible changes to unobservable inputs

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

3.6 Operational risk

Operational risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the segregation of duties principle is used in the Group'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 the Group and to evaluate capital requirements. The analysis of cases collected into the database enables the Group to identify the

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Initials I.S. Date 27.02.2020

flaws in business processes, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of Group is responsible for collecting information.

Compliance control and internal audit department have an important role in evaluating, monitoring and mitigating the operating risk. The main task of the Compliance Officer is to evaluate the activities of the Group in accordance with legislation, the supervision guidelines of the Financial Supervision Authority and procedure rules of the Group. Internal audit is an independent and objective function, assuring and consulting activity that is targeted at improving the Group's performance, processes and adding value. Internal audit helps achieving the goals of the Group, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.7. Compliance risk

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

The aim of managing compliance risk is to prevent the negative consequences from materializing.

Considering the volume and pace of changes to regulatory requirements LHV assesses compliance risk to remain high.

In order to manage the risk, the compliance function assesses changes to regulatory environment, evaluates their potential impact, informs management of changes and participates in the implementation thereof.

Monthly overviews to management include information collected from various sources, including supervisory guidelines,, EU, UK and Estonian regulatory acts. Board members take responsibility in implementing identified changes. In addition, the compliance function keeps track of all regulatory requirements applicable to LHV group entities.

The biggest challenges that LHV continues to face are similar to other market participants and include MiFID, GDPR, AMLD, PRIIP regulation and CRD-V package. Due to the nature of business model LHV places additional attention to changes in UK regulative environment, including those associated with UK leaving EU.

3.8. Anti-money laundering

AML/CTF Governance

LHV internal governance is based on three lines of defence principle. Business as first line of defence owns, takes and mitigates risks where AML, Compliance and Risk management as second line of defence are providing framework and guidance, also controlling first line. Internal audit as third line of defence is assuring that first and second line are set up and working properly, giving assurance to Supervisory Board.

All defence lines follow risk-based approach which is based on risk assessment of products, services, clients and countries, CDD and EDD measures depending on risk levels and on risk-based monitoring. High awareness and commitment from all employees and management is foundation on which is built strong AML culture supported by awareness rising, information sharing, training and reporting.

Management and Supervisory Board of LHV Group and LHV Bank have strong commitment towards implementing, maintaining and developing AML/KYC regime all over Group entities. There have been at least yearly updates in AML/CTF Policy and Customer Acceptance Principles. In 2019, Management Board approved Risk Assessment and Risk Appetite Framework. All internal AML/CTF procedures and guideline are constantly renewed.

Analytical and supported technical capabilities are key elements in AML system and LHV has invested a lot in 2019 into different new tools. AML monitoring is carried out by FICO Tonbeller software Siron and screening by Accuity`s Compliance Link. Both tools were launched in 2019. Beside Siron and Compliance Link analytical-visualisation software Tableau is used to monitor activities and trends. Co-operation with external experts from Salv (previous brand: Dataminer) is on-going in order to enhance further analytical capabilities of AML team. That co-operation includes testing Salv`s monitoring software with aim to enhance potentiality of analytics even more in future.

Beside investments into IT, also number of employees directly and indirectly related to the AML has significantly raised. Many new positions were generated both in to AML department and to KYC-EDD team in first line of defence.

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

AML Governance structure

Institution	Approves	Actions
Supervisory Board	- AML/CTF Policy and high-level risk appetite	- Monitors and supervises AML high-level area - Receives reports on AML
Management Board	- Customer Acceptance Principles - Risk assessment and risk appetite framework - AML framework - AML Committee procedure - High Risk Customer Acceptance Committee procedure	- Monitors and supervises AML area - Sets AML risk appetite - Regular reporting from AML and compliance - Sets AML risk appetite - Provides general guidance - Accepts high risk customers
AML	- AML internal guideline	- Co-ordinates AML procedures and processes - Gives guidance to first line of defence - Assesses AML risks (customer, product, service, channel, country) - Supports EDD measures (on-boarding risk assessment, on-site and off-site controls etc.) - Is responsible for monitoring - Is responsible for screening - Analyses all suspicious and unusual customers and transactions - Assesses AML risks associated with new services, products and processes - Reports to FIU - Reports to management - Provides training and raises awareness
Compliance		- Advises management bodies and the AML department to ensure compliance with applicable regulations - Assesses the potential impact of changes in the regulatory and supervisory environment - Carries out AML compliance controls and audits - Assesses compliance risks associated with new services, products and processes - Reports to the governing bodies
Internal audit		- Performs an independent evaluation of AML processes

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

		- Reports to the Supervisory Board and to the Audit Committee
Business	- Specific instructions on all work flows (including AML measures within)	- Performs KYC - Escalates internal SAR`s to AML

AML/KYC measures

LHV main principles:

- strong on-boarding CDD supported by Customers Acceptance Principles;
- conservative approach towards risk segmentation;
- regular CDD and EDD;
- robust risk based monitoring;
- screening of customers and transactions towards International financial sanctions lists and other sources (incl. US OFAC list and UK HM Treasury list);
- strong top and middle management commitment;
- regular training of employees;
- ongoing communication and cooperation with FIU and other relevant stakeholders;
- active participation in setting industry`s best practices.

LHV has implemented four levels of customer acceptance in on-boarding stage:

- Customer relationship manager
- Customer relationship manager and approval by senior employee (4-eye principle)
- Risk Customer Acceptance Committee
- Management

Combination of risk indicators determine with each customer which acceptance level is required.

Beside conservative and risk-based on-boarding procedures, also risk-based monitoring is implemented and regular updating of KYC information is carried out.

LHV has set risk tolerance towards non-resident legal customers' deposits outside of non-financial and non-governmental sectors to 25%. The cause of growth of non-resident deposits was related to the Banks decision to attract long term low risk deposits from German and Austrian market through deposit platforms Raisin and Deposit Solution.

Financial intermediaries

LHV is providing services to fin.tech companies who provide financial services to their customers. As providing service to fin.techs include different risks comparing to servicing regular resident customers, then Bank has dedicated special attention and measures to mitigate those risks. There are dedicated customer managers having area related competence. AML team constantly monitors trends, developments and threats coming from that sector and KYC measures are constantly updated. Bank has taken approach that all customers from fin.tech sector have to have same AML/KYC measures in place as does banking sector. During on-boarding and continuous KYC, Bank assesses customers business model, team, AML/KYC measures, technical capabilities for screening and monitoring, customer focus, customer risk segmentation, limit policy, source of funds and etc. LHV carries out on-site visits to ensure that measures on policies and procedures are implemented in reality and are really working. Special and continuous attention through dedicated monitoring is set on financial activities of such customers.

Country

Recent years money-laundering allegations have shaken Estonian and foreign media and Estonian reputation has been severely damaged. Still Estonian financial system and country itself is deemed one of the least risky ones in world. Basel Institute on Governance has ranked Estonia in 2019 as least risky country from money laundering risks perspective. Even if there have been shortcomings in KYC measures and setting proper risk appetite by some institutions historically, then in general Estonian AML system has been assessed as strong. Next significant evaluation will be against FATF standards in 2021-2022 by Moneyval.

Estonian regulator, FIU and financial sector have taken situation very seriously and a lot of different steps have been taken to improve AML system in all aspects. Banking sector has invested heavily in human resources, both from quantitative, but also from competence point of view. All market participants have been and are continuously improving usage of technology. Most of them are exploring ways to use modern technology (e.g. machine learning) to improve their technical and analytical capabilities. FSA has

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

issued new AML guideline in March 2019. As new component is list of money laundering trends and methods in Estonia through all three phases of money laundering. FIU has updated reporting software, being now able to have quicker and automated overview of all data reported to them. From regulatory point of view, many legislative initiatives are ongoing in order to improve AML system and cooperation between all stakeholders.

3.9. Other risks

3.9.1 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 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.

3.9.2 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 realisation of other risks (for example operational risk or strategic risk). In order to mitigate the risk on reputation, LHV regularly carries out risk management trainings and also the framework of risk management is constantly improved which will provide a strong risk culture.

3.9.3 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 preparing to start a business in the United Kingdom.

3.10. Offsetting assets and liabilities

The group has offset the following assets and liabilities

				Related arrangements not set off in the statement of financial position		
31.12.2019	**Gross amounts before offsetting in the statement of financial position**	**Offsetting**	**Net amount of exposure presented in the statement of financial position**	**Financial instru-ments**	**Cash collateral received**	**Net amounts**
ASSETS						
Derivatives	4	0	4	0	0	0
LIABILITIES						
Derivatives	8	0	8	0	0	0
31.12.2018						
ASSETS						
Derivatives	59	0	59	0	0	0
LIABILITIES						
Derivatives	2	0	2	0	0	0

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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 end of the reporting period, and the reported amounts of income and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates. Management's estimates have been applied to valuation of loans, receivables and investments (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.

The most significant management estimates and assumptions are related with the financial instrument standard IFRS 9, namely the criteria for SICR, calculation of PD and LGD, business model and SPPI assessment for classification of financial assets. Please see more information in Note 3.2 and below. There were no significant other changes in management estimates and assumptions in 2019.

When calculating expected credit loss (ECL) there are a number of key concepts that require a high level of judgement. Estimating expected credit loss is, by its very nature, uncertain and the accuracy of these estimates depends on many factors, e.g. macroeconomic forecasts and involves complex modelling and judgements. The assessment of significant increase in credit risk is a concept under IFRS 9 Financial Instruments and requires significant judgement. At the end of each reporting period the Group performs an assessment of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument, using key risk indicators that are used in the Group's existing risk management processes. Another area requiring significant judgement is the incorporation of forward-looking information and macroeconomic scenarios. IFRS 9 requires an unbiased and probability-weighted estimate of credit losses by evaluating a range of possible outcomes that incorporates forecasts of future economic conditions. LHV uses internally developed macroeconomic forecasts as the basis for the forward-looking information in the ECL measurement. LHV uses both models and expert based judgement in order to determine ECLs. The objective of applying expert based judgement is to incorporate the estimated impact of factors not captured in the modelled ECL. The degree of judgement that is required to estimate expected credit losses depends on the outcome from calculations, materiality and the availability of detailed information. The models, assessment and assumptions are regularly reviewed by the risk organisation of the Group and approved by the Group Risk Committee.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

NOTE 5 Net interest income

Interest income *(in thousands of euros)*	**2019**	**2018**
Interest income using effective interest calculation		
Corporate loans	37 130	27 701
incl. loans to related parties (Note 22)	28	31
*incl. stage 3 interests**	*164*	*340*
Hire-purchase	3 968	4 055
Consumer loans	7 240	5 313
Leveraged loans and lending of securities	500	456
Credit card loans	813	770
From balances with credit institutions and investment companies	270	141
Mortgage loans	5 248	1 761
incl. loans to related parties (Note 22)	34	20
Private loans	1 744	1 514
incl. loans to related parties (Note 22)	7	*12*
Other loans	891	1 336
Subtotal	**57 804**	**43 047**
Other similar interest income		
Leasing	3 253	2 439
incl. loans to related parties (Note 22)	*3*	*4*
From debt securities	356	136
incl. debt securities at FVOCI	-	13
incl. debt securities at fair value through profit or loss (Note 10)	356	123
Subtotal	**3 609**	**2 575**
Total	**61 413**	**45 622**
Interest expense		
Deposits from customers and loans received	-5 579	-1 881
From balances with central bank	-4 265	-3 360
Subordinated debt (Note 18, 22)	-3 654	-1 360
Total	**-13 498**	**-6 601**
Net interest income	**47 915**	**39 021**

Interest income of loans by customer location **(interests from bank balances and debt securities not included):**	**2019**	**2018**
Estonia	**60 787**	44 822
Lithuania	0	523
Total	**60 787**	**45 345**

*As most of the stage 3 loans are sold to debt collectors, the stage 3 interests are marginal in all loan portfolios except corporate loans.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

NOTE 6 Net fee and commission income

Fee and commission income *(in thousands of euros)*	**2019**	**2018**
Security brokerage and commission fees	3 658	3 687
Asset management and related fees	2 962	2 429
Currency exchange fees	1 867	1 639
Fees from cards and settlements	12 485	8 766
Other fee and commission income	3 185	2 381
Total	**24 157**	**18 902**
Fee and commission expense		
Security brokerage and commission fees paid	-546	-544
Expenses related to cards	-3 979	-2 765
Expenses related to acquiring	-3 967	-2 834
Fees related to consumer loans and hire-purchase paid	-674	-518
Other fee expense	-2 183	-1 138
Total	**-11 349**	**-7 799**
Net fee and commission income	**12 808**	**11 103**

Fee and commission income by customer location:	**2019**	**2018**
Estonia	24 157	18 902
Total	**24 157**	**18 902**

NOTE 7 Operating expenses

(in thousands of euros)	**2019**	**2018**
Wages, salaries and bonuses	13 078	10 687
Social security and other taxes*	3 964	3 191
Total staff costs	**17 042**	**13 878**
IT expenses	2 509	2 011
Information services and banking services	823	573
Marketing expenses	1 799	1 609
Office expenses	598	634
Transportation and communication costs	263	204
Training and travelling expenses of employees	647	585
Other outsourced services	2 104	1 988
Other administrative expenses	3 220	1 715
Depreciation	2 802	1 164
Operating lease payments	246	1 074
Other operating expenses	464	308
Total other operating expenses	**15 475**	**11 865**
Total operating expenses	**32 517**	**25 743**

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

The average number of employees working for the Group in 2019 was 405 (2018: 342).

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

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

(in thousands of euros)	31.12.2019	31.12.2018
Demand and term deposits with maturity of less than 3 months*	37 720	41 984
Statutory reserve capital at central bank	26 426	14 280
Demand deposit from central bank*	1 206 307	625 582
Total	**1 270 453**	**681 846**
* cash and cash equivalents in the statement of cash flows	1 244 027	667 566

Distribution of receivables by countries is presented in Note 3.2.

Mandatory banking reserve as at 31.12.2019 was 1% (2018: 1%) of all financial resources collected (deposits from customers and loans received). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 9 Equity instruments at fair value through other comprehensive income

(in thousands of euros)	
Equity instruments 31.12.2017	**0**
Reclassification on 1 January 2018	**220**
Revaluation of equity instruments	78
Equity instruments 31.12.2018	**298**
Revaluation of equity instruments	134
Equity instruments 31.12.2019	**432**

As of 31.12.2019 the Group has VISA shares in the amount of EUR 432 (2018: 298) thousand. The balance of other reserves in equity as at 31.12.2019 is EUR 212 (2018: 78) thousand, see also Note 19.

NOTE 10 Investments in debt and equity securities

Mandatory measurement as fair value through profit or loss:	**31.12.2019**
Shares and fund units	164
Debt securities	32 331
Foreign exchange forwards	4
Total financial assets	**32 499**
Interest rate swaps and foreign exchange forwards	8
Total financial liabilities	**8**

Mandatory measurement as fair value through profit or loss:	**31.12.2018**
Shares and fund units	157
Debt securities	38 697
Foreign exchange forwards	59
Total financial assets	**38 913**
Interest rate swaps and foreign exchange forwards	11
Total financial liabilities	**11**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Financial assets at fair value through profit or loss 31.12.2017	**49 239**
Net changes of investment securities at fair value through profit or loss	-11 710
Interest income (Note 5)	123
Revaluation	-1 261
Financial assets at fair value through profit or loss 31.12.2018	**38 913**
Net changes of investment securities at fair value through profit or loss	-6 492
Interest income (Note 5)	356
Revaluation	-278
Financial assets at fair value through profit or loss 31.12.2019	**32 499**

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.6). In 2019, a gain of EUR 86 thousand (2018: EUR 407 thousand) was recognised on the revaluation of bonds. Loss was obtained from the revaluation of interest rate swaps in 2019 and in 2018. Interest income from bonds is recognised in interest income.

NOTE 11 Loans and advances to customers

(in thousands of euros)	31.12.2019	31.12.2018
Loans to legal entities	**954 986**	**714 335**
incl. corporate loans	763 163	648 271
incl. retail loans	40 967	16 200
incl. overdraft	42 801	23 846
incl. trade finance	32 761	0
incl. hire-purchase	277	249
incl. leveraged loans	3 148	1 997
incl. leasing	66 078	44 277
incl. credit card loans	402	274
incl. credit letters	5 389	3 067
Loans to individuals	**738 152**	**214 702**
incl. consumer loans	49 412	33 989
incl. private loans	44 776	37 884
incl. hire-purchase	16 133	17 501
incl. leveraged loans	2 840	1 733
incl. leasing	16 133	15 888
incl. credit card loans	7 263	6 579
incl. real estate leasing	5 679	0
incl. mortgage loans	587 855	101 009
incl. overdraft	34	43
incl. study loan	750	76
Total	**1 693 138**	**929 037**
Incl. related parties (Note 22)	3 290	3 328
Impairment provisions	-6 104	-10 276
Total	**1 687 034**	**918 761**

In 2019 LHV purchased from Danske Bank Estonian Branche retail portfolio, increasing the retail loan portfolio by EUR 393 million, from which 97% were mortgage loans.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

In 2019, 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 2019	**Corporate loans, incl. overdraft**	**Retail loans**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consumer loans**	**Leasing**	**Leveraged loans**	**Credit letters**	**Total**
Balance as at 1 January	**-8 751**	**-184**	**-36**	**-27**	**-140**	**-568**	**-467**	**-3**	**-100**	**-10 276**
Impairment provisions/reversals set up during the year	-400	-11	-834	-98	-234	-746	-233	-4	100	-2 460
Written off during the year	5 485	42	19	72	262	690	61	1	0	6 632
Balance as at December 31	**-3 666**	**-153**	**-851**	**-53**	**-112**	**-624**	**-639**	**-6**	**0**	**-6 104**

Changes in impairments in 2018	**Corporate loans, incl. overdraft**	**Retail loans**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consumer loans**	**Leasing**	**Leveraged loans**	**Credit letters**	**Total**
Balance as at 1 January	**-4 594**	**-155**	**-243**	**-84**	**-235**	**-819**	**-770**	**0**	**0**	**-6 900**
Impairment provisions/reversals set up during the year	-4 272	-54	207	47	91	226	183	-3	-100	-3 675
Incl Changes in initial application of IFRS 9	-403	-46	0	-2	-50	-53	-158	0	0	-712
Written off during the year	115	25	0	10	4	25	120	0	0	299
Balance as at December 31	**-8 751**	**-184**	**-36**	**-27**	**-140**	**-568**	**-467**	**-3**	**-100**	**-10 276**

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

Net and gross investments on finance leases according to remaining maturity *(in thousands of euros)*	**Gross investment**	**Unearned future interest income**	**Impairment loss provision**	**Present value of lease payments receivable**
up to 1 year	26 375	-2 710	-164	23 501
1-5 years	68 211	-4 395	-457	63 359
over 5 years	2 753	-107	-18	2 628
Total as at 31.12.2019	**97 339**	**-7 212**	**-639**	**89 488**
up to 1 year	19 135	-1 710	-134	17 291
1-5 years	43 901	-2 535	-319	41 047
over 5 years	1880	-39	-14	1 827
Total as at 31.12.2018	**64 916**	**-4 284**	**-467**	**60 165**

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 maturity is disclosed in Note 3.4.
The geographical distribution of loans granted is disclosed in Note 3.2.
For interest income on loans granted, see Note 5.

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Initials I.S. Date 27.02.2020

NOTE 12 Receivables from customers

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Asset management fees from customers	222	185
Other fees for providing services to customers	2 523	2 324
Total	**2 745**	**2 509**

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

NOTE 13 Other assets

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Financial assets		
Guarantee deposits of Baltic stock exchanges	10	11
Guarantee deposits of MasterCard and VISA	2 236	2 925
Subtotal	**2 246**	**2 936**
Non-financial assets		
Prepayments to Financial Supervision Authority	399	359
Other prepayments *	1 458	982
Subtotal	**1 857**	**1 341**
Total	**4 103**	**4 277**

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

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

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

NOTE 14 Tangible and intangible assets

(in thousands of euros)	Tangible assets	Right of use assets	Total tangible assets	Intangible assets	Total
Balance as at 31.12.2017					
Cost	3 676	0	3 676	3 496	7 172
Accumulated depreciation and amortisation	-2 451	0	-2 451	-2 544	-4 995
Carrying amount	**1 225**	**0**	**1 225**	**952**	**2 177**
Changes in 2018:					
Purchase of non-current assets	396	0	396	999	1 395
Depreciation/amortisation charge	-499	0	-499	-665	-1 164
Balance as at 31.12.2018					
Cost	4 072	0	4 072	4 495	8 567
Accumulated depreciation and amortisation	-2 950	0	-2 950	-3 209	-6 159
Carrying amount 31.12.2018	**1 122**	**0**	**1 112**	**1 286**	**2 408**
Changes in 2019:					
Purchase of non-current assets	1 336	0	1 336	747	2 083
Non-current assets sold	-15	0	-15	0	-15
Changes in accounting policies	0	5 676	5 676	0	5 676
Write-off of non-current assets	-338	0	-338	-1 436	-1 774
Depreciation/amortisation charge	-555	-899	-1 454	-1 348	-2 802
Balance as at 31.12.2019					
Cost	5 055	5 676	10 731	3 806	14 537
Accumulated depreciation and amortization	-3 152	-899	-4 051	-3 121	-7 172
Carrying amount	**1 903**	**4 777**	**6 680**	**685**	**7 365**

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

In 2019 and 2018, there was no indication of impairment of tangible and intangible assets.

NOTE 15 Deposits from customers and loans received

(in thousands of euros)	Individuals	Financial inter-mediates	Legal entities	Public sector	31.12.2019 Total	Individuals	Financial inter-mediates	Legal entities	Public sector	31.12.2018 Total
Demand deposits	525 938	376 068	1 279 219	20 293	2 201 518	374 491	193 893	753 582	7 935	1 329 901
Term deposits	415 349	0	90 100	3 100	508 549	57 605	0	54 456	5 734	117 795
Loans received	0	0	25 643	0	25 643	0	0	21 528	0	21 528
Accrued interest liability	2 692	0	196	3	2 891	197	0	131	9	337
Total	**943 979**	**376 068**	**1 395 158**	**23 396**	**2 738 601**	**432 293**	**193 893**	**829 697**	**13 678**	**1 469 561**
incl. related parties (Note 22)	*1 308*	*0*	*14 755*	*0*	*16 063*	*1 091*	*0*	*32 417*	*0*	*33 508*

AS LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) in the amount of EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2019, the loan amount taken into use by the Bank amounted to EUR 12 250 thousandand the Bank repaid the principal in the amount of EUR 2 163 thousand. The outstanding balance as at 31.12.2019 is EUR 10 087 thousand. As at 31 12 2019, the Bank has received EUR 20 000 thousand loan from Nordic Investment Bank (NIB) and repaid the principal in the amount of EUR 4 444 thousand. As at 31.12.2019 the

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Initials I.S. Date 27.02.2020

balance of the loan received from (NIB) is EUR 15 556 thousand. NIB loan will be fully repaid in 2023.

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 and risk concentration is presented in Note 3.2.

NOTE 16 Accounts payable and other liabilities

Financial liabilities		
(in thousands of euros)	**31.12.2019**	**31.12.2018**
Trade payables	4 872	1 866
Other short-term financial liabilities	3 067	1 925
Accrued interest on subordinated loans (Note 18)	4 672	150
Lease liabilities (Note 17)	429	0
Payments in transit	7 395	16 800
Financial guarantee contracts issued	178	207
Subtotal	**20 613**	**20 948**
Non-financial liabilities		
Prepaid expenses	324	276
Performance guarantee contracts issued	266	263
Tax liabilities	1 094	1 100
Payables to employees	1 477	1 274
Subtotal	**3 161**	**2 913**
Total	**23 774**	**23 861**

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

NOTE 17 Right of use assets and lease liabilities

The Group leases office premises. Until 31 December 2018 leases of office premises were classified as operating leases. From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability from the date when the leased asset becomes available for use by the Group. All lease agreements are cancellable upon the consent of both parties. In 2019, the operating lease payments, i.e leases subject to low value items and short-term, for office premises were in the amount of EUR 327 thousand (2018: EUR 1 074 thousand).

As of 01.01.2019 the future non-cancellable lease payments in the amount of EUR 4 512 thousand were discounted at the Group's incremental borrowing rate of 3.75%. As a result the Group's total assets in the statement of financial position as at 01.01.2019 increased 4 042 thousand euros and liabilities increased 4 042 thousand euros. During the year 2019 EUR 1 634 thousand was additionally recorded as right-of-use assets and lease liability which was related to the new lease properties. The right of use assets balance as of 31 December 2019 is disclosed in the Note 14. The lease liability is disclosed in the Note 16. Interest expense on lease liabilities was EUR 81 thousand and the depreciation of the right of use assets was EUR 899 (Note 14).

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Initials I.S. Date 27.02.2020

The repayments of principal of lease liabilities in 2019 were EUR 1 003 thousand.

The minimum unilaterally non-cancellable lease payable in the next period as of 31.12.2018 are disclosed in the table below

(in thousands of euros)	**Up to 1 year**	**1 to 5 year**	**Total**
Non-cancellable lease payables as of **31.12.2018**	919	3 211	**4 130**

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.

Subordinated bonds issued in June 2014 in the amount of EUR 8 000 thousand were redeemed in 2019.

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.

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

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

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

In 2019 subordinated debts in the amount of EUR 15 900 thousand were redeemed. Group received the subordinated debts in the amount of EUR 40 000 thousand during the year 2019.

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

Subordinated debt

(in thousands of euros)	
Subordinated debt as at 31.12.2017	**20 000**
Subordinated bonds issued	10 000
Subordinated debt as at 31.12.2018	**30 000**
Subordinated bonds issued	48 500
Subordinated bonds redeemed	-8 000
Subordinated debt as at 31.12.2019	**70 500**

Interest expenses on subordinated bonds for each reporting period and accrued interest liabilities as at the end of each reporting period is disclosed in the table below. Interest liabilities are accounted in the statement of financial position using the effective interest rate.

Accrued interest on subordinated debts

(in thousands of euros)	
Accrued interest on subordinated debts as at 31.12.2017	**150**
Interest calculated for 2018 (Note 5)	1 360
Paid out during 2018	-1 360
Accrued interest on subordinated debts as at 31.12.2018	**150**
Interest calculated for 2019 (Note 5)	3 654
Paid out during 2019	-3 375
Accrued interest on subordinated debts as at 31.12.2019	**429**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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 23.7% of the voting rights and Andres Viisemann who owns 9.8% of the voting rights in AS LHV Group have significant influence over the company (31.12.2018: 24.9% 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 31.12.2018: EUR 25 million and EUR 100 million, respectively). The share capital is paid in full through cash contributions. In 2019, the share capital of AS LHV Pank was increased by EUR 26 million and in 2018 by EUR 10 million through a cash contribution by the sole shareholder AS LHV Group. The bank's share capital increased to EUR 95.5 million by the year-end 2019.

As at 31.12.2019, the adjusted unconsolidated retained earnings of the Group amounted to EUR 65 775 thousand (31.12.2018: EUR 49 679 thousand). Thus, as at 31.12.2019 it is possible to pay out dividends in amount EUR 52 723 thousand (2018: EUR 39 743 thousand) and the related income tax charge would be EUR 13 052 thousand (2018: EUR 9 936 thousand). If the dividends were to be paid, the Group's capital adequacy would remain compliant.

	31.12.2019	**31.12.2018**
Share capital (EUR thousand)	95 500	69 500
Number of shares (pcs)	95 500 000	69 500 000
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 2018 and in 2019.

In 2019, share options were granted to seven members of the Management Board of AS LHV Pank and seventy-one employees in the total amount of EUR 1 786 thousand. In 2018, share options were granted to seven members of the Management Board of AS LHV Pank and fifty-six employees in the total amount of EUR 1 166 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 2015 were exercised in 2018, when shares with nominal value of EUR 1 could be acquired for EUR 2.4 per share. In total, the former and current employees of the Group noted 278 594 shares. Share options issued in 2016 were exercised in 2019, when shares with nominal value of EUR 1 could be acquired for EUR 3.0 per share. In total, the former and current employees of the Group noted 237 594 shares.

Share options issued in 2017 can be exercised between the period of 01.04.2020-30.04.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share. Share options issued in 2018 can be exercised between the period of 01.04.2021-30.04.2021 and shares with nominal value of EUR 1 can be acquired for EUR 5.33 per share. Share options issued in 2019 can be exercised between the period of 01.04.2022-30.04.2022 and shares with nominal value of EUR 1 can be acquired for EUR 4.90 per share.

Statutory reserve capital in equity is composed of:

(EUR thousand)	
Statutory reserve capital as at 31.12.2017	**1 492**
Transferred from 2017 net profit	699
Statutory reserve capital as at 31.12.2018	**2 191**
Transferred from 2018 net profit	834
Statutory reserve capital as at 31.12.2019	**3 025**

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

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:

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Cash balance of customers	9 967	9 773
Securities of customers	**1 554 796**	**1 476 258**
incl. parent company (Note 22)	*169 050*	*93 100*
incl. shareholders of the parent company and related entities (Note 22)	*195 914*	*156 961*
Total	**1 564 763**	**1 486 031**

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

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

NOTE 21 Contingent assets and liabilities

Non-cancellable agreements *(in thousands of euros)*	**Performance guarantees**	**Financial guarantees**	**Letters of credit**	**Unused loan commitments**	**Total**
Liability in contractual amount 31.12.2019	11 078	14 139	10	359 230	**384 457**
Liability in contractual amount 31.12.2018	11 927	9 314	55	188 841	**210 137**

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 2018 - 2019. 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

:

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

According to sectors

(in thousands of euros)	**31.12.2019**	**31.12.2018**
Construction	6 429	6 594
Water supplies	1 001	2 600
Manufacturing	1 045	623
Professional, scientific and technical activities	1 307	1 157
Other areas at activities	1 297	953
Total	**11 078**	**11 927**

According to internal ratings	**31.12.2019**	**31.12.2018**
5 low credit risk	300	257
6 low credit risk	4 206	1 799
7 medium credit risk	4 054	6 055
8 medium credit risk	779	1 622
9 heightened credit risk	603	625
10 high credit risk	268	187
12 non-satisfactory rating	0	21
13 non-satisfactory rating	9	405
Non-rated	859	956
Total	**11 078**	**11 927**

Performance guarantees are over-collateralised as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2019 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

(in thousands of euros)	**Note**	**2019**	**2018**
Interest income	**5**	**37**	**27**
incl. management		37	27
Interest expenses	**5**	**3 662**	**1 402**
incl. management		*1*	*2*
incl. parent company		*3 654*	*1 360*
incl. shareholders, related entities and close relatives that have significant influence		*7*	*40*
Fee and commission income	**6**	**22**	**11**
incl. management		*5*	*2*
incl. shareholders, related entities and close relatives that have significant influence		*17*	*9*

Balances	**Note**	**31.12.2019**	**31.12.2018**
Loans and receivables as at the year-end	**11**	**3 290**	**3 328**
incl. management		*2 085*	*1 811*

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

incl. shareholders, related entities and close relatives that have significant influence		*1 205*	*1 517*
Deposits and loans received as at the year-end		**16 063**	**33 509**
incl. management	*15*	*283*	*222*
incl. parent company	*18*	*7 075*	*21 565*
incl. shareholders, related entities and close relatives that have significant influence	*15*	*8 705*	*11 722*

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

As at 31.12.2019 and 31.12.2018, the management did not have term deposits and the interest rate on demand deposits corresponds to the terms applicable to customers.

The subordinated loan received in June 2014 was redeemed during 2019. The subordinated debt received in 2015-2019 have the interest rate of 6.5%. Tier 1 subordinated debt received 2019 have the interest rate of 9.5%.

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

In 2019, salaries and other compensations paid to the management of LHV totaled EUR 1 009 thousand (2018: EUR 861 thousand), including all taxes. The Management Board of the Bank had seven members in 2019 and 2018. As at 31.12.2019, the remuneration for December and accrued holiday pay in the amount of EUR 57 thousand (as at 31.12.2018: EUR 59 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 31.12.2019 and 31.12.2018 (pension liabilities, termination benefits, etc.). In 2019 and 2018, 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 31.12.2019, the Bank has one subsidiary that has been consolidated in these financial statements:

- AS LHV Finance (ownership interest 65%)

AS LHV Pank paid in 2013 EUR 325 thousand of monetary contribution for 65% 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.

Summarized statement of financial position *(in thousands of euros)*	**AS LHV Finance** 31.12.2019	31.12.2018
	31.12.2019	**31.12.2018**
Loans and advances to customers and other current assets	65 415	51 338
Non-current assets	91	45
Current liabilities	1 966	1 996
Non-current liabilities	48 582	37 581

pwc Initialled for identification purposes only
Initials i.S. Date 27.02.2020

Total net assets	**14 958**	**11 806**

	AS LHV Finance	
Summarized statement of profit or loss and other comprehensive income	**2019**	**2018**
Net interest and fee & commission income	9 446	8 110
Profit before income tax	7 318	5 881
Income tax expense	-760	-838
Net profit	**6 558**	**5 043**
Total comprehensive income	6 558	5 043
Profit and other comprehensive income allocated to non-controlling interests	2 296	1 765

	AS LHV Finance	
Summarized statement of cash flows	**2019**	**2018**
Cash flows from operating activities	-4 925	-1 188
Interest paid	-1 636	-1 215
Income tax paid	-760	-838
Net cash from/(used in) operating activities	**-7 321**	**-3 241**
Net cash from/(used in) investing activities	-87	-28
Net cash from/(used in) financing activities	7 403	3 274
Net increase/(decrease) in cash and cash equivalents	**-5**	**5**
Cash and cash equivalents at the beginning of the year	5	0
Cash and cash equivalents at the end of the year	**0**	**5**

NOTE 24 Income tax expense

The Bank is calculating 14% advance income tax. Advance corporate income tax for the year 2019 was EUR 2 517 thousand (2018: 1 676 thousand).

(in thousand of euros)	**2019**	**2018**
Advance corporate income tax	2 517	1 676
Income tax paid on dividends	1 732	1 938
Total income tax expense	**4 249**	**3 614**

NOTE 25 Operating segments

Bank divides its business activities by 3 main business segments: retail banking, financial intermediates and corporate banking. The business segments form LHV Pank Group, with a separate access to financial data and which are subject to regular monitoring of operating result by the Group's decision-maker. The full planning and KPI setting is done on segments level. For each of the segment full statement of financial position and profit and loss statement is prepared. In addition to these high-level segments, Group has planning/measurement on department level.

Grouping is done based on the client/product base, where similar departments are grouped under one segment.

Retail banking segment covers all private individuals and small legal entities with credit exposure under EUR 500 thousand. This is the regular universal banking segment offering payments, cards, credits etc.

Corporate banking segment covers all corporate customers and other legal entities with credit exposure over EUR 500 thousand. The main products are credits and payments.

pwc Initialled for identification purposes only
Initials I.S. Date 27.02.2020

Hire-purchase and consumer finance unit in Estonia is separate legal entity covering small loan business to private individuals. These portfolios are relatively small, but due to clients different payment history these segments have to be looked separately.

Financial intermediates cover fintech companies with large volume of payments both in Estonia and in United Kingdom. Under that segment LHV reports also regular payment services.

Other activites include treasury activities through providing internal bank function to segments. Assets and liabilities are disclosed in a way how it is reported to the management of the Bank, ie the treasury function investments and fundings are allocated to other segments, but some of the interest income and expense are allocated to treasury. These are eliminated with intra-segment eliminations.

The management board of AS LHV Group has been designated as the decision-maker responsible for allocation of funds and assessment of the profitability of the business activities. The result posted by a segment includes revenue and expenditure directly related to the segment.

The revenue of a reported segment is based on the revenue per financial statements and includes gains from transactions between the segments, i.e. loans granted by AS LHV Pank to other group companies. The division of interest income and fee and commission income by customer location has been presented in Notes 5 and 6. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.

31.12.2019	**Retail banking**	**Corporate banking**	**Hire-purchase and consumer finance in Estonia**	**Financial intermediates**	**Other activities**	**Intra-segment elimi-nations**	**Total**
Interest income	18 907	35 107	11 209	752	6 825	-11 387	61 413
Interest expense	-3 723	-6 071	-1 691	-10	-13 390	11 387	-13 498
Net interest income	**15 184**	**29 036**	**9 518**	**742**	**-6 565**	**0**	**47 915**
Fee and commission income	6 754	2 147	602	14 654	0	0	24 157
Fee and commission expense	-502	-363	-674	-9 797	-13	0	-11 349
Net fee and commission income	**6 252**	**1 784**	**-72**	**4 857**	**-13**	**0**	**12 808**
Net income	**21 436**	**30 820**	**9 446**	**5 599**	**-6 578**	**0**	**60 723**
Net gains from financial assets	-10	-4	0	46	173	0	205
Administrative and other operating expenses, staff costs	-10 895	-7 661	-1 881	-9 114	-2 790	0	-32 341
Operating profit	**10 531**	**23 155**	**7 565**	**-3 469**	**-9 195**	**0**	**28 587**
Impairment losses on loans and advances	-1 194	-1 736	-247	-33	0	0	-3 210
Income tax	-803	-1 640	-760	-74	0	0	-3 277
Net profit	**8 534**	**19 779**	**6 558**	**-3 576**	**-9 195**	**0**	**22 100**
Total assets 31.12.2019	**1 075 705**	**1 613 557**	**65 506**	**298 806**	**0**	**-48 943**	**3 004 631**
Total liabilities 31.12.2019	**1 992 547**	**450 089**	**50 548**	**388 317**	**0**	**-48 618**	**2 832 883**

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Initials I.S. Date 27.02.2020

31.12.2018	Retail banking	Corporate banking	Hire-purchase and consumer finance in Estonia	Financial intermediates	Other activities	Intra-segment elimi-nations	Total
Interest income	10 944	25 359	9 380	1 211	5 315	-6 587	45 622
Interest expense	0	-4 401	-1 234	0	-7 553	6 587	-6 601
Net interest income	**10 944**	**20 958**	**8 146**	**1 211**	**-2 238**	**0**	**39 021**
Fee and commission income	14 256	1 910	517	2 132	87	0	18 902
Fee and commission expense	-6 953	-65	-553	-200	-28	0	-7 799
Net fee and commission income	**7 303**	**1 845**	**-36**	**1 932**	**59**	**0**	**11 103**
Net income	**18 247**	**22 803**	**8 110**	**3 143**	**-2 179**	**0**	**50 124**
Net gains from financial assets	-15	0	0	0	483	0	468
Administrative and other operating expenses, staff costs	-13 481	-5 503	-2 058	-1 298	-2 452	0	-24 792
Operating profit	**4 751**	**17 300**	**6 052**	**1 845**	**2 430**	**0**	**25 800**
Impairment losses on loans and advances	351	-5 027	-171	0	-32	0	-4 879
Income tax	-563	-987	-838	-106	-20	0	-2 514
Net profit	**4 539**	**11 286**	**5 043**	**1 739**	**2 378**	**0**	**18 407**
Total assets 31.12.2018	**989 879**	**535 836**	**51 383**	**109 987**	**0**	**-38 073**	**1 649 012**
Total liabilities 31.12.2018	**1 210 066**	**177 086**	**39 577**	**134 452**	**0**	**-37 748**	**1 523 433**

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Initials i.S. Date 27.02.2020

NOTE 26 Separate financial statements of parent company

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

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

(in thousands of euros)	**2019**	**2018**
Interest income	51 895	37 476
Interest expense	-13 498	-6 601
Net interest income	**38 397**	**30 875**
Fee and commission income	23 555	18 385
Fee and commission expense	-10 675	-7 246
Net fee and commission income	**12 880**	**11 139**
Net gains from financial assets measured at fair value	2 356	2 582
Foreign exchange rate gains/losses	79	64
Net gains/losses from financial assets	**2 435**	**2 646**
Other income	171	951
Administrative and other operating expenses	-30 631	-23 685
Operating profit	**23 252**	**21 926**
Impairment losses on loans and advances	-2 963	-4 708
Profit before income tax	**20 289**	**17 218**
Income tax expense	**-2 517**	**-1 676**
Profit for the year	**17 772**	**15 542**
Other comprehensive income/loss:		
Items that may be reclassified subsequently to profit or loss:		
Changes in the fair value of debt instruments measured at FVOCI	0	-36
Items that will not be reclassified to profit or loss:		
Net gains on investments in equity instruments designated at FVOCI	134	78
Total profit and other comprehensive income for the year	**17 906**	**15 584**

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Initials i.S. Date 27.02.2020

Statement of financial position of the parent

(in thousands of euros)	31.12.2019	31.12.2018
Assets		
Due from central bank	1 232 733	639 862
Due from credit institutions	32 247	24 974
Due from investment companies	5 473	17 005
Equity instruments at fair value through other comprehensive income	432	298
Financial assets at fair value through profit or loss	32 499	38 913
Loans and advances to customers	1 670 533	905 422
Receivables from customers and other financial assets	4 723	5 223
Other assets	1 828	1 317
Subsidiaries	325	325
Tangible assets	1 903	1 120
Right-of-use assets	4 777	0
Intangible assets	594	1 243
Total assets	**2 988 067**	**1 635 702**
Liabilities		
Deposits from customers and loans received	2 738 601	1 469 561
Financial liabilities at fair value through profit or loss	8	11
Accounts payable and other liabilities	21 844	22 031
Subordinated debt	70 500	30 000
Total liabilities	**2 830 953**	**1 521 603**
Equity		
Share capital	95 500	69 500
Statutory reserve capital	3 025	2 191
Other reserves	212	78
Retained earnings	58 377	42 330
Total equity	**157 114**	**114 099**
Total liabilities and equity	**2 988 067**	**1 635 702**

Statement of cash flows of the parent

(in thousands of euros)	**2019**	**2018**
Cash flows from operating activities		
Interest received	50 635	37 341
Interest paid	-10 664	-6 501
Fees and commissions received	23 555	18 385
Fees and commissions paid	-10 675	-7 246
Other income received	171	951
Staff costs paid	-15 260	-12 076
Administrative and other operating expenses paid	-10 073	-9 696
Income tax paid	-2 476	-1 132
Cash flows from operating activities before change in operating assets and liabilities	**25 213**	**20 026**
Net increase/(decrease) in operating assets:		
Net acquisition/disposal of trading portfolio	49	-115
Loans and advances to customers	-767 006	-197 658
Mandatory reserve at central bank	-12 146	1 094
Security deposits	690	-647
Other assets	-511	-485
Net increase/(decrease) in operating liabilities:		
Demand deposits of customers	871 616	-93 323
Term deposits of customers	390 754	-9 316
Net loans received (including loan repayments)	4 114	15 528
Financial liabilities held for trading at fair value through profit or loss	-3	8
Other liabilities	-6 393	-38 129
Net cash from/(used in) operating activities	**506 377**	**-303 017**
Cash flows from investing activities		
Purchase of tangible and intangible assets	-1 979	-1 367
Proceeds from disposal and redemption of investment securities	0	520
Net changes of investment securities at fair value through profit or loss	8 722	13 023
Net cash from/(used in) investing activities	**6 743**	**12 176**
Cash flows from financing activities		
Paid in share capital	26 000	10 000
Proceeds from subordinated debt	48 500	10 000
Subordinated debt redeemed	-8 000	0
Dividends paid	-2 230	-2 178
Repayment of principal of lease liabilities	-1 003	0
Net cash from financing activities	**63 267**	**17 822**
Effect of exchange rate changes on cash and cash equivalents	**79**	**64**
Net increase/(decrease) in cash and cash equivalents	**576 466**	**-272 955**
Cash and cash equivalents at the beginning of the year	667 561	940 516
Cash and cash equivalents at the end of the year	**1 244 027**	**667 561**

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Initials I.S. Date 27.02.2020

Statement of changes in shareholders' equity

(in thousands of euros)	**Share capital**	**Statutory reserve capital**	**Other reserves**	**Retained earnings**	**Total**
Balance as at 01.01.2018	**59 500**	**1 492**	**36**	**28 712**	**89 740**
Paid in statutory reserve capital	0	699	0	-699	**0**
Paid in share capital	10 000	0	0	0	**10 000**
Dividends paid	0	0	0	-2 178	**-2 178**
Share options	0	0	0	953	**953**
Net profit for the year	*0*	*0*	*0*	*15 542*	***15 542***
Other comprehensive income	*0*	*0*	*42*	*0*	***42***
Net profit and other comprehensive income for 2018	0	0	42	15 542	**15 584**
Balance as at 31.12.2018	**69 500**	**2 191**	**78**	**42 330**	**114 099**
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	7 674	7 674
Adjusted unconsolidated equity as at 31.12.2018	**69 500**	**2 191**	**78**	**49 679**	**121 448**
Balance as at 01.01.2019	**69 500**	**2 191**	**78**	**42 330**	**114 099**
Paid in statutory reserve capital	0	834	0	-834	**0**
Paid in share capital	26 000	0	0	0	**26 000**
Dividends paid	0	0	0	-2 230	**-2 230**
Share options	0	0	0	1 339	**1 339**
Net profit for the year	*0*	*0*	*0*	*17 772*	***17 772***
Other comprehensive income	*0*	*0*	*134*	*0*	***134***
Net profit and other comprehensive income for 2019	0	0	134	17 772	**17 906**
Balance as at 31.12.2019	**95 500**	**3 025**	**212**	**58 377**	**157 114**
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	9 723	9 723
Adjusted unconsolidated equity as at 31.12.2019	**99 500**	**3 025**	**212**	**65 775**	**166 512**

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

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Initials I.S. Date 27.02.2020

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 2019. The consolidated financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

27.02.2020

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 ("the Company") and its subsidiary (together – "the Group") as at 31 December 2019, 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 dated 27 February 2020.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2019;
- the consolidated statement of financial position as at 31 December 2019;
- the consolidated cash flow statement 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 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.

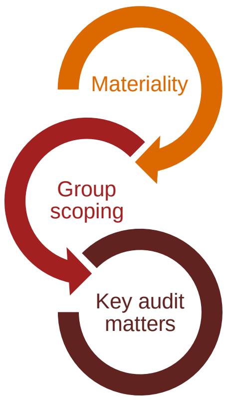
Independence

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. The non-audit services that we have provided to the Group in 2019 are disclosed in the management report.

Our audit approach

Overview



Materiality

Overall group audit materiality is EUR 1,250 thousand which represents 5% of profit before income tax.

Audit scope

A full scope audit was performed by PwC Estonia for all Group entities covering substantially all of the Group's consolidated assets, liabilities, revenues and expenses.

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 audit materiality	EUR 1,250 thousand
How we determined it	5% of profit before income tax
Rationale for the materiality benchmark applied	We have applied this benchmark, as profit before tax is the key measure used both internally by management and, we believe, externally by shareholder in evaluating the performance of the Group.

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 2019 loans and advances to customers amounted to EUR 1 687 million and related impairment loss for 2019 amounted to EUR 3.2 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, using complex models with subjective inputs. IFRS 9 has introduced a 3-stage Expected Credit Loss (ECL) model. ECL calculations are forward looking and probability-weighted, based on complex modelling and subjective inputs determined by the management. Key areas requiring significant management judgements and modelling in calculating ECL include: • the criteria for assessment of significant increase in credit risk for corporate and retail products (Note 3.2.3.1) for determining loan exposures in stage 1 and stage 2; • the modelling and calculation of key parameters of the ECL model, including probability of default (PD), loss given default (LGD) and exposure at default (EAD) (Note 3.2.3.3);	We assessed whether the Group’s accounting policies and methodology applied for the calculation of impairment of loans and advances to customers are in compliance with IFRS 9. We assessed the design and operating effectiveness of key controls over ECL data and respective calculations. This included controls over the allocation of loans into stages, data accuracy and completeness, credit monitoring and overdue loans monitoring. We have also assessed the IT general controls over relevant systems. 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 used in the ECL calculation system; • the compliance of key inputs used in the ECL calculation system with IFRS 9 methodology; • the accuracy and compliance of 12-month and lifetime ECL calculations with IFRS 9 methodology; • the accuracy of discounting in the ECL system; • the accuracy and completeness of data used for staging of loans;

- incorporating forward-looking information into ECL model and the indicators selected for corporate and retail products; estimating those indicators for reliable future period and for three different scenarios (base, upside and downside scenario) with different probabilities (Note 3.2.3.4); and
- ensuring completeness of the customer accounts that are included in the expected credit loss calculation.

For defaulted corporate loans, an individual impairment is calculated based on the exposure and realisable value of the collateral at the balance sheet date and this also requires significant management estimates.

- the internal assignment of credit ratings for corporate loan customers, which serve as inputs into the corporate loan ECL model;
- the correctness of information on collaterals and their values in the loan systems, which serve as an input into the ECL model; and
- the completeness of loans subject to stage 3 assessment and related ECL calculations.

We have assessed the reasonableness of key assumptions made by management, which serve as critical inputs in the ECL model, such as weights of different scenarios, corporate portfolio point in time PD estimate, key forecasts of macroeconomic information and multipliers used for different scenarios.

We performed analytical procedures to evaluate the ECL of different products through the year.

We also analysed the results of back-testing performed by management and considered the results of this analysis in verification of the assumptions used for estimating ECL for current period.

In case of some impairment provisions, we formed a different view from that of the management, but 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 Group 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 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 us 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. The other information comprises the Management report (but does not include 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 appointment has been renewed by tenders and shareholder resolutions in the intermediate years, recently on 11 April 2018, representing the total period of our uninterrupted engagement appointment for AS LHV Pank, as a public interest entity, of 11 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of AS LHV Pank can be extended for up to the financial year 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 2020

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

Proposal for profit distribution

The Management Board of AS LHV Pank proposes to the General meeting of shareholders to distribute the profit of the financial year 2019 as follows:

- transfer EUR 997 thousand to statutory reserve capital
- pay dividends in total amount of EUR 2 659 thousand
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 16 148 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.

27.02.2020

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	2019	2018
66121	Security and commodity contracts brokerage	6 620	6 116
64191	Credit institutions (banks) (granting loans)	75 697	55 969
64911	Finance lease	3 253	2 439
	Total income	**85 570**	**64 524**