

AS LHV Group
Consolidated Annual Report 2017

(Translation of the Estonian original)

Consolidated Annual Report 01.01.2017 – 31.12.2017

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Supervisory Board	Rain Lõhmus Andres Viisemann Tiina Mõis Heldur Meerits Raivo Hein Tauno Tats Sten Tamkivi
Auditor	AS PricewaterhouseCoopers

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Statement of the Managing Director

Dear LHV investor,

LHV has had the strongest year in its history. The year 2017 was characterized by good performance, strong growth in customer base, a number of new products and recognitions, and dividends paid for the first time. To offer relevant information, we started publishing our monthly results and financial plan. At the beginning of the year, LHV Pank was recognized on several occasions as the best-performing bank in Estonia, and our pension funds took an active role in investing in Estonian companies.

The group employs over 350 people. It is they who are behind the growth and performance of LHV. I hope that they continue to be motivated by passion to increase the importance of LHV as Estonian capital in the local financial services market and also contribute to the breakthrough of LHV into new markets and business areas. We are proud to be able to reward good motivation and provide our key employees with ownership status.

Good people create trust, which is best illustrated by the fact that LHV is managing EUR 3.8 billion worth of total assets. Of which, EUR 1.5 billion is deposits in the bank's balance sheet, EUR 1.1 billion in pension funds and EUR 1.2 billion as securities on clients' accounts. All indicators have increased significantly during the year.

In 2017, we achieved record performance in all our business volumes. Over the year, deposits increased by EUR 760 million, loans by EUR 194 million and pension funds' assets by EUR 129 million. At the same time, new record levels of customer activity were achieved in payments, card transactions and acceptance of card transactions.

The year was characterized by the fact that we were the first bank in Estonia to introduce video identification in the second quarter of 2017, and during six months, 650 customers have opened an account by using video identification. In addition, we introduced the Smart-ID authentication solution and developed a chatbot on the LHV Pank Facebook page. Together with the Tax and Customs Board, we launched a new Salary Payment service for our clients, which was also awarded with this year's Innovation Award by the Estonian Banking Association.

At the end of March, we unveiled a plan according to which LHV Pank will start putting more focus on servicing financial technology companies. To do this, we are opening a branch in the United Kingdom. Our role is to be the interface between technology companies and infrastructure, providing a complete solution for access to payment systems, acceptance of card transactions, electronic

banking or liquidity management. We expect to offer real-time euro and pound payment service over the next year.

In 2017, we updated LHV's private banking offerings. As new products, we introduced the car loan and the home repair loan. At the end of the year, we introduced LHV home insurance, which was well received by our customers, and we added purchase insurance to LHV Gold Card. We expanded our network of ATMs to Rakvere and Viljandi.

The investment strategy of LHV pension funds has clearly differed from competing pension funds. In 2017, LHV funds significantly increased investments in Estonia, making investment decisions connected to Estonia in the amount of EUR 170 million. The choice of LHV to direct pension funds' investments into alternative asset classes and to the local market is linked to the prolonged rise of global securities markets, where LHV Varahaldus assesses that investing has become expensive. By investing in the domestic market, it is possible to negotiate conditions and, in a situation of lower competition, achieve a better risk-return ratio for pension funds.

We are pleased to see that efforts for Mokilizingas to strengthen the team, increase efficiency and finding new business volumes have been fruitful for the past half year. In December, new members were elected to the Management Board of Mokilizingas, resulting in a clearer distinction between the functions and responsibilities of the supervisory board and executive management. The members of the elected management board will continue their activities in order to bring Mokilizingas to the growth path. In the second half of the year, Mokilizingas started cooperation with a local telecom partner, by acquiring partner loans for their clients' credit portfolios on a monthly basis.

Economic environment

LHV's strong underlying trends are also supported by the Estonian economic environment. Estonia has come out of a long period of sub-par performance and entered into a period of strong economic growth. In addition to rising labour costs, productivity has improved and it has contributed to improved corporate profits. We are pleased to note that the future prospects are improving for all our trading partners. Forecasts have been raised both for Scandinavia and the Baltic region, as well as for the euro zone, and Russia, which is restoring its position as a trade partner.

The biggest concerns for Estonian enterprises are the availability of labour and the rapid increase of labour costs. An increase in wages is rather inevitable in the current

economic environment, therefore, investments need to be increased in order to improve the labour efficiency. The continuing record-low levels of financing costs have created favourable conditions for that, which companies are increasingly taking advantage of.

The credit market has remained strong. All key credit products are growing, including corporate loans and housing loans. The financial health of households is quite strong, with the loan-to-deposit ratio improving. The share of overdue loans in the market has dropped below 1%, largely covered by write-downs

Financial results

The group's consolidated profit for 2017 amounted to EUR 22.2 million. This constitutes a EUR 2.3 million increase from the previous year and gives the shareholders of LHV a 17.6% return on equity. The profit was supported by high level of customer activity and good credit quality. All main business lines grew their business volumes and profits. In regard to the financial plan, the consolidated profit benchmark was exceeded by EUR 364 thousand due to results of Mokilizingas, which were better than expected, but the target was not reached for profit attributable to the owners of the parent company by EUR 146 thousand, due to lower than expected interest income from small financing products.

In the third quarter, the capital requirements established for LHV decreased. Based on the assessment of the Financial Supervision Authority and by adding internal buffers, the Board of LHV Group decided to set the minimum ratio for total capital requirements at 15.06% (16.19% earlier) and the minimum ratio for Tier 1 own funds at 12.29% (13.29% earlier). As a result of the dialogue between the European Central Bank and the Financial Supervision Authority, LHV was defined as a high-priority small bank, which means, in particular, more intensive monitoring.

In 2017, LHV Pank as the biggest business unit earned a net profit of EUR 15.5 million, which increased by EUR 2.3 million in a year. Loans to customers grew by EUR 188 million and reached EUR 719 million. New deposits were accumulated in the amount of EUR 766 million and by the end of the year, deposits amounted to EUR 1.6 billion. The number of customers increased by 21 thousand during the year and reached 165 thousand by the end of the year.

During the year, the volume of deposits, including deposits from non-residents, increased significantly. It mainly includes financial technology companies. For such companies, it may be common to hold a larger account balance in the bank, which the bank does not use for borrowing, keeping it liquid entirely. In this case, the demand deposit

balance is priced at a negative interest rate by the bank. As this business trend develops, the bank's liquidity ratios are expected to be more volatile and the loan to deposit ratio to decrease.

In 2017, LHV Varahaldus posted a net profit of EUR 5.8 million, which is EUR 0.3 million less than the year before. The net profit was reduced by the income tax expense in the amount of EUR 1.0 million that accompanied the dividends paid for the first time.

At the beginning of 2017, the new Investment Funds Act came into force, which resulted in the decrease of capital requirements for fund management companies, as well as the abolishment of fees for leaving the II pillar funds. Due to changed capital requirements, LHV Varahaldus reduced the share capital by EUR 6.6 million. LHV Varahaldus also paid dividends for year 2016 in the amount of EUR 3.8 million.

The profit for the Lithuanian business unit Mokilizingas in 2017 was EUR 1.9 million, increasing by EUR 0.1 million in a year. In the fourth quarter, the profit was positively influenced by the sale of claims recognised as loss making and reduction of discounts. The loan portfolio grew by EUR 13 million in a year and reached EUR 49 million. The return on equity for Mokilizingas was 24.8%.

Two major amendments in accounting standards will enter into force on 1 January 2018 - IFRS 9 and IFRS 15. The implementation of these regulations will also have a significant effect on LHV. IFRS 9 will trigger changes in provisioning, where in addition to the customer's financial position, the changes in the economic environment, compared to the moment of issue of the loan will need to be taken into account for provisioning.

The main impact of IFRS 15 on LHV relates to the external costs incurred for engaging a customer. These costs will need to be charged to expenses over the lifetime of the client contract. The sales costs incurred up to the end of 2017 in LHV Varahaldus are EUR 10.6 million after depreciation. As at 1 January 2018, the retained earnings will be increased by the mentioned amount, as well as the balance of intangible assets. In the following years, the capitalised sales expenses will be charged to expenses over the effective lifetime of customer contracts.

The future

According to our vision, the market value of LHV will reach EUR 1 billion by 2023. For that the existing activities should contribute EUR 500 million, new activities EUR 200 million and mergers or acquisitions EUR 300 million. The completion of such a plan would require new capital in the amount of EUR 100 million. Emphasis is given to the word vision,

and therefore the financial plans announced on the stock exchange will continue to express the most likely outcomes and do not include the directions planned with the vision until they become probable.

As practical targets, we have identified our goals for the years to come as follows:

- To be the best provider of financial services for private individuals who collect and invest in financial assets, and small and medium-sized enterprises, who need financing;
- To be an attractive and recognised employer who offers development, self-realisation and growth;
- To do business in a way that the return on equity would reach 20%;
- To become Estonia's most valuable stock company.

Taking into account the simplicity and modernity of the products offered, we believe that the growth will continue in all our key business lines in 2018:

- Deposits continue to grow at a pace comparable to today. Most of the deposits are from retail customers, somewhat less from private customers and companies. Deposits from financial technology companies are worth mentioning separately, but given the early phase of this new business trend, the plan may differ somewhat from reality. In 2018, we are expanding the range of financing sources.
- Loans to customers are growing at a record pace. The biggest source of growth is corporate lending, which is expected to have a slight decline in margins. Based on our cost structure, we are able to offer loans at better prices than before. Microloans from Mokilizingas and home loans issued in Estonia will follow in growth. All other loan products will also

continue to grow. In addition, we will enter the market with factoring.

- For servicing financial technology companies, the focus is on establishing a branch in the UK and joining a real-time pound payment system. As for sectors, we will focus on so-called neo-banks, currency service providers and financial intermediates.
- In 2018, we will introduce a II pillar fund investing only in Estonia. At the same time, we do not exclude almost any region or economic sector when selecting investments. The goal is to achieve the best long-term yield.

In 2018, the group will have enough capital for growth. Within the group, in order to support growth, a substantial amount of capital is needed for LHV Pank and in a smaller amount for Mokilizingas. LHV Varahaldus and LHV Finance will continue to pay dividends to the group. In the middle of the year, we will begin with preparations to explore new opportunities for possible refinancing of bonds in 2019 and attracting new capital needed for growth.

A more detailed plan for year 2018 activities and financials and a long-term forecast has been disclosed separately.

Madis Toomsalu

Business environment

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

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

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

sure on the competitiveness of the export sector.

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

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

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

Economic growth in Lithuania – a major destination market for LHV – continued at a good pace, accelerating to 3.4% in the third quarter. The economic sentiment is strong, on a broad basis, but the rapid growth of private consumption in Lithuania is being affected by one of the highest rates of inflation in the euro zone. On a balancing note, the economy was supported by an increase in investments, which should gain a more significant role in the coming years. Strong external demand, a lack of qualified labour and a record

use of production capacities – all this is forcing companies to make new investments. The volume of projects financed with the EU support is also increasing. The consensus forecasts that economic growth in Lithuania will slow down to 3.2% in 2018 and to 3.0% in 2019.

Economic growth in Estonia slowed down to 4.2% in the third quarter, which is nevertheless a very high pace. This was supported mainly by domestic demand driven by investments and private consumption. The construction sector's contribution to economic growth was again one of the largest. There was a decrease in the export of low-margin electronic equipment, which had largely been fuelling the decrease in export volumes and the negative effect of net export. The inflation rate, which rocketed last year, significantly slowed the growth in private consumption. Consumer prices increased by 3.4% in December. An important aspect is that despite the continuation of the rapid growth in wages, corporate profits have recovered and productivity has improved. The sentiment indicators reflecting the different sectors remain strong, continuing

to indicate a positive sentiment. In its forecast published in December, the Bank of Estonia considerably raised its expectations of economic growth. It is estimated to remain around 4.2% this year and 3.1% in 2019. Private consumption and investments will be the driving engines, while the contribution of net export into economic growth is negative. Private consumption continues to be positively influenced by a rapid increase in wages and the steep rise of the income-tax-free minimum wage accompanied by a marginal decrease in the pace of inflation. Investments are driven by a more active use of the resources of the EU structural funds in the public sector. Despite strong external demand, the investment volumes of enterprises will not grow in 2018 due to the impact of ship purchases in the reference base. The key problems revolve around the shortage of labour and its potential magnification in connection with the increase in general government expenditure. The priority lies in the achievement of sustainable, long-term economic growth, balanced between the different sectors.

Key economic indicators of Estonia*

	2008	2009	2010	2011	2012	2013	2014	2015	Eesti Pank forecast		
									2016	2017E	2018E
Nominal GDP (EUR billion)	16,52	14,15	14,72	16,67	17,93	18,89	19,76	20,25	21,10	22,99	24,94
GDP volume**	-5,4%	-14,7%	2,3%	7,6%	4,3%	1,4%	2,8%	1,4%	2,1%	4,3%	4,2%
Private consumption expenditures***	-4,9%	-15,3%	-1,6%	3,7%	4,3%	3,8%	3,3%	4,7%	4,4%	2,7%	5,1%
Government consumption expenditures	4,6%	-3,2%	-0,4%	1,3%	3,2%	1,9%	2,7%	3,4%	1,9%	1,2%	2,1%
Fixed capital formation	-13,1%	-36,7%	-2,7%	34,4%	12,7%	-2,8%	-8,1%	-3,3%	-1,2%	13,3%	2,0%
Exports	0,9%	-20,3%	24,0%	24,2%	4,8%	2,3%	3,1%	-0,6%	4,1%	2,1%	2,6%
Imports	-6,2%	-30,6%	21,2%	27,2%	9,7%	3,2%	2,2%	-1,4%	5,3%	3,1%	4,5%
CPI	10,4%	-0,1%	3,0%	5,0%	3,9%	2,8%	-0,1%	-0,5%	0,1%	3,5%	3,2%
Unemployment rate											
(% of the labour force)	5,5%	13,5%	16,7%	12,3%	10,0%	8,6%	7,4%	6,2%	6,8%	5,9%	7,3%
Current account (% of GDP)	-8,7%	2,5%	1,8%	1,3%	-1,9%	-0,4%	0,9%	2,2%	1,9%	2,1%	0,3%
Budget balance (% of GDP)****	-2,7%	-2,2%	0,2%	1,2%	-0,3%	-0,2%	0,7%	0,1%	-0,3%	-0,5%	-0,4%

** Numbers reported are annual rates of change in per cent, if not noted otherwise;

** GDP and its components are chain-linked; *** including NPISH;

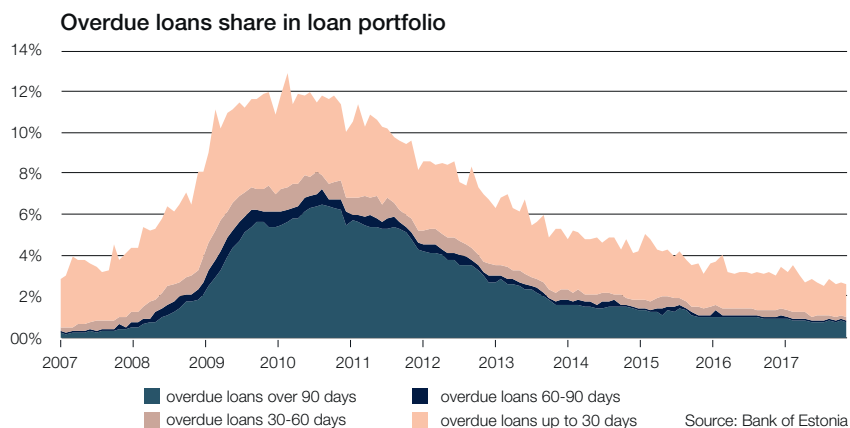
**** the budget balance forecast considers only those measures on which sufficient information was available at the date of the forecast.

Sources: Eesti Pank, Eurostat, Statistics Estonia"

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

By economic sectors, the risks remain higher-than-average in the overheating construction sector, and transport and warehousing sectors. LHV remains conservative with

regard to the real estate market, monitoring the dynamics on the local and Scandinavian markets and paying particular attention to developments in Sweden. Rental property projects involve a risk of insufficient demand for absorbing the developed volumes in the near future, with corrections expected in either rental prices or vacancy rates.



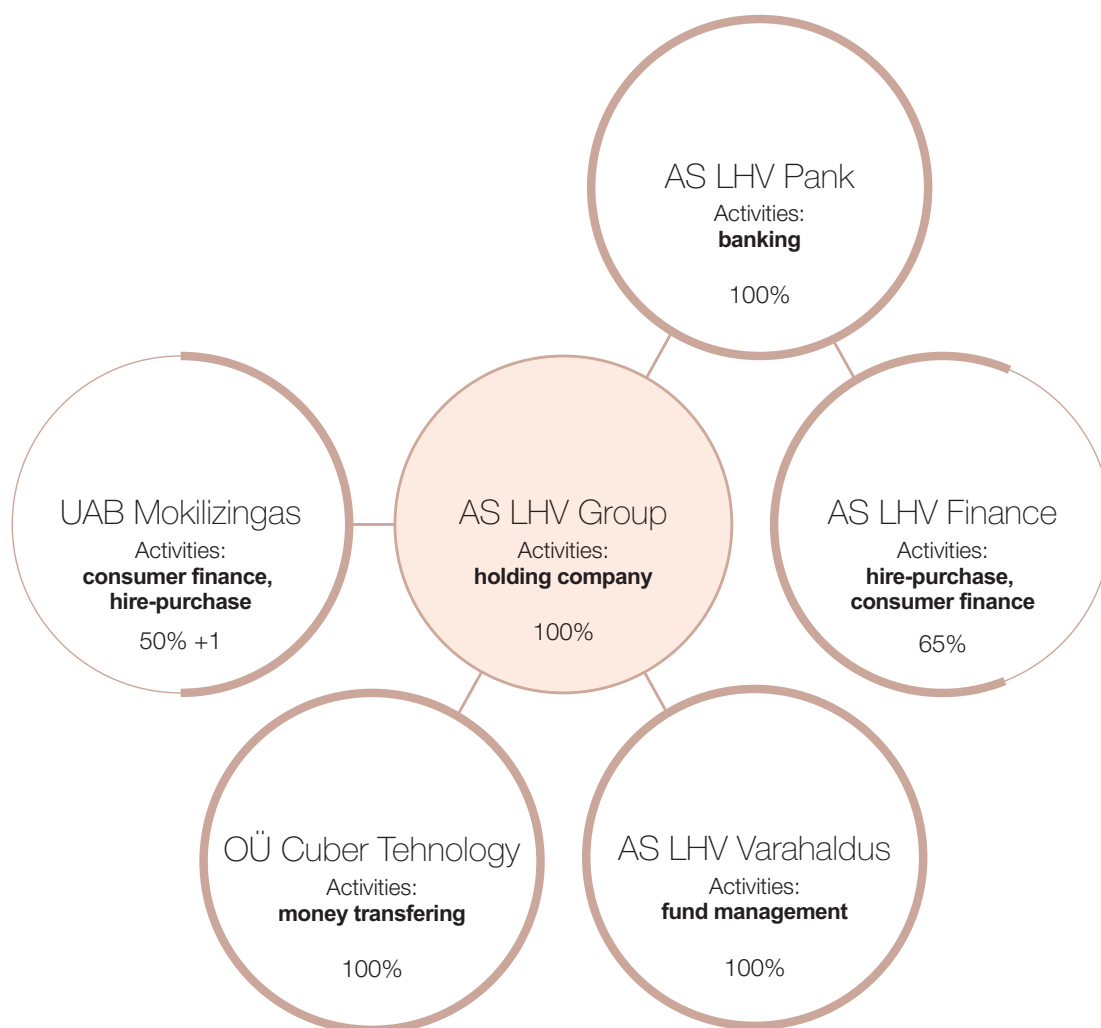
On a positive note, the financing environment remains favourable. The balance of loans taken from credit institutions continues to grow, but the pace has somewhat slowed down compared to the beginning of the year. The growth of housing loans has been steadily increasing. The loan to deposit ratio and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

and tight interbank competition having a positive impact on local entrepreneurship, the opportunities should be further exploited. LHV stands ready to boldly and efficiently contribute to the search of new sources of growth, offering a long-term partnership to enterprises and making an effort to create additional value.

Management report

AS LHV Group (hereinafter: the Group or LHV) is the biggest domestic finance group and capital provider in Estonia. The main subsidiaries of AS LHV Group are AS LHV Pank (hereinafter: the Bank) and AS LHV Varahaldus (hereinafter: LHV Varahaldus). LHV was established in 1999 by people with long experience in investing and entrepreneurship.

LHV-s offices for client servicing are located in Tallinn and Tartu, Vilnius office was closed on March 31, 2017. Over 350 people work in LHV. Over 165 000 customers use banking services offered by LHV and the LHV's pension funds have over 201 000 clients.



Operating principles

The mission of LHV is to help create local capital and to support the development of local entrepreneurship.

LHV concentrates on active and independent customers with an entrepreneurial mind-set. For private consumers LHV offers high quality universal banking services. For corporate clients LHV offers flexible and suitable financing and managing of everyday financial operations.

The products and services provided by LHV are simple, transparent and appropriate. Client interaction is mainly

conducted using modern electronic communication channels. Costs avoided will reach the clients of LHV through affordable cost of everyday service.

LHV was created as a partnership and partnership is the central way of growing LHV's business. New initiatives will be implemented faster and more successfully when partners have same interests and long-term support of each other.

LHV is public company, which is listed on the Tallinn Stock Exchange since May 2016, so all clients and partners of LHV may be owners of LHV.

Key events in 2017:

- **First dividend pay-out**

LHV paid for the first time in the history of the company dividends of 15 cents per share.

- **LHV Bank**

Fast growth in loans, deposits and payments. The bank was authorized to establish a branch office in the United Kingdom.

The Financial Supervision Authority decided that LHV is among the systemically important credit institutions. This will raise the requirements that the LHV internal processes have to meet.

- **Mokilizingas**

In both Lithuania and Latvia, Mokilizingas started to buy

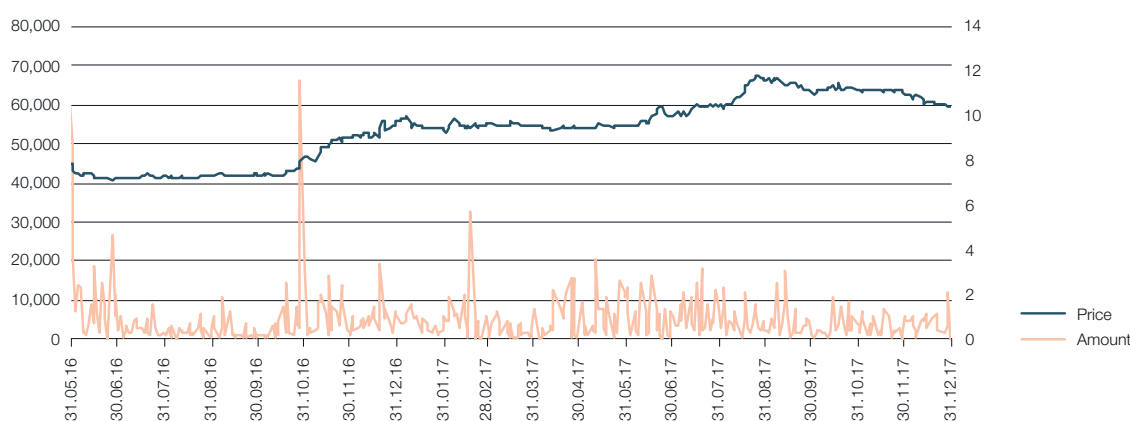
the portfolio of a telecom company, which significantly increased the portfolio of Mokilizingas. Significant changes took place in the management.

- **LHV Varahaldus**

LHV Varahaldus started to make direct investments in the Estonian economy, and over the year, investments to Estonia were made in the amount of EUR 170 million.

Shares and bonds issued by LHV

The shares of LHV Group is traded on NASDAQ Tallinn since May 2016. Since then, the share price has risen by 50%, reaching EUR 10.4 by the end of 2017. In 2017, the lowest traded price was 9.16 euros and the highest 11.9 euros. Based on the stock price, LHV's market value was EUR 268 million.



During 2017, 1.2 million shares in the amount of EUR 12.24 million changed the owner on the stock exchange, which makes 10.2 euros for the average trading price.

At the end of 2017, LHV Group had 5 281 shareholders, of whom 83.5% were also customers of LHV Bank. They were followed by Swedbank customers (11.5%) and SEB customers (3.7%). 76% of the shares belonged to enterprises and 24% to private individuals. Among the shareholders, the Estonian residents or their related companies, who own 99.9% of the shares, are clearly dominant

AS LHV Group has 25 767 342 common shares with par value of 1 euro. As at 31.12.2017, the distribution of shares was as follows:

- 13 371 474 shares (51.9%), belonged to the members of the supervisory board and management board and to their related parties.
- 12 395 868 shares (48.1%) belonged to Estonian entrepreneurs and investors and to their related parties.

Ten biggest shareholders as at 31.12.2017:

Number of shares	Percentage	Name of the shareholder
3 357 920	13,0%	AS Lõhmus Holdings
2 538 367	9,9%	Rain Lõhmus
2 079 344	8,1%	Viisemann Investment AG
1 595 620	6,2%	Ambient Sound Investments OÜ
1 210 215	4,7%	OÜ Krenno
999 456	3,9%	AS Genteel
951 978	3,7%	AS Amalfi
722 297	2,8%	OÜ Kristobal
653 165	2,5%	SIA Krugmans
589 177	2,3%	OÜ Bonaares

LHV has had two subordinated debt issues on Nasdaq Tallinn Stock Exchange. The maturity of the first bond is in 2024 and the second in 2025. In 2017 no new bonds were issued, nor redeemed. Bonds were traded in 2017 in the total amount of EUR 0.8 million.

At the end of the year 2017 LHV Group had almost 1000 bondholders, 70.3% of them were also customers of LHV Pank. They were followed by the customers of Swedbank at 14.7% and SEB at 11.4%. Of the investor base, 68% were companies and 32% were private individuals.

Market share

Every year, LHV has set the goal to grow faster than the market and thereby increase its market share. In terms of new clients, the goal is to increase the client portfolio that the growth would be higher than the number of children born each year. In recent years, we have almost doubled this target.

LHV has not set a specific target for market share, the goal is profitable growth combined with taking advantage of opportunities offered by the market.

The volume of corporate loans issued in 2017 was EUR 308 million and the market share for LHV corporate loans was 5.1%. The volume of retail loans issued during the year amounted to EUR 98 million, including EUR 41 million of issued housing loans, which constitutes a 3.4% market share for LHV, according to the Central Bank statistics.

At the end of the year, deposits held in Estonian credit institutions totalled EUR 17.1 billion, increasing by EUR 0.7 billion in a year. The market share of LHV's deposits based on this is 9.1% (from the balance). Based on asset value, the market share of LHV's pension funds at the end of the year was 29.5%.

Remuneration policy

The remuneration principles for LHV Group and its affiliated companies are described in the internal Remuneration Policy

In LHV, there are no regional differences in the remuneration principles. The most significant difference between group companies is that LHV Varahaldus has no remuneration committee and has separate disclosure requirements.

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law. A broader goal of the remuneration policy is the recruitment of employees with the capabilities, skills and experience necessary to implement the strategy, to reconcile the interests of employees and shareholders, to motivate the employees and to ensure effective risk management for growing business activities. The remuneration system consists of basic and variable remuneration, compensations and employee benefits. LHV does not provide employees with services at a lower than the market price, does not make payments to a third pillar pension fund at the expense of the employer and does not provide benefits such as a company car, a mobile phone or a laptop for personal use. The maximum ratio between variable and basic remuneration is 100%, with the approval of shareholders the ratio is up to 200% for members of the management board and persons treated as such.

The general remuneration strategy is to ensure a motivating pay to achieve long-term goals, creating a strong link between remuneration and the financial results of LHV. When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

- Performance criteria are in line with sound and effective risk management principles. The performance criteria established by LHV must keep in mind the long-term interests of LHV, including not stimulate excessive risk-taking or sale of unsuitable products.
- The performance criteria must not merely contain performance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield) but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).
- The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's professional behaviour. In the interest of long-term goals, the assessment and control of risk behaviour will take place at an individual employee level.
- A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.
- Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.
- Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, creativity, motivation and co-operation with other business units and the internal control function.

LHV's recruitment strategy is to find, engage and keep the best people of the job market. In determining remuneration, LHV is rather willing to make exceptions than restrict its choices with strict remuneration intervals for a specific position. To keep its employees, LHV will develop its benefits and compensations in cooperation with its employees. In determining remuneration, the following is taken into account:

- Commitment and results of the employee,
- Workload,

- Responsibility,
- The required level of education,
- Management level,
- Intensity of work,
- The necessary knowledge and experience for the position,
- The existence of additional benefits,
- The situation in the labour market,
- The pay level of the geographical location,
- The level of criticality of the position

The determination of the amount of remuneration must be objective. The remuneration is paid according to the work done and its value, not according to the personality, gender, age, origin, etc. of the employee.

LHV applies a general principle that employees should not use personal hedging strategies or remuneration and liability insurance, which would undermine the effectiveness of the hedging of risks integrated into the Remuneration Policy. In the decisions made on remuneration policy, the financial situation and sustainability of the capital base of LHV are taken into account.

LHV carries out regular self-assessment, the purpose of which is to identify all employees whose professional activities affect or may affect the risk profile of LHV significantly. These specified groups of employees are listed in the table below together with ratios between variable and basic remuneration in 2017.

Specified group of employees	Ratio in 2017
Senior management	0,67
Staff performing control functions	0,25
Employees with significant impact on the credit risk position (the nominal value of transactions made by the employee is at least 0.5% of LHV Tier 1 own funds and is in the amount of at least EUR 5 million)	0,51
Employees, that belong in the 0.3% share, which was assigned the highest remuneration in the previous financial year	0,86
Key personnel who manage significant business units (at least 2% of LHV's internal capital)	0,25
Key personnel who perform important support functions	0,30

Self-assessment is carried out once a year at the beginning of the financial year. The assessment covers both the past period (including financial results, risk analysis) and takes into account the forthcoming financial year. The

specified group of employees that are determined in the course of the self-assessment are required, within one calendar year after exercising the options, to keep the underlying LHV shares in their own possession and to not sell them, or to encumber in any form (including pledge). The specified group of employees are forbidden to transfer the risk of the decline of the share price to other parties, for example, through insurance or certain type of financial instruments. Self-assessment is carried out by taking into account the degree of complexity, performance indicators and structure of LHV. The competence lies on the Management Board, who will conduct the analysis in the form of a discussion at a board meeting. The self-assessment is initiated by the Human Resources department, the compliance of the process and results are assessed by the department of Compliance Control, whose representative is also present at the self-assessment. The Remuneration Committee reviews annually the qualitative and quantitative criteria related to the employee and the self-assessment process, which is used for decision-making. The results of the self-assessment are independently reviewed by the internal audit, the results are summarized and presented to the Supervisory Board.

For successful large-scale and significant projects, employees can be rewarded with a one-time bonus after the completion of the project. The purpose of such a bonus is to recognize very good results or to compensate for the extra effort made during a time and energy-consuming project, which was not part of the ordinary job tasks.

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 key employees. The aim of issuing share options is to align the interests of management board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labour market that is equal to competitors and comprehensive

As part of the program, there is an annual performance pay added to basic salary, the amount or issue of which corresponds to the fulfilment or non-fulfilment of individual and LHV objectives. The objectives of the program are:

- Ensuring a competitive remuneration, to be attractive in the labour market,
- Keeping and motivating key personnel through creating a relationship of ownership,
- Reconciling the interests of shareholders and employees,

- Increasing company value through performance management.

The instruments of performance pay under the option program are 100% equity options. The term of share options is 3 years from the moment the options were granted. The three-year vesting period before issuance of shares gives the opportunity to evaluate the results in the long run. It is not possible to take the specified amount in cash in lieu of share options. Share options are issued annually in the amount of up to maximum 2% of the total number of LHV shares. LHV has the right to refuse to exercise and issue equity options to the entitled person, in whole or in part, if:

- LHV General Meeting or the Supervisory Board under the instructions from the General Meeting does not adopt the decision on the increase of LHV share capital and issuance of shares;
- The management body member agreement or the employment relationship of the person entitled to receive options has ceased at the initiative of the person entitled to receive options or in pursuant to § 88 of the Employment Contracts Act or, if the Employment Contracts Act is amended, on an analogous basis, however, based on the decision of the Supervisory Board it is possible to make exceptions to the applicability of this paragraph;
- The financial results of LHV or its relevant subsidiary have substantially deteriorated compared to the previous period;
- The person entitled to receive options no longer meets the performance criteria or does not meet the requirements prescribed by law to the head or an employee of a credit institution or a fund management company.
- LHV or its relevant subsidiary no longer meets the prudential regulations or the company's business risks are not adequately covered by own funds;
- The issuance of options has been determined based on information, which proved to be substantially misstated or incorrect.

Similarly to 2014, share options were also issued in 2015, 2016 and 2017. Share options are also likely to be issued in 2018. In 2017, the options issued in 2014 were fully exercised.

The granting and size of share options was dependent upon the successful achievement of operational targets of the overall company and the targets of individual management board members and employees. In the beginning of 2017 the share options were granted for 69 people in the amount of 1 573 thousand euros. In the beginning of 2016, the share options were granted for 49 people in the amount of 826 thousand euros. In 2015, the share options were granted for 48 people in the amount of 681 thousand euros. In 2014, the share options were granted for 35 people in the amount of 645 thousand euros. The company entered into share option agreements with the members of the management board and employees for a three-year term for the granting of share options. Share options issued in 2014 were exercised in 2017 where shares with nominal value of 1 euro can be acquired for 2 euros per share. Share options issued in 2015 can be exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of 1 euro can be acquired for 2.4 euros per share. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of 1 euro can be acquired for 3 euros per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of 1 euro can be acquired for 4.65 euros per share.

Governance of the Group

Supervisory board



Rain Lõhmus is a founder of LHV and the chairman of the supervisory board. He is a member of the supervisory boards of AS LHV Pank and AS Arco Vara and a member of the management boards and supervisory boards of other companies. Rain Lõhmus graduated from Tallinn University of Technology and management program of Harvard Business School. Rain Lõhmus owns 2,538,367 and his related parties own 3,939,638 shares of AS LHV Group.



Raivo Hein is the owner and a member of management board of OÜ Kakssada Kakskümmend Volti. He is a member of the supervisory board of AS LHV Pank and a member of management boards and supervisory boards of other companies. Raivo Hein graduated from Tallinn University of Technology. Raivo Hein does not own shares of AS LHV Group. OÜ Kakssada Kakskümmend Volti owns 490,190 shares of AS LHV Group and OÜ Lame Maakera owns 3,670 shares of AS LHV Group.



Heldur Meerits is the owner and a member of the management board of AS Amalfi. He is a member of the supervisory boards of AS LHV Pank and Kodumaja AS and a member of the management boards and supervisory boards of other companies. Heldur Meerits graduated from the Faculty of Economics and Business Administration of Tartu University. He is a member of the supervisory boards of SA Avatud Eesti Fond, SA Dharma and other foundations. Heldur Meerits does not own shares of AS LHV Group. AS Amalfi owns 951,978 shares of AS LHV Group.



Tiina Mõis is the owner and manager of AS Genteel. She is a member of the supervisory boards of AS LHV Pank, AS Baltika and other companies. Tiina Mõis graduated from Tallinn University of Technology. Tiina Mõis does not own any shares of AS LHV Group. AS Genteel owns 999,456 shares of AS LHV Group.



Sten Tamkivi is a member of the management board of Teleport Technologies OÜ and a member of the management boards and supervisory boards of other companies. Sten Tamkivi graduated from the Stanford University Graduate School of Business. Sten Tamkivi owns 355 shares and Seikatsu OÜ owns 1,825 shares of AS LHV Group.



Tauno Tats is a member of the management board of Ambient Sound Investments OÜ. He is a member of the supervisory board of EFTEN Kinnisvarafond AS and a member of management boards and supervisory boards of other companies. Tauno Tats graduated from Tallinn University of Technology. Tauno Tats does not own shares of AS LHV Group. Ambient Sound Investments OÜ owns 1,595,620 shares of AS LHV Group.

Management board



Andres Viisemann is the founder of LHV and the manager of LHV pension funds. He is a member of the supervisory boards of AS LHV Pank, AS LHV Varahaldus and AS Fertilitas and a member of the supervisory boards and management boards of other companies. Andres Viisemann graduated from the University of Tartu and obtained a Master's degree at INSEAD in International Business Management. Andres Viisemann does not own shares of AS LHV Group. His related parties own 2,544,399 shares of AS LHV Group.



Madis Toomsalu is the chairman of the supervisory boards of AS LHV Pank and AS LHV Varahaldus. He is member of the Management Board of MTÜ Finance Estonia. Madis Toomsalu has obtained a bachelor's degree in business management from Tallinn University of Technology in 2009 and a master's degree in 2011 in public sector finance. Madis Toomsalu owns 19,488 shares of AS LHV Group.

Members of committees formed on the Supervisory Board level

Kristel Aarna, Urmas Peiker, Tauno Tats, Madis Toomsalu, Rain Lõhmus, Andres Viisemann, Tiina Mõis. Kristel Aarna and Urmas Peiker do not own LHV shares.

Supervisory and management boards of the subsidiaries

AS LHV Pank

Supervisory board: Madis Toomsalu (chairman), Raivo Hein, Heldur Meerits, Tiina Mõis, Rain Lõhmus, Andres Viisemann

Management board: Erki Kilu (chairman), Jüri Heero, Andres Kitter, Meelis Paakspuu, Indrek Nuume, Martti Singi

AS LHV Finance

Supervisory board: Erki Kilu (chairman), Rain Lõhmus, Veiko Poolgas, Jaan Koppel

Management board Nele Roostalu (until 04.02.2018), Kadri Kiisel (from 05.02.2018)

AS LHV Varahaldus

Supervisory board: Madis Toomsalu (chairman), Erki Kilu, Andres Viisemann

Management board: Mihkel Oja (chairman), Joel Kukemelk

Cuber Tehnology OÜ

Management board: Jüri Laur

UAB Mokilizingas

Supervisory board: AS LHV Group, AS LHV Pank, UAB Inovatyvūs prekybos sprendimai, UAB "K2Z"

Management board: Benas Pavlauskas, Saulius Kuliešius (until 23.01.2018), Raimondas Štreimikis, Jonė Virbickienė (chairman)

CEO: Benas Pavlauskas

Financial results

EUR million	2014*	2015	2016	2017	2017 forecast
Volume of deposits	457	633	778	1 543	881
Volume of net loans	316	410	538	732	700
Volume of funds	504	570	974	1 103	1 158
Net interest income	20.3	23.2	30.0	35.5	
Net fee income	12.8	14.7	19.2	22.2	
Net financial income	0.5	0.4	1.3	1.0	
Net income	33.6	38.3	50.5	58.7	59.7
Expenses	21.7	24.1	28.9	31.9	32.1
Operating profit	11.9	14.3	21.7	26.6	27.5
Loan provisions	2.6	1.4	1.5	3.2	4.1
Income tax expense	-0.4	-0.3	-0.3	1.2	1.5
Profit from discontinued operations	0.0	2.2	0.0	0.0	0.0
Profit	9.7	14.8	19.9	22.2	21.8
including attributable to owners of the parent	9.2	13.7	17.8	19.6	

The Group's pre-tax profit for 2017 amounted to EUR 23.4 million and net profit totalled EUR 22.2 million. Pre-tax profit is 16% more than a year before. Net interest income grew 18% and net fee income increased 16%. Financial income decreased by 25%. The Group's net income was EUR 58.7 million and increased by 16% compared to the previous year. Operating expenses amounted to 31.9 million euros and increased by 10% over the year. The Group met the financial forecast published at the beginning of 2017.

By the end of December, the total volume of the Group's loan portfolio less impairments amounted to EUR 732 million (December 2016: EUR 538 million). The volume of portfolio increased 36% in a year. In the loan portfolio, the majority is corporate loans that increased 34% in a year to EUR 510 million (2016: EUR 380 million). The portfolio of retail loans increased 41% in a year, amounting to EUR 230 million (2016: EUR 163 million).

The volume of Group's deposits increased 98% in a year and totalled EUR 1 537 million by the year-end (2016: EUR 777 million). The share of demand deposits of all deposits increased and reached 92% (31.12.2016: 80%).

By business units, in consolidated figures in 2017, AS LHV Pank earned a profit of EUR 15.5 (2016: 13.2) million, AS LHV Varahaldus earned EUR 5.8 (2016: 6.1) million and UAB Mokilizingas earned EUR 1.9 (2016: 1.9) million. LHV Group as a separate entity earned a profit of EUR 2.7 million (2016: a loss of EUR 1.3 million), due to the fact that the subsidiary LHV Varahaldus paid dividends to LHV Group.

Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Group, calculated according to the definitions of the Basel Committee, was 121.3% at the end of December (31.12.2016: 222.2%; 31.12.2015: 271.6%). The liquidity situation of the Group has not changed, as the depletion of the LCR is caused by deposits made by financial intermediaries, which are 100% covered by liquid funds. As at 31.12.2017, the Group's LCR is 216.8%, if the deposits from financial intermediaries are not taken into account. The Group considers cash in the central bank and in other credit institutions and bond portfolios to be included in its liquidity buffer, that accounted for 57% of the balance sheet total (31.12.2016: 40%). The Group's loan-to-deposit ratio at the end of 2017 was 48% (31.12.2016: 70%).

The Group's level of own funds as at 31.12.2017 was EUR 141.6 million (31.12.2016: EUR 123.9 million). Compared to the internal capital adequacy target of 15.06%, the Group is well capitalised as at the end of the reporting period. The level of capital adequacy was 19.6% (31.12.2016: 22.3%) and Tier 1 capital ratio was 15.3% (31.12.2016: 16.8%).

The Group uses the standard method for the calculation of credit risk and market risk capital requirements and the basic indicator approach for the calculation of operational risk capital requirements. The Group has complied with all capital requirements during the financial year and in previous year.

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

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2017 was 5.83% (31.12.2016: 9.5%). Leverage ratio is calculated as Group's total Tier 1 own funds divided by Group's total risk exposure measure (incl. risk position on assets and off the balance sheet liabilities). As at the end of the reporting period, the leverage ratio is the arithmetic mean of the monthly leverage ratios over the last quarter.

On December 2017, the Financial Supervision Authority introduced a new prudential regulation for LHV Pank, a

minimum requirement for own funds and eligible liabilities (MREL). The ratio is a part of the crisis resolution plan and obliges LHV to have sufficient own funds and unsecured long-term liabilities that can be used to cover losses under the crisis resolution plan. The minimum requirement for MREL ratio is set at 5.79% and it is reviewed annually by the Financial Supervision Authority. At the end of the year, LHV Pank had the ratio at the level of 6.67% and it contains an adequate buffer for the growth plans of 2018. On the other hand, it forces LHV to change its existing policy of financing by deposits and the Group will also include liabilities in the form of bonds or loans, which qualify for MREL, in order to manage the ratio.

Key figures,

EUR million	2017	2016	change	2015	change	2014	change
net profit	22.2	19.9	11%	14.8	34%	9.7	53%
net profit attributable to owners of the parent	19.6	17.8	10%	13.7	30%	9.2	49%
average equity	111.2	86.2	29%	62.9	37%	43.1	44%
return on equity (ROE) % *	17.6	20.7	-3.1	21.8	-1.1	21.4	-0.4
average assets	1 354	846	60%	656	29%	485	35%
return on assets (ROA) %	1.6	2.4	0.8	2.3	0.1	2.0	0.3
price to earnings	13.56	13.29	0.27	-	-	-	-
dividend to net profit ratio %	21.0	26.7	-5.7	-	-	-	-
dividend per share	0.16	0.15	7%	-	-	-	-
net interest income	35.5	30.0	18%	23.2	29%	16.5	41%
average interest earning assets	1 333	832	60%	641	30%	471	36%
net interest margin (NIM) %	2.66	3.60	-0.94	3.62	-0.02	3.50	0.14
spread %	2.62	3.52	-0.9	3.55	-0.03	3.44	0.11
cost to income ratio %	54.4	57.2	-2.8	62.8	-5.6	67.5	-4.7

* Return on equity is calculated based on LHV Group 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

price to earnings = share price/net profit/number of shares (average)

dividend to net profit ratio = dividend/net profit

net interest margin (NIM) = net interest income/average interest earning assets * 100

spread = yield on interest earning assets – cost of interest bearing liabilities

yield on interest earning assets = interest income/average interest earning assets * 100

cost of interest bearing liabilities = interest expenses/average interest bearing liabilities * 100

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

Capital base <i>(in EUR thousands)</i>	31.12.2017*	31.12.2017	31.12.2016
Paid-in share capital	25 767	25 767	25 356
Share premium	46 304	46 304	45 892
Statutory reserves transferred from net profit	2 471	2 471	1 580
Other reserves	36	36	-40
Accumulated profit/(deficit)	24 468	24 468	10 517
Intangible assets (subtracted)	-7 940	-7 940	-8 114
Net profit for accounting period	19 603	19 603	17 816
Dividend offer (including income tax)	-5 153	0	0
Total Tier 1 capital	105 555	110 709	93 007
Subordinated debt	30 900	30 900	30 900
Total Tier 2 capital	30 900	30 900	30 900
Exceeding limitations of subordinated debts and preference shares	0	0	0
Net own funds for capital adequacy calculation	136 455	141 609	123 907
Capital requirements			
Central governments and central bank under standard method	945	945	1 498
Credit institutions and investment companies under standard method	6 950	6 950	7 415
Companies under standard method	428 428	428 428	334 314
Retail claims under standard method	144 237	144 237	114 689
Public sector under standard method	185	185	216
Housing real estate under standard method	20 039	20 039	7 079
Overdue claims under standard method	20 956	20 956	2 313
Investment funds' shares under standard method	6 281	6 281	10 886
Other assets under standard method	13 824	13 824	7 610
Total capital requirements for covering the credit risk and counterparty credit risk	641 845	641 845	486 020
Capital requirement against foreign currency risk under standard method	3 551	3 551	5 032
Capital requirement against interest position risk under standard method	412	412	1 709
Capital requirement against equity portfolio risks under standard method	585	585	601
Capital requirement against credit valuation adjustment risks under standard method	15	15	24
Capital requirement for operational risk under base method	75 999	75 999	61 812
Total capital requirements for adequacy calculation	722 407	722 407	555 198
Capital adequacy (%)	18.89	19.60	22.32
Tier 1 Capital Ratio (%)	14.61	15.32	16.75

*audited numbers which include the dividend offer

Overview of the Group's subsidiaries in 2017

AS LHV Pank consolidation group

AS LHV Pank is based on Estonian capital. The Bank's clients include private individuals, small and medium-sized companies and institutional investors. The branch offices of the Bank are located in Tallinn and Tartu (Vilnius office was closed 31.03.2017). The Bank employs over 290 people. More than 133 000 clients use the Bank's services. AS LHV Pank is one of the largest brokers on NASDAQ OMX Baltic stock exchanges and the largest broker for Baltic retail investors in international markets. The Bank owns 65% of the subsidiary AS LHV Finance that provides hire purchase and consumer finance services.

Business activities

2017 has been year of growth in all business segments. Growth of loans and deposits transaction volumes exceeded the budget.

The volume of deposits grew by 98% year-on-year and reached EUR 1 551 million by year-end (2016: EUR 785 million). Large part of the growth in volume was attributable to deposits from financial intermediaries, which reached EUR 607 million by the end of the year. Continuing focus was kept on increasing the volume of stable deposits and reduction of interest costs. The European Central bank continued to keep the base interest rates low, which resulted in increased costs of holding liquid assets. The proportion of demand deposits has increased, accounting for 92% of all deposits as at the end of December (81% one year ago).

The loan portfolio volume grew by 35% year-on-year and amounted to EUR 719 million at the end of December (2016: EUR 531 million). Corporate loans, which also include retail loans for companies, increased by 34% to EUR 510 million (2016: EUR 380 million) and loans issued to private individuals increased by 64% to EUR 141 million (2016: EUR 86 million). The largest part of the loan portfolio continued to be corporate loans, followed by housing loans, leasing, instalment loans and small loans. Bank issued a loan to the other subsidiary of AS LHV Group, UAB Mokilizingas, the amount of which at the year-end was EUR 36.8 million (31.12.2016: EUR 30.5 million).

New developments include launching new private banking offering, new Salary Payment service was added, chatbot on the Facebook page, video identification and Smart-ID. As new products, we began to offer home insurance and added car loans and an instalment loan product called New and Better to LHV Finance portfolio. Together with Telia, mTasku was added to the portfolio, which allows you to pay with a smartphone at many stores.

In the internet bank and mobile bank, a banking link was created for businesses and upgrades for the mobile bank, where all loan agreements were made visible to customers as a new service. The possibility of premature termination of standard credit agreements in the internet bank by the client was added as an additional functionality. The mobile bank was supplemented with information on second pillar pension funds.

Bank's organizational structure is divided into four larger business lines: retail banking, private banking, financial intermediary banking and corporate banking; and three larger support functions: IT, Finance and support and Risk management. Marketing and communication; and Human resource department are across the group.

At the end of first quarter, the Lithuanian unit was closed. The Bank's operations in Lithuania were small-scale, offering only brokerage service. In its business pursuits, the Bank has been governed, above all, by the business interests of its customers and endeavours to keep pace with the customers. Estonian enterprises currently need more services and support on the Western European front.

Bank received several awards. We received Member of the Year award by NASDAQ for the fifth time; research agency Dive nominated us as the Bank with Best Service in the Baltics for second year in a row. In March, the bank was ranked third in the reputation survey of IT employers, conducted by EMOR, as the most preferred employer in the IT field in Estonia.

Financial results

The net profit of the Bank in 2017 amounted to EUR 15.5 million, up 17% compared to the previous year (EUR 13.2 million). Net interest income grew by 22% and net fee and commission income increased by 35%. Financial income was higher by 32% compared to the previous year.

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

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

Operating expenses grew by 16% year-on-year, which was expected given the current phase of high growth and new business development.

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

Organisation

The organisational structure of the Bank continues to be divided in seven major areas: Retail Banking, Private Banking, Business Banking, Information Technology, Finance and Operations, and Risk Management (incl. compliance).

Financial results,

EUR million	2017	2016	change
Net interest income	31.13	25.55	22%
Net fee and commission income	7.70	5.72	35%
Net gains from financial assets	0.68	1.00	-32%
Total net operating revenues	39.51	32.27	22%
Other income	0.01	0.38	-98%
Operating expenses	-20.42	-17.64	16%
Loan losses	-3.58	-1.77	103%
Net income	15.52	13.24	17%

Volumes,

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

AS LHV Varahaldus

AS LHV Varahaldus is involved in the management of investment funds. The principal units of LHV Varahaldus are the investment unit, risk management unit, operations unit and sales and customer service unit.

In 2017, the volume of investment funds managed by LHV Varahaldus exceeded EUR 1 billion. The volume of funds grew by EUR 129 million, amounting to EUR 1 103 million at the end of the year. Prevailing volume of funds is comprised of actively managed pension funds where the investment strategy of LHV's funds has been clearly distinct from that of competing funds. During the year, LHV's funds increased investments in Estonia noticeably, as the total volume of the Estonia-oriented investment decisions of LHV's actively managed pension funds amounted to EUR 170 million. Investments were mainly in unlisted bonds (including subordinated bonds). However, building of two specially designed houses for renting purpose were also started in Põhja-Tallinn and investing in several venture capital and real estate oriented funds.

The choice of LHV to direct pension funds' investments into alternative asset classes and the local market is linked to the prolonged rise of international securities markets, where LHV Varahaldus assesses that investing has become expensive. By investing in the domestic market, it is possible to negotiate conditions and, in a situation of lower competition, achieve a better risk-return ratio for pension funds. LHV Varahaldus is optimistic over investment opportunities offered by their home market and therefore has planned to launch in 2018 the first II pillar pension fund, which invests only in Estonia.

Investing less in international stock exchanges is associated with the risk that in the situation of increasing markets, competing pension funds perform better in a short-term comparison of yields than LHV's funds. This scenario realized in the second half of the year 2017 as equity markets continued their dynamic climb. Short-term yield has its clear impact on the number of joining and leaving clients of pension funds. The number of clients decreased by 2.7 thousand as a consequence of the entry of a new competitor to the market and a short-term comparison of yields. In 2017, the yield of LHV's conservative 2nd pillar funds were between -0.4% to -0.6%, the yield of actively managed funds with equity-risk were between +2.3% to 3.5% and the yield of passively managed funds with equity-risk was +6.2%. In the comparison of last three years, the LHV's actively managed pension funds were the best in the three risk categories of the four.

With the entry into force of the Investment Funds Act at the beginning of the year 2017, the capital requirements became lower and the exit fees of 2nd pillar funds were abolished. Regarding the changes in the capital requirements, LHV Varahaldus decreased its share capital by EUR 6.6 million. LHV Varahaldus also paid dividend in the amount of EUR 3.8 million.

In regards of the purchase AS Danske Capital and merger into its organization, the number of investment funds managed by LHV increased in 2016, however, the investments policies were similar in several funds. In 2017, LHV merged similar pension funds and became more effective as a result. Costs also decreased due to the change of depositary banks. At the end of the year, the depositary bank of funds managed by LHV Varahaldus was AS SEB Pank.

Increasing efficiency and increase in the volume of funds are also reflected in the management fees of the funds. In addition to abolishment of exit fees, also the management fees of LHV's II pillar funds lowered by 19% on average. Management fees will continue to decrease in the future as volumes increase. For example, from February 2018, the fees of LHV's funds will decrease by an average of 6%.

LHV Varahaldus posted a net profit of EUR 5.8 million in 2017 - EUR 0.3 million less than the year before. Income tax related to paid dividends decreased net profit by EUR 1.0 million. Net fee and commission income increased by EUR 0.4 million to EUR 13.3 million. The growth in operating income can be attributed to the growth in total fund volume, which compensated the decrease of average fees. Operating expenses decreased by EUR 0.2 million and amounted to EUR 6.7 million. Higher operating expenses in the previous year were related to merger of AS Danske Capital.

Financial results

EUR million	2017	2016	change
Net fee income	13.3	12.9	3%
Other financial income	0.2	0.2	0%
Total net operating revenues	13.5	13.1	3.1%
Operating expenses	-6.7	-6.9	-3%
Net profit	5.8	6.1	-5%
Assets under management	1 103	974	13%
Number of clients in pension funds (thousands)	202	204	-1%

UAB Mokilizingas

In Hire Purchase and Consumer Loan segments, Mokilizingas continued to work in a strong collaboration with main partners, launching seasonal campaigns and supporting the sales. In 2017, the sales amounted to EUR 52.3 million (2016: EUR 44.9 million), of which Consumer Loan sales amounted to EUR 7.0 million and decreased by 14% compared to 2016. Sales margins slightly decreased compared to 2016.

The credit card portfolio continued to increase during 2017. The customers' average monthly expenditures with credit cards also exceed the forecast. The goals of the first quarter of 2018 were to increase the usage rate of the cards and to introduce the possibilities of the product to clients. In particular, the existing cardholders are in focus on taking advantage of the full potential of the credit card with revolving limit.

In the first quarter of 2017, Mokilizingas started with a new challenging integration with BoL (Bank of Lithuania) liability databases. This had a significant impact to service quality, because it lengthened the customer evaluation process. By optimizing the processes, Mokilizingas managed to

shorten the time of the evaluation from 4 minutes to 30 seconds, even in the situation of new requirements. As a result, after March 2017, the sales recovered significantly compared to the beginning of the year. After a slow start of the year, new sales increased significantly, especially thanks to the purchase of a hire purchase portfolio from a Lithuanian telecommunication company.

2018 will be dedicated to further optimize the internal processes and business development. Further developments include new services, in order to improve customer experience.

Corporate Governance report

This report is presented in accordance with the Accounting Act of the Republic of Estonia and provides an overview of the governance of AS LHV Group and compliance of governance with the Corporate Governance Recommendations of NASDAQ OMX Tallinn stock exchange and Financial Supervision Authority. LHV adheres to the Corporate Governance Recommendations, unless specified otherwise in this report

1. General meeting

LHV is a public limited company, with its governing bodies being the general meeting of shareholders, the Supervisory Board and the Management Board.

The general meeting, where shareholders can exercise their rights, is the highest governing body of LHV. The primary duties of the general meeting include amendment of the Articles of Association, increase and decrease of share capital, decisions on issuance of convertible bonds, election of and extension of the powers of Supervisory Board members, premature removal of Supervisory Board members, approval of the annual report and profit allocation, approval of the share option programme and establishment of terms and conditions for the realisation of options, determination of the number of auditors, appointment and recall of auditors and other decisions within the competence of the general meeting, as provided by law and the Articles of Association.

A resolution on amendment of the Articles of Association shall be adopted if at least two-thirds of the votes who participate in the meeting are in favour. A resolution on amendment of the Articles of Association shall enter into force as of the making of a corresponding entry in the commercial register. The resolution of the general meeting on the amendment of the Articles of Association, minutes of the general meeting and the new text of the Articles of Association shall be attached to the application filed to the commercial register.

A shareholder has the right to participate in the general meeting, address the general meeting with regard to items on the agenda, ask relevant questions and make proposals.

The Management Board calls the general meeting. The annual general meeting, with the approval of the annual report on the agenda, is held at least once a year. The Management Board calls the annual general meeting within six months after the end of the financial year at the latest. The Management Board gives at least three weeks' notice of the annual or special general meeting.

The agenda of the general meeting, proposals of the Management Board and Supervisory Board, draft resolutions and other relevant materials are made available to the shareholders prior to the general meeting. Materials are made available on LHV's website. Shareholders are given the opportunity to ask questions about items on the agenda before the general meeting, with the questions and responses published on LHV's website.

The list of shareholders entitled to participate in the general meeting is established based on the share register seven days before the general meeting.

One annual general meeting of shareholders was held in 2017, which was the first LHV as a public company's general meeting. No special general meetings were held. The annual general meeting of shareholders was held on 29 March 2017, where the Annual Report 2016 was approved and profit for the financial year 2016 was distributed, including the initial payment of dividends. The terms of payment of the performance fees were approved. In addition, an overview of the economic results for the first two months of 2017 was given, the amendments to the articles of association were approved and the powers of the members of the supervisory board were lengthened. The general meeting was held in the Estonian language.

The annual general meeting of 2017 was chaired by Daniel Haab, Head of Legal Department of AS LHV Pank, who introduced the procedure of the general meeting and the procedure for asking questions regarding the company's activities from the Management Board.

In 2017, member of the Management Board Madis Toomsalu, Chairman of the Supervisory Board Rain Lõhmus, members of the Supervisory Board Andres Viisemann, Tiina Mõis, Heldur Meerits, Raivo Hein, Sten Tamkivi and Tauno Tats, Andres Viisemann, Tiina Mõis, Heldur Meerits were represented by empowerment and auditor Verner Uibo attended the annual general meeting.

None of the shareholders hold any shares, which would grant them special control rights or voting rights. LHV is not aware of any agreements in place between shareholders that would address the coordinated exercise of shareholder rights.

Shareholders with significant influence include Rain Lõhmus and parties related to him (25.14%) and Andres Viisemann and parties related to him (9.87%).

2. Management board

2.1. Duties of the Management Board

The Management Board is a governing body of LHV, charged with the task of representing and managing LHV. Pursuant to the Articles of Association of LHV, the Management Board consists of one to five members. The member of the Management Board is appointed for a term of five years, unless otherwise decided by the Supervisory Board. An extension of the term of office of a member of the Management Board may not be decided before one year before the scheduled term of office and for a longer period than the maximum period prescribed in the law or the articles of association. If the Management Board of LHV has more than two members, the Supervisory Board must appoint the Chairman of the Management Board. The Chairman of the Management Board organises the work of the Management Board. The Supervisory Board may revoke a member of the Management Board regardless of the reason. A member of the Management Board may resign from the board, regardless of the reason, informing the Supervisory Board. The rights and obligations arising from a contract concluded with a member of the Management Board shall expire in accordance with the contract.

The LHV Management Board currently consists of a single member and Madis Toomsalu serves as the member of the Management Board. The Supervisory Board has entered into a management board member contract with Madis Toomsalu. The Supervisory Board establishes the remuneration principles for Management Board members and sets the severance compensation policy for premature termination of the management board member contract.

The Management Board makes everyday management decisions at its own discretion, governed by the best interests of LHV and its shareholders, and not his or her personal interests. The duties of the Management Board member include day-to-day management of LHV, representation of the company, management of LHV's operations in foreign markets and investor communication, coordination of the development of LHV's strategy and its implementation by serving as an active chairman of the supervisory boards of the major subsidiaries of LHV.

The Management Board shall ensure the functioning of risk management and internal control within LHV, depending on the business area pursued by LHV. LHV's internal control system covers all activities carried out by the Supervisory Board, management and staff members of LHV with the aim of ensuring efficiency of operations, adequate risk management, reliability and accuracy of internal and external reporting, unconditional compliance with all legal acts. The internal audit system covers all business, support and control units.

The objective of risk management within LHV is to recog-

nise, correctly measure and manage the risks. On a wider horizon, the objective of risk management is to enhance corporate value by minimising damage and reducing volatility of results.

Risk management is based on a strong risk culture and built on the principle of three lines of defence, with the first line of defence, i.e. business areas, being responsible for risk-taking and day-to-day management of risks. The second line of defence, i.e. the risk management area, is responsible for developing risk management methods and reporting on risks. The third line of defence, i.e. internal audit, exercises independent supervision over the entire organisation.

2.2. Management remuneration principles

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law.

Competence for the establishment of remuneration for members of the Management Board shall lie with the Supervisory Board. The Remuneration Committee shall review the basis of management remuneration on an annual basis. In assessing the activities of the members of the Management Board, the Remuneration Committee shall, above all, consider the professional duties of the Management Board member, his or her activities, the activities of the entire Management Board as well as LHV's financial position, the current status of and outlook for business operations in comparison with companies operating in the same sector of economy.

The remuneration payable to a member of the Management Board, including the options programme, must motivate the individual to operate within the best interests of LHV. The basic salaries of members of the Management Board shall be set forth in the employment contract, and the basic salary of the Chairman of the Management Board in the Management Board member contract. The principles of remuneration of management or staff members engaged in internal control and risk management shall ensure their independence and objectivity in the performance of their risk management/internal control duties. The remuneration of this staff shall not depend on the results posted by the units supervised. The objectives shall be described on the level of individual staff members.

When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

The performance criteria established by LHV must not stimulate excessive risk-taking or sale of unsuitable products.

The performance criteria must not merely contain perfor-

mance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield) but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).

The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's professional behaviour.

A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.

Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.

Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, creativity, motivation and co-operation with other business units and the internal control function.

LHV applies the long-term performance pay programme, i.e. the options programme. An annual performance pay shall be added to the basic salaries of Management Board members, top managers and key personnel included in the options programme (including staff members equivalent to management members), the amount and disbursement of which corresponds to the achievement or non-achievement of individual targets or LHV's targets. The basis for establishment of performance pay in the options programme shall be objective and justifiable, with the time period for which performance pay shall be paid previously determined. The performance pay instruments consist fully of stock options.

Severance compensation payable to a member of the Management Board shall correspond to his or her previous work results. No severance compensation shall be paid, if this is liable to damage the interests of LHV. The size of the severance compensation shall correspond to the results achieved over time, and to the remuneration received.

In 2017, salaries and other compensations paid to the management of LHV and its subsidiaries totalled EUR 1 371 thousand (2016: EUR 1 198 thousand), including all taxes.

2.3. Conflicts of interests

The members of the Management Board submit a declaration of economic interests and conflicts of economic interests once a year. Transactions between LHV and the members of the Management Board, their close relatives or related persons must be previously approved by the Supervisory Board. In 2017, such transactions did not take place.

Madis Toomsalu is not a management board member or supervisory board member in any other issuer. Management Board members have not been granted authority to issue or buy back shares.

3. Supervisory Board

The Supervisory Board is a governing body of LHV, charged with the task of planning the activities of LHV, organising the management of LHV and conducting supervision over the activities of the Management Board. The Supervisory Board determines and regularly reviews LHV's strategy, the general plan of action, risk management principles and the annual budget. The Supervisory Board has five to seven members. The members of the Supervisory Board are appointed for a term of three years. The members of the Supervisory Board elect amongst themselves the Chairman of the Supervisory Board, charged with the task of organising the activities of the Supervisory Board.

Rain Lõhmus (Chairman), Andres Viisemann, Tiina Mõis, Heldur Meerits, Raivo Hein, Tauno Tats and Sten Tamkivi serve as members of the Supervisory Board. The term of office of Supervisory Board members is set to expire on 29 March 2020. The general meeting of shareholders has resolved to establish for the Supervisory Board members a gross remuneration of 500 euros per each meeting of the Supervisory Board, where the member participates.

Supervisory Board members submit an annual declaration of economic interests and conflicts of economic interests. No significant transactions were concluded between LHV and its Supervisory Board members, their close relatives or related parties in 2017.

A total of eleven ordinary meetings and one extraordinary meeting of the Supervisory Board was held in 2017 and once the decisions were approved electronically. Rain Lõhmus and Andres Viisemann and participated in all meetings of the Supervisory Board in 2017. Raivo Hein and Tauno Tats were absent on one occasion, Tiina Mõis and Heldur Meerits on two occasions and Sten Tamkivi on three occasions. All members of the Supervisory Board participated in more than half of the meetings of the Supervisory Board.

The Supervisory Board has formed three committees,

charged with the task of advising the Supervisory Board in issues related to audit, remuneration and risk, as described below.

During the meetings, the Supervisory Board got regular overview of LHV's and its subsidiaries operating and financial results. Risk reports and reports from internal auditor were quarterly reviewed. In the beginning of the year, The Supervisory Board approved the Annual Report 2016, Management Report and proposal of profit distribution and made a proposal to pay dividends 15 cents per share. The financial and capital plan, and also the financial calendar were approved for the year 2017. In August, most of the meeting were dedicated to debate on LHV's strategy. During the year, dozens of procedures, policies and internal rules of LHV and its subsidiaries were reviewed, updated and approved. Thoroughly were reviewed all the remuneration policies and principles by approving the necessary documents. The pricing and issuing of share options for the results of the year 2016, initial realization of options and the share options of resigning staff members were approved. New members of the Audit Committee were chosen and the rules of procedure of the Audit Committee was updated. Overviews were obtained from the activities and outcomes of various sectors, including real estate market and portfolio and banking in Baltics. Decisions were made to publish LHV's monthly results and conclusions of forecasts and financial plan for the next five (5) years. The approvals were made to decrease AS LHV Varahaldus's share capital and to increase LHV's share capital in regard to realization of the options' program.

3.1. Audit committee

The Audit Committee is formed by Supervisory Board as an advisory body with regard to monitor effectiveness of accounting (including budgeting process), audit, risk and capital management, internal control and internal audit, also compliance with regulations. The Audit Committee is governed, in its activities, by the Auditors' Activities Act and the rules of procedure established by the Supervisory Board of LHV.

The Audit Committee has been charged with the task of monitoring and analysing the processing of financial information in the extent necessary for preparing quarterly and annual financial statements, the procedure for audit of the financial statements or consolidated financial statements, as well as the independence of the audit firm or a sworn auditor representing the audit firm on the basis of the law and compliance of their activities with the requirements of the Auditors' Activities Act.

The Audit Committee is responsible for making proposals to the Supervisory Board and providing recommendations for appointment or removal of the audit firm, appointment

or removal of the internal auditor, prevention or elimination of problems or inefficiencies within the organisation, and compliance with legal acts and good practice.

The Audit Committee consists of a minimum of three members. Members of the Audit Committee are appointed by the Supervisory Board for a term of three years, with the aim of ensuring diversity of competences and independence of committee members. In 2017 changed the members of Audit Committee. From April 2017 the members of the Audit Committee Kristel Aarna, Tauno Tats and Urmas Peiker (Chairman). The Audit Committee's powers of attorney are valid until 31 March 2020. In the meeting of the Audit Committee held in March 2017 participated members from the old and from the new Audit Committee in order to share thoughts and experience. Committee members are paid a monthly net remuneration of 500 euros.

Pursuant to the rules of procedure, the Audit Committee gathers for meetings at least on a quarterly basis, but in 2017, the Audit Committee has gathered for meetings on ten occasions. In the first meeting of this year, the rules of procedure of the Audit Committee and, the rules of procedure of the Internal Audit were reviewed and updated and presented to the Supervisory Board for approval. Two meetings focused on the preparation of the selection of a new external auditor, as the external auditor has recently been elected by the general meeting for a period of 3 years ending in 2017, it is necessary to carry out a new selection process. The Audit Committee looked through tender documentations, listened presentations of tenderers and questioned them. As a result of a thorough discussion, the Audit Committee proposes to the general meeting to approve the external auditor for a period 2018-2019.

At seven meetings, representatives of the Risk Management gave the members of the Audit Committee an overview of the various risk management topics, bank and group risk exposures, and indicators and measures used to monitor and manage them – as well as the transition process to IFRS 9 and anti-money laundering.

In most of the meetings were discussed the issues raised by the internal audit, along with the various audit reports, in addition to other topics. The internal auditor gave an overview of the audits conducted. The Audit Committee has reviewed all the reports prepared by the internal audit and discussed the observations made, and the Audit Committee has formulated its views on the observations. In the penultimate meeting of the year, an external auditor gave an overview of findings from interim audit. In the same meeting was also discussed work plan of the internal audit for the year 2018. The Audit Committee also confirmed and approved specific additional services provided by an external auditor.

3.2. Remuneration committee

The Remuneration Committee has been charged with the task of evaluating the principles of remuneration within LHV's subsidiary, the credit institution AS LHV Pank, and the impact of any remuneration-related decision on adherence to the requirements established for the management of risks, own funds and liquidity. The Remuneration Committee consists of a minimum of three members.

The Remuneration Committee conducts supervision of the remuneration of Management Board members and staff members, evaluates implementation of the remuneration policy at least on an annual basis and, where necessary, proposes to update the remuneration principles and prepares the related draft resolutions for the Supervisory Board.

The Remuneration Committee met once in January 2017, when remuneration policy and strategic principles for remuneration, market comparison, critical positions and planned positions in 2017 were reviewed. The committee discussed and made a proposal to the Supervisory Board with regard to the recipients of share options and the related amounts for the results posted in 2016, as well as with regard to the pricing of share options and the share options of resigning staff members. The remuneration system, the objectives of the members of the Management Board and the principles for remuneration of the members of the Management Board and persons who were equal to the members of the Management Board were reviewed.

Members of the Remuneration Committee are Rain Lõhmus, Andres Viisemann and Madis Toomsalu (Chairman) who have powers of attorney valid until 21 May 2018. No remuneration is paid to members of the Remuneration Committee.

Rain Lõhmus and its related parties (Lõhmus Holdings OÜ, OÜ Merona Systems) hold 6 478 005 shares, which form 25.13% of all shares. Andres Viisemann is the founder of LHV, member of the Supervisory Board of LHV and manager of the pension funds of AS LHV Varahaldus. Andres Viisemann and its related parties (Viisemann Investments AG, Viisemann Holdings OÜ) hold 2 544 399 shares, which form 9.87% of all shares. Andres Viisemann has an opportunity to get 32 939 shares of LHV from share options issued in 2015, 2016 and 2017. Madis Toomsalu is a member of the Management Board of LHV. Madis Toomsalu holds 19 488 shares of LHV. Madis Toomsalu has an opportunity to get 31 333 shares of LHV from share options issued in 2015, 2016 and 2017.

3.3. Risk and capital committee

The Risk and Capital Committee has been charged with the task of advising the Supervisory Board and Management Board of LHV with regard to risk management principles and risk tolerance, assessing the risks taken by LHV and monitoring implementation of the risk policy within LHV Group companies. The Risk and Capital Committee also carries out supervision of the implementation of risk management principles by the Management Board in accordance with the instructions given by the Supervisory Board, checks that the probability and timing of risk, capital, liquidity and revenue is taken into account in remuneration principles, and that the business model and risk management principles are taken into account in the fees established for customers.

Four ordinary meetings of the Risk and Capital Committee were held in 2017, reviewing regular risk reports, ICAAP report, loans with high risks and current situations of IRB. The overview of macro-financial environment, the Financial Supervisory Authority's on-the-spot checks and principles of remuneration were reviewed. The Supervisory Board was advised on criteria's regarding anti-money laundering, AML risk assessment principles and security risk of ID card. Summary of Asset Quality Review (AQR), IFRS 9 and its impact, operational risk assessment principles and credit risk assessment principles were revised.

Rain Lõhmus (Chairman), Andres Viisemann and Tiina Mõis serve as members of the Risk and Capital Committee whose powers of attorney are indefinite. No remuneration is paid to members of the Risk and Capital Committee.

Tiina Mõis is a member of the Supervisory Board of LHV, and the owner and managing director of AS Genteel. Tiina Mõis does not hold any shares of AS LHV Group. AS Genteel holds 999,456 shares of AS LHV Group.

4. Cooperation of Management Board and Supervisory Board

The Management Board and Supervisory Board work in close co-operation to best protect the interests of LHV. The co-operation is, above all, based on an open exchange of views between as well as within the Management Board and the Supervisory Board.

The Management Board and the Supervisory Board joint their efforts to lay out the objectives and strategy of LHV. In the management of LHV, the Management Board is governed by the strategic instructions given by the Supervisory Board. The Management Board regularly discusses strategic management issues with the Supervisory Board within the framework of an open dialogue. The Board is invited to participate in monthly meetings of the Supervisory Board.

The Management Board regularly informs the Supervisory Board of the key circumstances regarding the activity plans and business activities of LHV, the risks involved and management of such risks.

No conflicts of interests occurred in the financial year 2017.

5. Disclosure of information

LHV treats all shareholders equally and notifies all shareholders of material developments accordingly. Information is disclosed in accordance with the rules set forth for publicly traded companies.

LHV has set up an investor relations website, making available all documents and information in accordance with the Corporate Governance Recommendations. LHV publishes on its website a financial calendar containing the publication dates of the annual report and interim reports and the date of the annual general meeting of shareholders. As of 2017 LHV also disclosed its annual plans and monthly results via the stock exchange announcements.

LHV's dividend policy is available on LHV's website, stipulating the dividend payment principles, according to which the key precondition for payment of dividends includes external and internal regulatory capital standards, which have to be met in a sustainable manner. LHV may decide to waive dividend payment under the corresponding growth and/or investment plans. Where the preconditions are met, LHV shall pay a minimum of 25 per cent of the shareholders' profit before taxes in dividends, income tax included.

In 2017, meetings and webinars with investors were held as needed and based on investor requests. The relevant presentations are available on LHV's website.

6. Financial reporting and auditing

LHV publishes its annual report on an annual basis. The annual report is audited, and approved by the Supervisory Board and is approved by General Meeting.

The number of auditors is determined and the auditors appointed by the general meeting of shareholders. The general meeting also establishes the procedure for remuneration of auditors. Auditors are appointed for a single audit or for a specified term.

In 2015, the Management Board, in cooperation with the Audit Committee, organised a tender for the appointment of an auditor. As part of the tender, LHV met with and requested bids from four major internationally recognised companies. As a result of the tender, AS PricewaterhouseCoopers was chosen and appointed the company's auditor at the annual general meeting of shareholders held on 29 April 2015. A three-year contract was entered into

with AS PricewaterhouseCoopers for the audit of the financial years 2015-2017.

During 2017, the auditor has rendered contractual services to LHV consolidation group companies, including audits of the financial statements of group companies and reviews of the profits disclosed in quarterly financial statements, translation services, tax advisory services, controlled the merger agreements and merger reports of the funds managed by LHV Varahaldus and other assurance services, which are required to be performed by auditors according to Credit Institutions Act, Securities Market Act and Investment Funds Act.

Transactions with related parties are disclosed in Note 24 to the financial statements.

Declaration of conformity

LHV adheres to the Corporate Governance Recommendations, with the exception of the following instructions and recommendations for the reasons stated below:

"1.3.3. Issuers shall make participation in the General Meeting possible by means of communication equipment (Internet) if the technical equipment is available and where doing so is not too cost prohibitive for the Issuer."

Observation of the general meeting and participation thereof has not been made possible by means of communication equipment. There has been no need, no corresponding requests and no suitable solution for such a facility. Nonetheless, LHV stands ready to ensure participation of shareholders at the general meeting via secure electronic means (without being physically present at the general meeting), with the corresponding option added to the Articles of Association of LHV.

"2.2.1. The Management Board shall have more than one (1) member and a Chairman elected by its members."

The Management Board or Supervisory Board shall establish an area of responsibility for each member of the Management Board, defining as clearly as possible the duties and powers of each board member. The principles for co-operation between members of the board shall also be established.

The Chairman of the Supervisory Board shall conclude a contract of service with each member of the board for discharge of their functions."

The Management Board of LHV has one member. LHV is a holding company without any day-to-day operational business activities. Thus, a single member of the Management Board ensures sufficient and comprehensive management of LHV. The major subsidiaries of LHV have management boards consisting of several members.

2.2.7. Basic wages, performance pay, severance packages, other payable benefits and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on website of the Issuer and in the Corporate Governance Recommendations Report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the Issuer or the amount of foreseeable expense as of the day of disclosure.

The Chairman of the Supervisory Board shall present the essential aspects of the management board remuneration and changes in it to the General Meeting. If the remuneration of some of the Management Board members has occurred on a different base, then the General Meeting shall be presented the differences together with the reasons therefore.”

LHV discloses the total amount of remuneration paid to Management Board members in Note 24 to the financial statements. LHV does not disclose the remuneration of individual members of the Management Board because this constitutes personal data, the disclosure of which is not unavoidably necessary for evaluation of the operations and management quality of LHV.

“3.2.2. At least half of the members of the Supervisory Board of the Issuer shall be independent. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number dependent members.”

Independent member of the Supervisory Board of LHV is Sten Tamkivi. Other members of the Supervisory Board of LHV are not independent in the meaning of the Corporate Governance Recommendations, as they have served in their current position for more than three (3) consecutive years. LHV has been in the stage of active development and growth, where it has preferred people of long-term management skills and banking experience as members of the Supervisory Board. These people are also the largest shareholders of LHV. LHV believes that, as members of the Supervisory Board, the largest shareholders are best motivated to contribute to the management of LHV and its development over the long-term horizon.

6.2.1. /.../ The Supervisory Board shall describe in its evaluation report to judgment of the auditors work inter alia

the services (including advisory services) that the auditor has provided to the Issuer during the preceding year or shall provide during the next year. Also the remuneration the Issuer has paid or shall pay to the auditor shall be published. /.../“

LHV has agreed with its foreign auditor not to disclose the contractual fees paid or payable to the auditor, since this constitutes the parties' confidential information the disclosure of which is not unavoidably necessary for assessing the activities of LHV. Once a year, LHV's Audit Committee shall review the services rendered by the foreign auditor, the relevant volumes and fees.

“Pursuant to subsection 24² (4) of the Accounting Act, a large undertaking whose securities granting voting rights have been admitted for trading on a regulated securities market of Estonia or another Contracting State shall describe in the corporate governance report the diversity policies carried out in the company's management board and senior management and the results of the implementation thereof during the accounting year. If no diversity policies have been implemented during the accounting year, the reasons for this should be explained in the corporate governance report.”

LHV has not deemed it necessary to implement a diversity policy, as LHV is governed in the recruitment of staff and management members by the best interests of LHV – the education, skills and previous experience of the person on a gender neutral on non-discriminatory basis.

Tiina Mõis serves as a member of the Supervisory Board of LHV and as a member of the Risk and Capital Committee, and Gerli Kilusk and Marilin Hein as members of the Audit Committee. Together with the management members, LHV's subsidiaries engage a total of 40 middle-level managers of whom 15 are women.

Social responsibility in LHV

LHV Group is committed to doing business in a sustainable and socially responsible manner. For this, we contribute to Estonia – the local economy, society and community around LHV. We also wish to influence the development of the Estonian financial market and banking in a positive direction. Responsibility also manifests itself in our goal to be the best employer to people working for LHV. For our clients, we are a partner who is reflective, understands the needs of our clients, and offers the most advanced banking services and the best service.

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's values: simple, supportive, effective.

As provided for by our internal policies, we take into account that in addition to the contingent liabilities set out by the law, social responsibility means the voluntary consideration of social factors in business processes.

Social responsibility in LHV is a purposeful, consistent, voluntary contribution which extends beyond the obligations required by law and serves the interests of the society.

Even though social responsibility constitutes a limitation in the pursuit of profit, LHV has set its sights on enhancing social benefits without seeking profit.

The purpose of adherence to the principle of social responsibility is to create long-term value for LHV's counterparties.

Responsible management

The activities of LHV and the behaviour of our people are governed by various internal policies, which have been drawn up, among other things, based on the principles of responsibility, and one of the core objectives of which is to ensure corporate social responsibility. Daily management decisions are made based on policies. These include:

- Credit Policy
- Code of Ethics
- Investment Policy
- Personnel Policy
- Remuneration Policy
- Capital Management Policy
- Risk Management Policy
- Liquidity Risk Policy
- Market Risk Policy

- Operational Risk Policy
- Compliance Policy
- Money Laundering and Terrorist Financing Prevention Policy
- Foreign Relations Procedure
- Social Media Policy
- Corporate Governance Code.

The following chapters describe how LHV's responsible management applies to the company operations.

We believe that an ethical and appropriate course of action will ensure success in the long term. Therefore, all managers and employees must behave ethically and responsibly. LHV's Code of Ethics is the foundation of LHV's various policies, internal procedure rules and procedures regulating the specifics of adherence to the Code of Ethics. In our activities, we are guided, above all, by the principle of legality, good practice and common sense.

The risk management and analysis of own activities are essential parts of LHV's management system. The area of risk management has been thoroughly analysed and takes into account credit risks, liquidity risks, market risks, crime risks and operational risks. LHV has three lines of defence for risk monitoring and risk control, including an essential Internal Control System.

Community

For LHV, there are different stakeholders in the corporate community: clients of banking services and investment funds, people working for LHV, investors, partners, financial market participants, regulators and supervisors, but also the public in general. In relations with all stakeholders, we consider partnership, honesty, goodwill, engagement and transparency, and at the same time trust in our bilateral relations, to be important.

We wish to serve our clients and communicate with them soundly, kindly and politely. Our respect for our clients is reflected in understanding the client's needs, in our responsibility, in our availability to our clients as well as in our effective administration. We organise regular internal training sessions and the necessary certification to provide the best customer service. We have developed a customer service textbook to provide the best service. According to the research company DIVE, LHV's service was the best in the Estonian banking sector in 2016 and 2017, and we

managed to maintain an excellent level in 2018 (91/100%).

We have taken various steps with client engagement. All client complaints and proposals are registered and taken into account when organising the bank's work. We have organised client satisfaction surveys and developed our services in line with our clients' wishes. We have created convenient and diverse communication channels for communicating with our clients. The official channels include phone, e-mail and live chat; information and feedback can be shared on social media channels and through the LHV financial portal.

Attracting and retaining of our cooperation partners is based on the same general principles as client communication. For LHV, the partnership means openness, transparency, consideration for each other and the discussion of disagreements.

In 2017, we started developing a new business line, which is to provide financial intermediaries with service. This will position LHV firmly in Europe as part of the fintech innovation community. We provide banking infrastructure to innovative and technology-intensive companies. We want to contribute to the development of new generation service providers who often lack the opportunity to find partners in the international banking market. The development of banking and financial technology is essential as new service providers bring a new level of quality of service to a client, making it more available and affordable. Therefore, we contribute to the growth of competition and help to expand opportunities.

LHV has constructive cooperation and competition with other actors in the financial market. LHV Pank is an active member of the Estonian Banking Association, LHV Varahaldus is an active member of the Association of Managing Companies; additionally, we cooperate with other financial service providers within the framework of Finance Estonia. We contribute to cross-sectoral issues, such as the sharing of money wisdom in Estonia, law making, the adaptation of regulations, prevention of money laundering and the fight against terrorist financing, and the organisation of payments.

LHV is precise and cooperative in dealing with regulators and monitoring agencies. We comply with all obligations and accountability arising from the law.

We conduct regular surveys to understand the community's mindset and LHV's role in society. We also participate in the analysis and research projects across the banking sector.

As a leader of the investor community, LHV takes responsibility for sharing money wisdom and advancing investor education. We contribute via the following activities:

- We organise regular, free-of-charge "Investor school" seminars for those interested in investing. The "Investor school" seminars had a total of 3,400 participants in 2017. We have also started organising "Investor meets" seminars, allowing heads of publicly traded companies to meet investors.
- We co-operate with other Estonian financial institutions and participate in the money wisdom month organised by the Estonian Banking Association as well as other money wisdom projects initiated by Estonian banks. LHV's staff members gave lectures to school children on the Money Wisdom Day.
- We have set up a library of investment and economic literature. Our libraries in Tallinn and Tartu hold a total of more than 1,000 different publications that are available to lend to our clients. In addition to those interested in investing, our library is also available to economics students. We continue to update the library.
- LHV manages the LHV financial portal and the forum set up for discussing investment-related subjects and sharing information. LHV regularly contributes to creating content which could be of interest to Estonian investors.
- Since 2007, we have published the free-of-charge journal "Investeeri", addressing various topics related to entrepreneurship and investing. In 2017, the journal published four editions. The circulation of a single edition is between 45,000 and 52,000 copies.

LHV Group is a company based on Estonian capital with more than 5,200 investors. Anyone who buys the entity's shares on a regulated market can be an owner of LHV. We are committed to developing a good relationship with the investor community, and our goal is to become the best stock company on the Baltic stock exchanges. We announce monthly LHV results to our investors. From 2017, we disclose the annual financial plan in February. As of 2018, we also disclose a five-year financial forecast. We organise quarterly investors' meetings, the summaries of which are available for everyone to see. The goal is to be open to questions, to be transparent and to report to our investors on our activities. We explain our goals and trends to the public. We have public opinion on possible trends and changes in the regulatory and business environment. We disclose all information regarding their service to our clients. We appreciate that a large part of LHV's investors are also our clients.

Essentially, LHV is an Estonian company, based on domestic capital, focusing on maintaining and growing the assets of Estonian companies and people as its principal activity. We are part of the Estonian economy and society. We acknowledge our responsibility towards Estonia as a

community. Most of our sponsorship relationships (see below), as well as activities, are targeted in this direction. We also consider it essential to help Estonian producers and companies through our procurement and cooperation relations. LHV knowledgeably uses the products and services of Estonian entrepreneurs (from office coffee to Estonian design and work clothes).

We are also supporting LHV's employees in contributing to Estonian society and the country. A good example is that we maintain 100% salary for employees who participate in the reservist training of the Estonian Defence Forces

Natural Environment

The impact of LHV's activity on the natural environment is limited, arising from the form of organisation. LHV Group companies are located in two places of business, in the centre of Tallinn and Tartu. As a matter of principle, we do not manage a broad office network. We also offer our services through electronic channels, which, among other things, reduces the impact of our activities on the natural environment.

In recent years, we have made several decisions in the direction of having less environmental impact. In this way, we are in the process of reducing the use of paper in LHV's activities (the transition to paperless document management, the provision of electronic customer agreements and the so-called FollowMe Printing System solution). We separate the waste paper from other household waste. We have also replaced the use of water machines in our offices with drinking tap water.

To reduce the transport volumes, LHV has developed solutions for holding meetings through electronic communication, for example, administration between Tartu and Tallinn is mostly carried out by electronic means.

Work Environment

People working at LHV constitute a community that is the company's most important asset. LHV's goal is to be the best employer so that each person working in the company may contribute to the formation of the company and feel the importance of their own contribution.

We have developed various measures to get feedback from our employees and encourage in-house communication. Every two years, we organise employee satisfaction surveys (the survey of 2016 showed a record level of satisfaction); we consider proposals in management. To make in-house changes, we organise workshops for our employees. A managers' club comes together to develop and support managers and to receive feedback there-

from. We have introduced social media and the intranet as internal communication channels. Employees can give their input and contribute to the development of the company at meetings and strategy days. We collect feedback from the new employees at the end of the probationary period and take it into account in the organisation of their future work.

Becoming and being an owner of LHV is favoured. Among other things, there is an optional programme for managers and key employees. It is a long-term performance pay programme (which lasts for at least four years for managers), thereby integrating the interests of the owners and the performance pay receivers, and encouraging the reaching of risk-informed long-term results over short-term results.

We contribute to the individual development of our people. LHV's training department is guided by a person-centred approach, based on the personality needed to improve skills, motivation, qualifications, including providing training, teaching materials etc. If necessary, we offer internal LHV rotation. We have developed an internal training programme, including training and language training for new employees. The professional requirements and instructions are documented in the internal procedure rules that are available to everyone when necessary. For managers, we have worked out a development programme.

LHV contributes to the physical and mental health of its employees.

We support the sports initiatives of our employees (football, basketball, volleyball, squash and tennis) and offer sporting benefits (sports expenses, rehabilitation). We reimburse dental care.

An occupational healthcare theme has been well-organised at LHV. LHV is part of a health-promoting network of employers. We consider health care recommendations: we use eye-sensitive computer screens, 100% adjustable chairs and desks, and, if necessary, provide people with assistive devices. In the office, we have healthy and natural carpets with high wool content.

A working environment council operates at LHV, representing both the employer and the employees.

We emphasise occupational safety. All work surfaces have undergone risk analysis. On each floor of the offices, there are first aid assistants who have received the corresponding training, and those responsible for fire safety.

We try to take the personal needs of people working at LHV into consideration. For example, we provide students with part-time working hours or flexible working hours, if possible. Every tenth employee has started at LHV as a trainee, i.e. we offer students the opportunity to work. To balance work and family life, we prioritise family life: in the

case of a child being born, we also enable 15-day parental leave for fathers, we support employees financially at the beginning of a child's school, employees have the right to a shorter working day on a child's birthday, and, in the case of marriage, the right to a day off. We offer a childbirth allowance and a death grant.

We have been organising additional events for employees with families: family days, children's Christmas party.

In our Remuneration Policy, we are objective and do not consider the employee's personality. For positions, where required, we always check compliance with the entry criteria.

All of the above ensures that LHV's work environment is the best possible and takes into account employees' expectations.

Social Environment

LHV Group does all that it can to support activities and initiatives which contribute to the development of Estonian society. In our sponsorship projects, we prefer long-term and substantial cooperation. We are willing to contribute to the development of Estonian society and to the realisation of innovative ideas that help to make life in Estonia better.

Estonian culture

- Estonian Music Days – in 2016, we began supporting Estonia's oldest music festival, and present Estonia's new musical composition award.
- Enn Soosaar Foundation – with LHV's support, the awarding of an annual prize – named in honour of Enn Soosaar – "Ethical Essay-Writing Prize" began in 2012.
- Books of Estonian art – we support the publication of a book of an Estonian artist's works
- Music events – in 2017, LHV supported the Intsikurmu Festival in Põlva, the AcouSSION Live Festival in Central Estonia, the Südamemuusika Festival in Võrumaa and the cultural festival SÄRTS in Rapla.

Sports, healthy way of life

- The Estonian Football Association – LHV Pank has been the main sponsor of the Association and the Estonian National Team since 2010. In addition, we have created the support system for the LHV's Football Card that earned a record amount for Estonian football in 2017.
- Estonian Optimist Class Association – we have helped to ensure the sustainability of Estonian sailing for the last ten years. The activities of the association were revived in 2007 when active work

started again, sparking interest in sailing among children.

- Running events – we supported organising LHV's health run and walk series.
- We organise a corporate football event, the LHV Cup. It took place for the first time in 2017 with 100 amateur athletes participating. We plan to change it into a regular event.

Economy and Entrepreneurship of Estonia

- Estonian Entrepreneur of the Year competition – we have been one of the main sponsors of the Estonian Entrepreneur of the Year competition since 2012.
- The Gazelle movement – LHV is the sponsor of the Gazelle movement. The movement supports and acknowledges rapidly growing Estonian companies.
- Tallinn Restaurant Week – we have been supporting the ERL since 2011 when it first started. Tallinn Restaurant Week aims to popularise and promote eating out as an opportunity to obtain a cultural experience and socialise.
- Supporting the organising of Fintech Forum 2017.
- We supported the organising of tech conference Latitude59 for the second time in a row.
- We started to issue an export refund in cooperation with the Tallinn Creative Incubator.

We support many smaller local initiatives with our knowledge, LHV's thematic gifts, advice and performances by our people. We participate in fairs, cooperate with universities, also within the framework of internship programmes. We are a member of the Estonian Association of Information Technology, the Estonian Chamber of Commerce and Industry (ECCI) and the Estonian Employers' Confederation.

Market Environment

The business environment and banking market in Estonia are essential for us. We want to have an impact on Estonian entrepreneurship as well as on the financial behaviour of the people of Estonia towards smarter management through our best market-knowledge, activity and services.

Responsible lending

LHV cares about the business and living environment and makes an effort to minimise the negative environmental impact of its activities and processes.

The Group's credit policy stipulates that LHV strives to operate in a socially responsible manner, setting an example

for both its employees and the general public. Thus, any credit decision, for example, must be governed by the principle that LHV will not finance counterparties whose activities are liable to cause disproportionate damage to the environment or do not comply with the principles of social responsibility.

LHV takes special caution in financing tax transactions, so as not to violate the spirit and meaning of the laws on tax.

Private clients are financed based on the principle of responsible lending. It is also evident in the Group's high credit quality.

We are committed to responsible advertising in our marketing activities; we adhere to the advertising requirements for the financial sector and pay special attention to the advertising of credit products and investment services.

Prevention of money laundering and terrorism

We are exemplary in respecting all requirements for identifying clients and the parties related thereto by understanding their activities. We have increased the team engaged in the prevention of money laundering and terrorism. We cooperate with supervisory authorities.

Supporting Estonian business environment

The better the Estonian economy, the higher the quality of life. Banking is the circulation of the world economy. As a local financial group, we are aware of our role in supporting and promoting the economy. We bring capital from Estonian depositors by directing it to Estonian companies.

We contribute to the development of Estonian capital markets. We made an effort to set an example with the initial public offering of LHV's shares on the Tallinn Stock Exchange. Our institutional brokerage helps Baltic companies to engage funds from investors. LHV's pension funds are among the largest local institutional investors.

Pension funds investing in Estonia

LHV's pension funds have invested a considerable portion of the clients' pension assets in Estonia and the Baltic countries. We have invested in Estonian real estate, enterprises and forest. In 2017, LHV Varahaldus made positive investment decisions in Estonia in the amount of 170 million euros. We not only added capital to the economy but also created new investment instruments and opportunities by developing the Estonian capital market.

Our goal is to search for and analyse local investment opportunities. We are willing to create such opportunities ourselves.

LHV is the best market participant on Baltic stock exchanges

Our daily brokerage activities as well as our strive to set an example contribute to the functioning of Estonian capital markets. In 2017, LHV Pank received the "Member of the Year" award of NASDAQ Baltic stock exchanges. In our activities, we help our local companies to enter the stock exchanges. With targeted investor communication, we are showing an example of openness and transparency, and we would like to be a Baltic company with the best investor communication..

Open banking

We create and develop our services based on the principles of open banking. We aim at developing the Estonian business environment and B2B cooperation by enhancing partnership, innovation and transparency. We promote innovation and innovative solutions. For example, the salary payment opportunity brought to the market with the Tax and Customs Board is an initiative to reduce paperwork and simplify business operations.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of profit or loss and other comprehensive income

<i>(in thousands of euros)</i>	Note	2017	2016
Interest income		40 636	35 160
Interest expense		-5 133	-5 184
Net interest income	5,7	35 503	29 976
Fee and commission income		27 603	23 290
Fee and commission expense		-5 424	-4 104
Net fee and commission income	5,8	22 179	19 186
Net gains from financial assets measured at fair value	11,12	714	1 414
Foreign exchange rate gains/losses		265	-105
Net gains from financial assets	5	979	1 309
Other income		36	156
Other expense		-182	-69
Staff costs	9	-14 664	-12 976
Administrative and other operating expenses	9	-17 273	-15 940
Operating profit		26 578	21 642
Impairment losses on loans and advances	5,13	-3 153	-1 480
Share of result of associates	5	0	1
Profit before tax		23 425	20 163
Income tax expense	5,6	-1 248	-270
Net profit for the year	5	22 177	19 893
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale investments:			
Revaluation of available-for-sale financial assets	11	76	-17
Total profit and other comprehensive income for the year		22 253	19 876
Total profit attributable to:			
Owners of the parent		19 603	17 815
Non-controlling interest		2 574	2 078
Total profit for the year	5	22 177	19 893
Total profit and other comprehensive income attributable to:			
Owners of the parent		19 679	17 798
Non-controlling interest		2 574	2 078
Total profit and other comprehensive income for the year		22 253	19 876
Basic earnings per share (in euros)	25	0.77	0.72
Diluted earnings per share (in euros)	25	0.75	0.70

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Notes on pages 40 to 101 are an integral part of the consolidated financial statements.

Consolidated statement of financial position

<i>(in thousands of euros)</i>	Note	31.12.2017	31.12.2016
Assets			
Due from central bank	10	920 714	265 127
Due from credit institutions	10	26 312	33 300
Due from investment companies	10	14 186	8 073
Available-for-sale financial assets	11	775	799
Financial assets at fair value through profit or loss	12	55 859	75 391
Loans and advances to customers	13	732 043	537 641
Receivables from customers	14	9 800	3 479
Other financial assets	15	2 289	941
Other assets	15	1 516	1 391
Tangible assets	16	1 421	1 191
Intangible assets	16	4 327	4 500
Goodwill	6	3 614	3 614
Total assets	5	1 772 856	935 447
Liabilities			
Deposits from customers and loans received	17	1 542 929	777 581
Financial liabilities at fair value through profit or loss	12	2	209
Accounts payable and other liabilities	18	71 070	19 031
Subordinated debt	20	30 900	30 900
Total liabilities	5	1 644 901	827 721
Equity			
Share capital	21	25 767	25 356
Share premium	21	46 304	45 892
Statutory reserve capital	21	2 471	1 580
Other reserves	11,21	1 449	1 244
Retained earnings		44 071	28 335
Total equity attributable to owners of the parent		120 062	102 407
Non-controlling interest	6	7 893	5 319
Total equity		127 955	107 726
Total liabilities and equity		1 772 856	935 447

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Consolidated statement of cash flows

<i>(in thousands of euros)</i>	Note	2017	2016
Cash flows from operating activities			
Interest received		40 276	34 731
Interest paid		-5 415	-5 354
Fees and commissions received		27 601	23 291
Fees and commissions paid		-5 423	-4 105
Other income received		-133	86
Staff costs paid		-13 534	-12 956
Administrative and other operating expenses paid		-15 922	-14 898
Income Tax		-1 248	0
Cash flows from operating activities before change in operating assets and liabilities		26 202	20 795
Net increase/(decrease) in operating assets:			
Net increase/(decrease) in financial assets held for trading at fair value through profit or loss		278	-287
Loans and advances to customers		-202 857	-129 439
Mandatory reserve at central bank		-7 639	-1 598
Security deposits		-1 348	-1
Other assets		-765	-546
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers		785 454	191 312
Term deposits of customers		-25 052	-31 506
Loans received		6 000	0
Repayments of loans received		-779	-14 731
Financial liabilities held for trading at fair value through profit or loss		-207	120
Other liabilities		51 856	-918
Net cash from/(used in) operating activities		631 143	33 201
Cash flows from investing activities			
Purchase of tangible and intangible assets	16	-1 466	-1 603
Proceeds from sale of tangible and intangible assets	16	61	10
Acquisition of subsidiaries, net of cash acquired	6	0	-9 902
Proceeds from disposal and redemption of investment securities	11	100	3 608
Net changes of investment securities at fair value through profit or loss	12	19 962	35 292
Net cash from/(used in) investing activities		18 657	27 405
Cash flows from financing activities			
Paid in share capital (incl. share premium)	21	823	13 900
Paid dividends		-3 804	0
Net cash from financing activities		-2 981	13 900
Effect of exchange rate changes on cash and cash equivalents		254	-105
Net increase/(decrease) in cash and cash equivalents		647 073	74 401
Cash and cash equivalents at the beginning of the year	10	298 764	224 363
Cash and cash equivalents at the end of the year	10	945 837	298 764

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Consolidated statement of changes in equity

<i>(in thousands of euros)</i>	Share capital	Share premium	Statutory reserve capital	Other reserves	Retained earnings	Total	Non-controlling interest	Total equity
Balance as at 01.01.2016	23 356	33 992	895	551	11 205	69 999	3 241	73 240
Paid in share capital	2 000	11 900	0	0	0	13 900	0	13 900
Transfer to statutory reserve capital	0	0	685	0	-685	0	0	0
Share options	0	0	0	710	0	710	0	710
Profit for the year	0	0	0	0	17 815	17 815	2 078	19 893
Other comprehensive loss	0	0	0	-17	0	-17	0	-17
Total profit and other comprehensive income for 2016	0	0	0	-17	17 815	17 798	2 078	19 876
Balance as at 31.12.2016	25 356	45 892	1 580	1 244	28 335	102 407	5 319	107 726
Balance as at 01.01.2017	25 356	45 892	1 580	1 244	28 335	102 407	5 319	107 726
Paid in share capital	411	412	0	0	0	823	0	823
Transfer to statutory reserve capital	0	0	891	0	-891	0	0	0
Dividends paid	0	0	0	0	-3 804	0	0	-3 804
Share options	0	0	0	129	828	957	0	957
Profit for the year	0	0	0	0	19 603	19 603	2 574	22 177
Other comprehensive loss	0	0	0	76	0	76	0	76
Total profit and other comprehensive income for 2017	0	0	0	76	19 603	19 679	2 574	22 253
Balance as at 31.12.2017	25 767	46 304	2 471	1 449	44 071	120 062	7 893	127 955

Additional information on equity is provided in Note 21.

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Notes to the consolidated financial statements

NOTE 1 General information

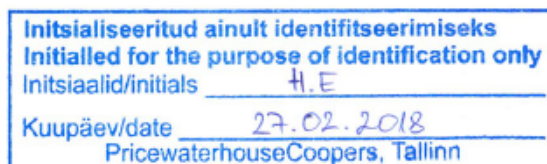
These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2017 for AS LHV Group and its subsidiaries AS LHV Pank, AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus, OÜ Cuber Technology and UAB Mokilizingas (hereinafter referred together as "the Group". AS LHV Group holds 50% + 1 share interest in UAB Mokilizingas and 65% interest in LHV Finance through AS LHV Pank.

AS LHV Group is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. AS LHV Group is a holding company, whose subsidiary AS LHV Pank provides banking, financial advisory and securities brokerage services to customers in Estonia. There are offices for client servicing in Tallinn and Tartu (Vilnius office was closed 31.03.2017). AS LHV Finance offers hire-purchase services to merchants and consumer finance. AS LHV Varahaldus offers fund management services for pension funds and other funds to clients

in Estonia. UAB Mokilizingas offers consumer finance and hire purchase services in Lithuania. As at 31.12.2017 the Group employed 365 full-time employees, incl. 16 non-active (31.12.2016: 348 employees, incl. 14 non-active).

The consolidated annual report (incl. financial statements) was approved by the management board on 22th of February 2018. Rain Lõhmus, who owns 25.14% of the voting rights and Andres Viisemann, who owns 9.87% of the voting rights (see also Note 21), 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 all the consolidated group entities, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as: “financial assets and liabilities at fair value through profit or loss”, including derivatives and assets available for sale.

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

The financial year started at 1 January 2017 and ended at 31 December 2017. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new 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 2017. 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 2017.

Disclosure initiative - Amendments to IAS 7 (effective for annual periods beginning on or after 1 January 2017. The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities. Group has disclosed the required information in accordance with the new standard in note 20.

There are no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on or after 1 January 2018 that have a material impact on the Group.

(b) New accounting pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2018, and which the Group has not early adopted.

IFRS 9, Financial instruments (effective for annual periods beginning on or after 1 January 2018). Earlier application is permitted but LHV does not intend to early adopt the standard. LHV does not either intend to restate the comparative figures for 2017 in the annual report 2018 due to IFRS 9. Key features of the new standard are as follows:

- Financial assets are required to be classified into three measurement categories (AC)
- assets to be measured subsequently at amortised cost
- assets to be measured subsequently at fair value through other comprehensive income (FVOCI)
- assets to be measured subsequently at fair value through profit or loss (FVPL).

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

Investments in equity instruments are always measured at fair value. However, management can make an irrevocable

election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

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

There were no significant changes in the measurement of financial instruments compared to IAS 39. No significant impact is thus expected on LHV's financial position, financial performance or equity in the period of initial application.

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

One important driver for size of provisions under IFRS 9 is the trigger for transforming an asset from stage 1 to stage 2. The transition to IFRS 9 brought the change in loan provisions in the amount of EUR 749 thousand. For assets to be recognized going forward, changes to the lifetime Probability of Default (PD) will be used as the trigger. In addition customers with forbearance measures and customers with payments more than thirty days past due will also be trans-

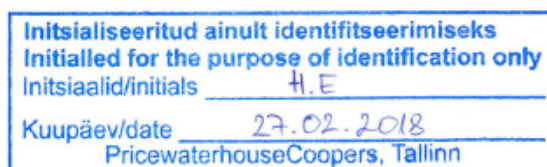
ferred to stage 2.

The provisions under IFRS 9 will be calculated as the exposure at default times the probability of default times the loss given default. For assets in stage 1 this calculation will only be based on the coming 12 months, while it for assets in stage 2 will be based on the expected lifetime of the asset

For assets where there has been a significant increase in credit risk, LHV currently holds provisions based on the losses estimated to occur during the period between the date when the loss event occurred and the date when the loss event is identified on an individual basis, while IFRS 9 will require provisions equal to the lifetime expected loss. When calculating lifetime losses under IFRS 9, including the staging assessment, the calculation should be based on probability weighted forward-looking information.

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

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



The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on 1 January 2018:

in thousands of euros	Note	Measurement category		Carrying value per IAS 39(closing balance at 31 December 2017)	Effect Remeasurement	Carrying value per IFRS 9 (opening balance at 1 January 2018)
		IAS 39	IFRS 9			
Due from credit institutions	10	L&R	AC	26 312	0	26 312
Due from investment companies	10	L&R	AC	14 186	0	14 186
Due from central bank	10	L&R	AC	920 714	0	920 714
Total cash and cash equivalents				961 212		961 212
Debt instruments	11	AFS	FVOCI	555	0	555
Debt instruments	12	FVTPL	FVTPL	55 859	0	55 859
Total debt instruments				56 414		56 414
Equity instruments	11	AFS	FVOCI	220	0	220
Total equity instruments				220		220
Loans and advances to customers	13	L&R	AC	732 043	-749	731 294
Receivables from customers	14	L&R	AC	9 800	0	9 800
Other financial assets	15	L&R	AC	2 289	0	2 289
Total other financial assets				1 761 978		1 761 229

There were no reclassifications because the financial assets are in the same classification category under both IAS 39 and IFRS 9.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. As at 31 December 2017, the Group had long-term commitments from operating lease contracts in the amount of EUR 2 152 thousand (Note 19). Starting from 1 January 2019, the corresponding amount will be recognized on the Group's balance sheet as assets and liabilities, thus increasing the balance sheet total of the Group.

IFRS 15, Revenue from contracts with customers (effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that

revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. It will have the largest impact on AS LHV Varahaldus, where we need to capitalize sales costs from previous years and amortize over the expected lifetime of the customer contract, which in the case of pension funds is above 20 years. This effect will significantly increase LHV Varahaldus own funds at the moment of adoption of this IFRS standard. As at 1 January 2018, the Group's retained earnings through LHV Varahaldus will be increased by the sales costs incurred and capitalized until the end of 2017 in the amount of EUR 10 618 thousand and the assets will be increased in the same amount. Starting from 1 January 2018, the sales expenses will be recognized as intangible assets and in the income statement, the sales expenses will be replaced with depreciation costs from client contracts.

Revenue from Contracts with Customers - Amendments to IFRS 15 (effective for annual periods beginning on or after 1 January 2018).

The amendments do not change the underlying principles

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

Prepayment Features with Negative Compensation, Amendments to IFRS 9 (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU) The amendments enable measurement at amortised cost of certain loans and debt securities that can be prepaid at an amount below amortised cost, for example at fair value or at an amount that includes a reasonable compensation payable to the borrower equal to present value of an effect of increase in market interest rate over the remaining life of the instrument. In addition, the text added to the standard's basis for conclusion reconfirms existing guidance in IFRS 9 that modifications or exchanges of certain financial liabilities measured at amortised cost that do not result in the derecognition will result in a gain or loss in profit or loss. Reporting entities will thus in most cases not be able to revise effective interest rate for the remaining life of the loan in order to avoid an impact on profit or loss upon a loan modification. The Group intends to apply the amendment to the standard together with IFRS 9, after it has been adopted by the European Union. The guidance for changing the standard has been taken into account when assessing whether the cash flows from financial assets meet SPPI requirement.

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

2.2 Consolidation

The 2017 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank, AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus, UAB Mokilizingas and OÜ Cuber Technology. AS LHV Group holds 50% + 1 share interest in UAB Mokilizingas and 65% interest in LHV Finance through AS LHV Pank.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group

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

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

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is 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 consol-

dated 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 27), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

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

2.3 Associates

An associate is an entity over which the Group has significant influence but which it does not control. Generally, significant influence is assumed to exist when the Group holds between 20% and 50% of the voting rights. The Group does not have any associate as at 31.12.2017 and 31.12.2016

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognized at cost which is thereafter adjusted for post-acquisition changes in the investor's share of the investee's equity (changes both in the profit/loss of the associate as well as other equity items) and with elimination or depreciation/amortisation of the differences between fair values and carrying amounts of the investee's assets, liabilities and contingent liabilities as determined in the purchase analysis. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of impairment of the assets.

When the Group's share of losses in the associate accounted under the equity method exceeds the carrying amount of the associate, the carrying amount of the investment is reduced to zero and such long-term loans granted to the associate that in substance form a part of the investment are written down. Further losses are carried off-bal-

ance sheet. When the Group has guaranteed or incurred obligations on behalf of the associate, the respective liability as well as the loss under the equity method are recorded in the statement of financial position. Other receivables from the associate are recorded at amortised cost less a provision for impairment.

An investment in the assets and liabilities of the acquired associate and goodwill that arose on acquisition is presented as a net amount in the statement of financial position line "Investments in associates".

At each balance sheet date, it is assessed whether there is any indication that the recoverable amount of the investment has fallen below its carrying amount. If any such indications exist, an impairment test is performed. To determine the recoverable amount of the investment, the principles described in section 2.9 are used.

2.4 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of entities in the Group is euro.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the balance sheet date. Non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the fair value measurement date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of profit or loss under the line "Foreign exchange rate gains/losses". Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the statement of profit or loss under the line "Foreign exchange rate gains/losses".

2.5 Cash and cash equivalents

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

2.6 Financial assets

The Group classifies its financial assets into the following categories:

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

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

Financial assets

IAS 39 category	Class (applied by the Group)		31.12.2017	31.12.2016
Loans and receivables	Loans and advances to banks and investment companies		961 212	306 500
	Loans and advances to customers	Loans to legal entities	542 913	415 637
		Loans to individuals	189 130	122 004
	Other receivables		9 800	3 479
	Other financial assets		2 289	941
Financial assets at fair value through profit or loss	Securities held for trading	Shares	430	408
		Listed bonds	49 138	63 817
		Derivatives	30	250
	Designated as at fair value through profit or loss upon initial recognition		Equity securities	6 261
Available-for-sale financial assets	Investment securities	Listed bonds	555	579
		Unlisted shares	220	220

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

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

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

Regular way purchases and sales of financial investments are recognised at the trade date in the statement of financial position.

Financial instruments included in this category are initially recognised at fair value; transaction costs are taken directly to the profit or loss. After initial recognition, financial assets in this category are measured at fair value. Interest income is calculated based on financial assets' amortised cost using the effective interest rate method and is recorded within interest income in the statement of profit or loss. Changes in fair values of these financial assets are recog-

nised consistently, either as a profit or loss in the statement of profit or loss of the reporting period under "Net gains/losses from financial assets measured at fair value". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognised in the line "Dividend income" of the statement of profit or loss when the right to receive dividends by the Group is established.

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

Derivative financial instruments (futures, forward, swap and option contracts) are initially recognised in the statement of financial position at fair value at the trade date and are subsequently valued at fair value through profit or loss. If

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

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

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

Refer to Note 3.6 for fair value of financial assets.

(b) Held-to-maturity financial investments

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

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

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

(c) Available-for-sale financial assets

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

(d) Loans and receivables

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

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

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

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

The impairment of loans and advances is assessed in accordance with the principles described in clause 2.7.

2.7 Impairment of financial assets carried at amortised cost

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

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

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

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

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

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

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

Uncollectible assets are written off against the related impairment loss provision after all the necessary proce-

dures to recover the asset have been completed and the amount of the loss has been determined. Subsequent receipts of amounts previously written off are recognized in the income statement as a deduction from impairment charges.

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

2.8 Tangible fixed assets

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

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

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

2.9 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis. The annual amortisation rate for purchased licenses is 33%. The amortisation method for client agreements is diminishing balance method. The annual amortisation rate for purchased client agreements is 12% of the residual value of those assets. At each balance sheet date, the appropriateness of amortization rates, methods and residual values is assessed. 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.

2.10 Impairment of assets

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

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

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

Impairment losses are recognized in profit or loss.

At each following balance sheet date, assets that have been written down are assessed to determine whether their recoverable amount has increased (except for impairment losses of goodwill that are not reversed). If the impairment test indicates that the recoverable amount of an asset or asset group (cash-generating unit) has increased above its carrying amount, the previous impairment loss

is reversed up to the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognised for the asset in prior years. Reversals of impairment losses are recognized in the income statement as a reduction of the impairment loss.

2.11 Financial guarantees and performance guarantees

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

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.

2.12 Financial liabilities

The Group classifies financial liabilities to two categories:

- a) financial liabilities measured at fair value through profit or loss
- b) financial liabilities measured at amortised cost

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

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

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

2.13 Payables to employees

Payables to employees include unpaid salary accruals and a vacation pay accrual calculated in accordance with employment contracts and the laws in force in employee residential country as at the balance sheet date. The liability related to the payment of a vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the statement of financial position and as staff costs in the statement of profit or loss.

Social security tax includes payments to the state pension fund. Group has neither existing legal nor constructive obligations to make pension or similar payments supplementary to social security tax.

2.14 Share-based payments

AS LHV Group operates a share-based compensation plan, under which the company receives services from group employees as consideration for equity instruments (options) of LHV Group. The fair value of the employee services received in exchange for the grant of the options is recognised during the share-based compensation program as group's staff expense and as an increase in the equity (other reserves). The total amount to be expensed is determined by the fair value at the time of issuing the options. The fair value of the options granted:

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

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

When the options are exercised, LHV Group issues new shares.

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

2.15 Provisions and contingent liabilities

Liabilities arising from an obligating event before the balance sheet date that have either a legal basis or that have arisen from the Group's current operating practice (legal or constructive obligation) that require probable outflow of resources, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the statement of financial position. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the statement of financial position in the amount which according to the management is

necessary as at the balance sheet date for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and an expense from the change in the carrying amount of provisions are included within expenses in the reporting period. Provisions are not set up to cover future operating losses.

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

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

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

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

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

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

2.17 Revenues and expenses

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

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

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

Interest income and expense is recognised in the statement of profit or loss for all financial instruments carried at amortised cost using the effective interest method or for debt securities measured at fair value through profit or loss. Transaction costs of debt securities measured at fair value through profit or loss is recognised as part of effective interest method. Loan commitment fees that are directly related with the undrawn portion of the loan commitment and which changes based on the portion of the unused commitment are recognised as interest income during the period when draw down is available.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instru-

ment to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future impairment losses. The calculation includes all significant fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flows discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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

2.18 Asset management services

The Group is engaged in providing asset management services (Note 22). 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.

2.19 Leases - Group as the lessee

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

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

2.20 Taxation and deferred income tax

Corporate income tax in Estonia

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying amounts of assets and liabilities and no deferred tax assets or liabilities arise. Instead of the income tax payable on

profits, the Estonian entities pay corporate income tax on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. The tax rate from 01.01.2015 is 20/80 on net dividends paid. The corporate income tax arising from the payment of dividends is recognised as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

Starting for the second quarter of 2018, credit institutions will be subject to changes in taxation, the result of which is, that credit institutions will start paying a 14% advance tax on income.

Corporate income tax in other countries

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

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

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the consolidated statement of financial position. The main temporary differences arise from depreciation and tax loss carry-forwards. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry-forwards will be 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.

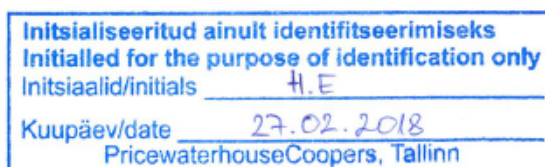
A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the statement of financial position. The maximum amount of income tax payable, which would arise from paying out the retained earnings as dividends, is disclosed in the Note 21 to the financial statements.

2.21 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the 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 3.11.

2.22 Statutory reserve capital

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

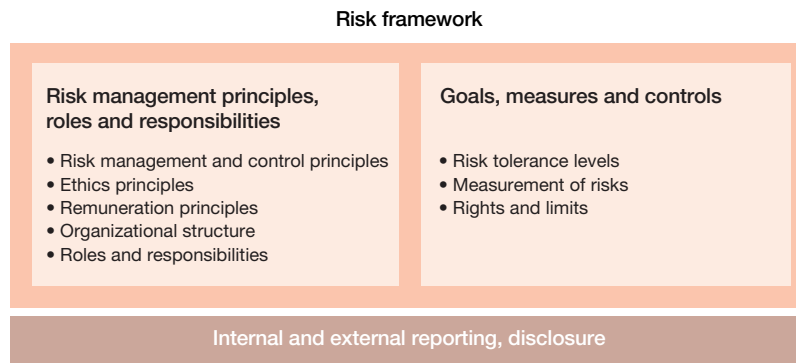


NOTE 3 Risk management

Risk is defined as a potential negative deviation from expected financial results. LHV encounters several risks in its day-to-day operations. The objective of risk management at LHV is to recognise these risks, to measure them appropriately, to manage and to report them. More broadly, the aim of risk management is to increase the value of LHV by minimising losses and reducing the volatility of results. Risk management at LHV is based on a strong risk culture and is built on the principle of three lines of defence where the first line of defence, the business units, are responsible for taking risk and for day-to-day management. The second line of defence, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of

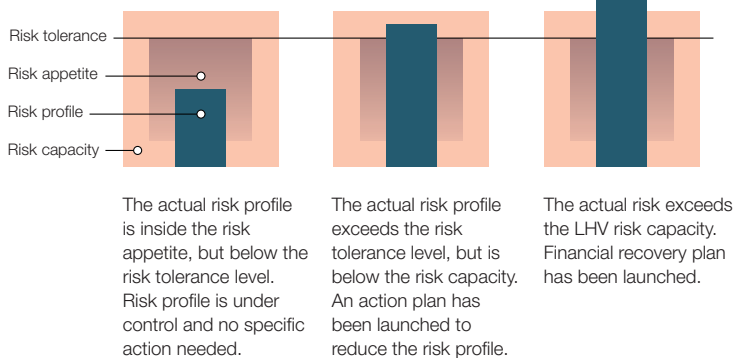
defence, the internal audit, conducts independent supervision over the entire group. Risk management principles, requirements and areas of responsibility are described in risk management policy. The principles and objectives of capital management are described in internal documents (capital management policy and capital objectives). More detailed risk management processes are described in the policies of the respective field.

Under the leadership of the Risk Management Unit, LHV has developed a group-wide risk appetite framework, approved by the Supervisory Board. The framework includes quantitative risk tolerance levels by main risks.



The risk appetite reflects LHV's willingness to take risks in order to achieve its goals. LHV has defined the limit of the risk appetite as risk tolerance – the maximum risk that LHV is willing to take in order to achieve its goals. Risk capacity is defined as the greatest

risk that LHV can withstand. The figure below illustrates the three different risk profile levels to levels of risk tolerance and briefly describes the activities in these situations.



Risk capacity – the maximum damage that LHV can withstand. Financial recovery plan has been launched to overcome the risk.

Risk tolerance – the maximum risk that LHV is prepared to take to achieve its goals. When exceeding the risk tolerance level the activities at enterprise level will be launched to reduce the risk profile.

Risk appetite is the recommended level of risk that LHV plans to take to implement its plans and goals. Risk appetite reflects the desired risk profile. The maximum risk appetite is defined as a risk tolerance.

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

As seen from the figure, if the actual risk profile remains within the limits of the risk appetite, it is a foreseeable situation and no further action is needed. If the actual risk profile exceeds the risk tolerance level, an action plan is put in place to reduce the risk

profile. It is also necessary to inform the Supervisory Board in that case. The management of LHV risk profile and ensuring it stays within the limits of the risk appetite is the responsibility of the first line of defence, while independent monitoring and reporting is the responsibility of the risk

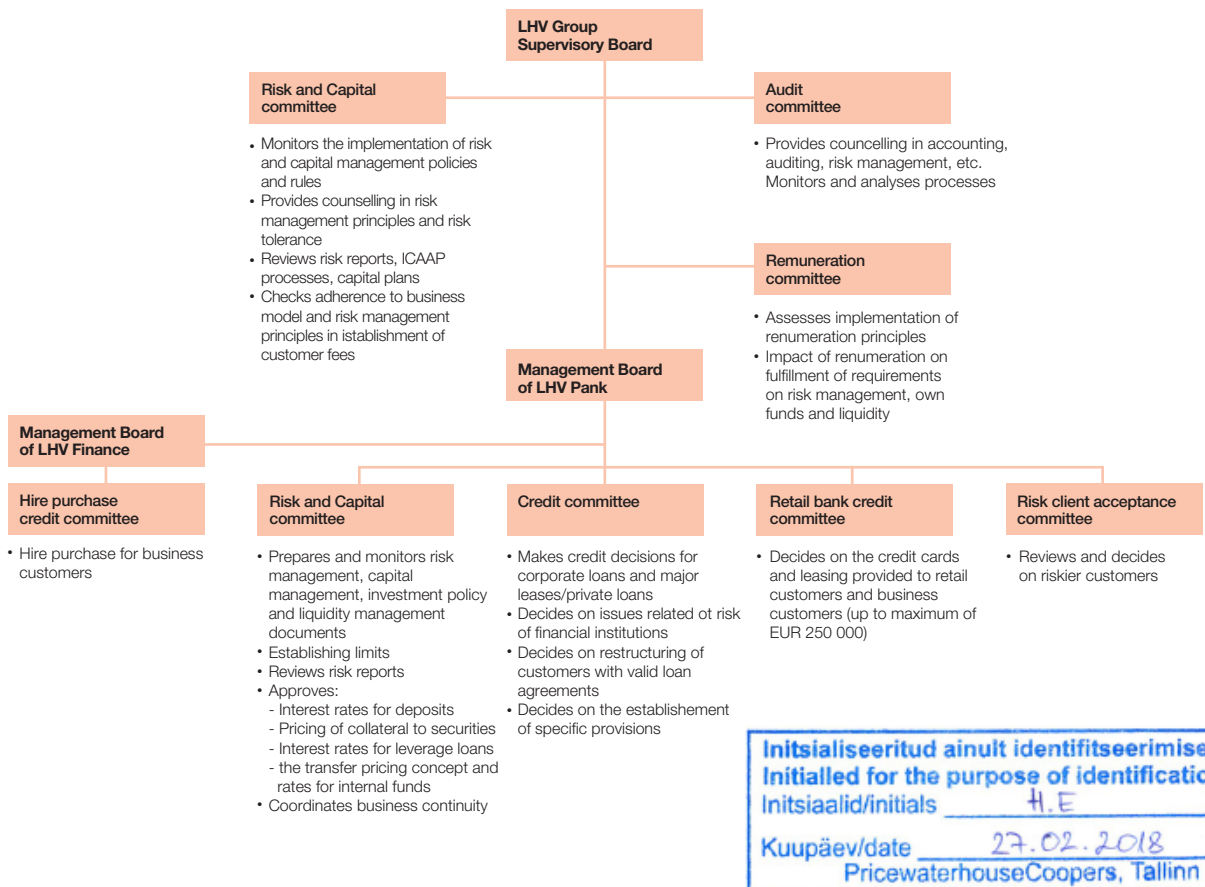
management unit. Within the framework of the financial recovery plan, LHV has developed early warning indicators with thresholds and corresponding measures.

In accordance with risk management policy, the risk tolerance levels must be specified at minimum for capital risk,

credit risk, market risk, operation risk, liquidity risk and anti-money laundering risk. The levels of risk tolerance are described in each of the respective risk policies, which are approved at Supervisory Board level. Detailed instructions and guidelines are described in the policies.

Approver	Document	Risk appetite							
Supervisory Board of the Group	Risk management policy	List in which risk categories the risk tolerance must be assigned							
Supervisory Board of the Group	<table border="1"> <tr> <td>Capital policy and targets • Min. capital adequacy targets • Leverage</td> <td>Credit policy • The average credit loss throughout the cycle</td> <td>Operational risk policy • Losses from the op. risk • Incidents</td> <td>AML policy • Proportion of non-resident deposits</td> <td>Compliance policy</td> <td>Liquidity risk policy • LCR • NSFR</td> <td>Market risk policy • Losses % to capital</td> </tr> </table>	Capital policy and targets • Min. capital adequacy targets • Leverage	Credit policy • The average credit loss throughout the cycle	Operational risk policy • Losses from the op. risk • Incidents	AML policy • Proportion of non-resident deposits	Compliance policy	Liquidity risk policy • LCR • NSFR	Market risk policy • Losses % to capital	Specific risk tolerance levels
Capital policy and targets • Min. capital adequacy targets • Leverage	Credit policy • The average credit loss throughout the cycle	Operational risk policy • Losses from the op. risk • Incidents	AML policy • Proportion of non-resident deposits	Compliance policy	Liquidity risk policy • LCR • NSFR	Market risk policy • Losses % to capital			
Management Board / manager	<table border="1"> <tr> <td>Guides, rules</td> <td>Guides, rules</td> <td>Guides, rules</td> <td>Guides, rules</td> <td>Guides, rules</td> <td>Guides, rules</td> <td>Guides, rules</td> </tr> </table>	Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules	More detailed risk tolerance levels if needed
Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules	Guides, rules			

LHV has a system of committees and decision-making competencies. The functions of the main committees are shown in the figure below.



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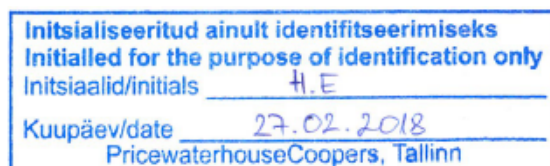
As part of the risk policy framework, LHV has developed a risk reporting process. The table below gives an overview of the main reports prepared by the risk management

department, which are presented to the governing bodies and their reporting frequency.

Governing body	Members	Title of the report	Report frequency	Coverage of risks
Supervisory board of the Group	All the members of the supervisory board of the Group	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Compliance overview	Once a year	Compliance risks
		ICAAP report, ICAAP macroscenario, SREP report	Once a year	All the risks
Supervisory board of the LHV Pank	All the members of the supervisory board of the Pank	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Risk management overviews	Once a year	All the risks
		ICAAP report, ICAAP macroscenario, SREP report	Once a year	All the risks
Risk and Capital Committee of the Group	Rain Lõhmus, Andres Viisemann, Tiina Mõis	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Problematic loan clients	Quarterly	Credit risk
Audit committee	Kristel Aarna, Urmas Peiker, Tauno Tats	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
CEO of the Group, The Chairman of the Supervisory Board of the Pank	Madis Toomsalu	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
Risk Capital Committee of the Pank	Management board members of the Pank	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
		Business continuity test and planning	After every test	Operation risks
		Risk self-assessment	After assessment	Operation risks
Management Board of the Pank	Management board members of the Pank	Compliance overview	Once a year	Compliance risks
		Anti-money laundering overview	Once a year	Anti-money laundering risks
		Monitoring of legislation	Monthly	Compliance risks
		Compliance audit	After every audit	Compliance risks
		ICAAP report, ICAAP macroscenario, SREP report	Once a year	All the risks

LHV has established a risk management policy, which sets the risk management framework. Separate policies are set for major risk categories. The risks are analysed and monitored and reported to different levels on a monthly and quarterly basis. The risk report, which is compiled on a monthly basis, presents information by type of risk. The risk report also includes information on capital adequacy. It

allows getting a regular overview of all the important risks at the company level and to monitor their development, identify bottlenecks, and react promptly.



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 as capital. The amount of capital that the Group managed as at 31.12.2017 was EUR 141 609 thousand (31.12.2016: EUR 123 907 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

(in thousands of euros)

	31.12.2017	31.12.2016
Paid-in share capital	25 767	25 356
Share premium	46 304	45 892
Statutory reserves transferred from net profit	2 471	1 580
Other reserves	36	-40
Accumulated profit/(deficit)	24 468	10 517
Intangible assets (subtracted)	-7 940	-8 114
Net profit for accounting period	19 603	17 816
Total Tier 1 own funds	110 709	93 007
Subordinated debt	30 900	30 900
Total Tier 2 own funds	30 900	30 900
Total net own funds	141 609	123 907

The net capital of a credit institution at any time shall be equal to or exceed the minimum amount of share capital prescribed in the Credit Institutions Act (EUR 5 million). In 2014, the capital of banks and investment firms in the European Union became subject to a 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.

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) and 0.92% (imposed by Estonian Central Bank), respectively. As the aforementioned buffers are incremental to the Tier 1 and the total baseline capital requirements, the minimum Tier 1 requirement in Estonia is 9.42% and the total capital requirement is 11.42%. The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions. An overview of capital requirements is provided in the table below:

Requirements	CET1	Tier1	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%

Capital requirements valid until August 2017:

Capital requirements	CET1	Tier1	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 August 2016:

Capital requirements	CET1	Tier1	CAD
Base capital requirement	4.50%	6.00%	8.00%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemic risk buffer	2.00%	2.00%	2.00%
Capital requirements total	9.00%	10.50%	12.50%

Each year, the Group's supervisory board confirms the goals of capitalization and the target level of capital adequacy to cover potential risks arising from fast growth. Each year, an internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential internal capital needs in addition to regulatory capital requirements. Internal capital adequacy targets for 2017 are as follows:

- Tier 1 capital adequacy 12.29%
- Total capital adequacy 15.06%

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. LHV uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement.

The own funds of LHV Varahaldus as the fund manager need at any given time exceed the minimum amount of share capital laid down in the Investment Funds Act (EUR 3 million). The net own funds of a fund manager, who managed pension funds with the market value of over EUR 125 million, had to be till January 10th 2017 at least EUR 2.5 million and 1% of the market value of managed pension funds, which exceeds EUR 125 million. In addition, the fund manager had to maintain additional own funds equal to 0.02% of the portion of the market value of all managed funds, which exceeds EUR 250 million. Starting from January 10th 2017, the net own funds of a fund manager have to be 0.5% of the market value of managed pension funds with the market value less than EUR 1 billion and 0.02% of the market value of managed pension funds with the market value more than EUR 1 billion.

The Group and its subsidiaries have complied with all capital requirements during the financial year and in previous years.

3.2 Credit risk

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

3.2.1 Distribution of credit risks

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

- | | |
|--|---|
| <ul style="list-style-type: none"> a) debt securities and derivatives b) loans and advances to central bank and credit institutions (referred to as "banks" in the tables) and investment companies c) leveraged loans (loans secured by debt or equity securities), incl. repo loans d) corporate loans and overdraft | <ul style="list-style-type: none"> e) retail loans f) consumer loans without collateral g) credit cards and overdraft to individuals h) leasing i) hire-purchase j) mortgage loans k) financial guarantees l) unused loan commitments |
|--|---|

Maximum exposure to credit risk

<i>(in thousands of euros)</i>	Note	31.12.2016	31.12.2015
Loans and advances to banks and investment companies	10	961 212	306 500
Available for sale financial assets	11	555	579
Financial assets at fair value (debt securities)	12	49 168	64 067
Loans and advances to customers	13	732 043	537 641
Receivables from customers	14	9 800	3 479
Other financial assets	15	2 289	941
Total financial assets		1 755 067	913 207
Exposures related to off-balance sheet items, excluding performance guarantees and letters of credit	23	185 571	137 962
Total maximum exposure to credit risk		1 940 638	1 051 169

For all loan products, except leverage and repo loans, LHV uses either rating or scoring systems to assess customer credit risk, as outlined in the table below. All credit products have application models, whose outputs are used for

making credit decisions. There are also portfolio scoring models developed and models to cover the dimensions of Loss Given Default (LGD) and Credit Conversion Factor (CCF).

Client type	Segment	Definition	Application	PD Portfolio	LGD	CCF
Corporate clients	Large companies	Legal entities, exposure > 250 EUR thousand	Rating methodology		-	-
Retail clients	SME	Legal entities, exposure < 250 EUR thousand	Internal model	Internal model	Internal model	Internal model
	Mortgage loans	Mortgage loans to private persons	Internal model	Internal model	Internal model	Internal model
	Retail loans in Estonia	Retail loans to private persons	Internal model	Internal model	Internal model	Internal model
	Retail loans in Lithuania	Retail loans to private persons	Internal model	Internal model	Internal model	Internal model

a) Debt securities and derivatives

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

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

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

Ratings distribution (in thousands of euros)	FVTPL					Total 31.12.2017
	Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	AFS	
AAA	0	29 869	0	0	0	29 869
A- to A+	18 223	0	1 046	0	555	19 824
Non-rated	0	0	0	30	0	30
Total (Note 11,12)	18 223	29 869	1 046	30	555	49 723

Ratings distribution (in thousands of euros)	FVTPL					Total 31.12.2016
	Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	AFS	
AAA	5 209	33 904	0	0	0	39 113
A- to A+	19 558	1 942	1 104	0	579	23 183
BBB- to BBB+	1 050	0	1 050	0	0	2 100
Non-rated	0	0	0	250	0	250
Total (Note 11,12)	25 817	35 846	2 154	250	579	64 646

b) Loans and advances to banks and investment companies

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. 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 most conservative rating is used. The positions are held as follows:

Rating (in thousands of euros)	31.12.2017		31.12.2016		Total 31.12.2016
	Credit institutions	Investment companies	Credit institutions	Investment companies	
Central bank (The Bank of Estonia)	920 714	0	265 127	0	265 127
AA- to AA+	2 321	0	9 470	0	9 470
A- to A+	8 856	0	7 195	0	7 195
BBB to BBB+	6 294	14 116	11 454	7 919	19 373
Non-rated	8 841	70	5 181	154	5 335
Total (Note 10)	947 026	14 186	298 427	8 073	306 500

c) Leveraged loans

The Bank issues margin loans secured by debt or equity securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account, and on the general limit set by the Bank, which is currently EUR 100 thousand (or an equivalent in a foreign currency) per customer. Granting loans above the threshold assumes an analysis of the portfolio offered as collateral by the customer and the decision is within the competence of the Credit Committee. The list of acceptable marketable financial instruments and the levels of the required collateral are published on the Bank's website www.lhv.ee. The risks arising from financial leverage are mitigated by constant monitoring of the market values of the financial instruments required as collateral. The Group has set sufficiently conservative limits to the ratio of the loan and the collateral assets value. When the value of collateral assets falls

below the established limit, the Bank is entitled to demand a transfer of additional collateral to the account or pay off the loan in the customer's account without the customer's trade order, liquidating the collateral asset for this purpose. See Note 3.2.2. for more detailed information on the credit quality of loans.

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

The Bank had no impaired leveraged loans as at 31.12.2017 and 31.12.2016.

d) Corporate loans and overdraft

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

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

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

After issuing the loan, follow-up monitoring of each customer's financial position is performed at least once a quarter. All client ratings are reviewed at least once a year. See Note 3.2.2. for more detailed information on the credit quality of loans. As at 31.12.2017, the group-based impairment

reserve makes up 0.5% of corporate loans and overdraft and the related interest receivables (31.12.2016: 0.5%).

e) Retail loans

In 2016, 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. In addition to micro loans, the retail banking segment also includes other corporate credit commitments in the amount of up to EUR 250 thousand. Credits below EUR 250 thousand are analysed with a more cost-efficient scoring process. The scoring is carried out at the request of the loan and it is one of the criteria for issuing the loan. Financial data and information on payment behaviour of the company is used when calculating the probability of default (PD). The structure of assets and liabilities are taken into account, also the profitability and cash flow ratios. Regarding the guarantees, the same principles apply as for business loans.

Retail loans of legal entities are included in the retail loans financial statement line item. As at 31.12.2017, the group-based impairment reserve makes up 1.1% of retail loans and related claims (31.12.2016: 1.4%).

f) Consumer loans without collateral

As consumer loans are homogeneous loans, provisions for potential credit loss level is calculated based on historical performance of these homogeneous loans and applied to current portfolio at the balance sheet date. For the purpose of recognition of group-based impairment losses, the receivables are grouped into subclasses on the basis of homogeneous credit risk features, considering customers' payment practice, past due time and the time passed from initiation of proceedings by the bailiff. In Estonia, the Group has entered into agreements where overdue consumer loans are sold – usually when loans reaching overdue of 70 days. Similar contract was signed also in Mokilizingas in Lithuania in third quarter. For the receivables that have been grouped, the amount of the impairment loss is the multiple of the carrying amount of the receivables in the group and the group's percentage rate of impairment loss. The framework is based on the method of calculating the probability of default (PD), loss given default (LGD) and exposure at default (EAD).

Consumer loans are classified as performing (less than 90 days overdue and are not terminated), non-performing (more than 90 days overdue and/or terminated) and doubtful (original loan schedule has expired and there has been no cash flows received for continuous period of 6 months, fraud case, etc.). Loss rates are calculated from

the past historical data for defaults and full history of recoveries. In Lithuania due to default rate volatility and uncertain data quality a conservative buffer of 20% shall be imposed'.

PD and LGD values are updated at least once a year with new historical data in order to maintain adequate provision levels on portfolio. If necessary, additional impairments will be made in the statement of financial position. If non-performing or doubtful loan recovery is neither economical nor practical to continue, the loan is written off as irrecoverable.

As at 31.12.2017, the group-based impairment reserve makes up 3.4% of consumer loans and the related interest receivables (31.12.2015: 5.8%).

g) Credit cards

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

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework is based on PD, LGD and EAD indicators. As of 31 December 2017, the group-based impairment reserve amounted to 1.9% of credit card loans and related receivables (31.12.2016: 2.4%).

h) Leasing

The Bank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using scoring models, which mainly consists of characteristics described for consumer loans. The leasing provisioning is done based on Leasing scoring models. As of 31 December 2017, the group-based impairment reserve amounted to 0.3% of leasing portfolio (31.12.2016: 0.5%).

In Lithuania, leasing products are offered to individuals as well as legal entities. The creditworthiness of customers is assessed by using scoring models, which mainly consists of characteristics described for consumer loans.

Provision for finance lease is calculated using following methodology: net book value of portfolio minus net present value of portfolio. Net present value is calculated from future cash flows discounted by effective interest rate and adjusted for coefficient of possible losses. In addition to homogenous impairment, some problematic loans are assessed individually based on the market/distressed sale value of the underlying assets.

As of 31 December 2017, the group-based impairment

reserve amounted to 5.3% of leasing portfolio (31.12.2016: 6.5%).

i) Hire-purchase

Group offers hire-purchase service for merchants through its subsidiary LHV Finance in Estonia. The creditworthiness of customers is assessed by using scoring models, which mainly consist of characteristics described for consumer loans. Similarly, to other homogenous portfolios provisions are made based on the same framework as consumer loans. As of 31 December 2017, the group-based impairment reserve amounted to 1.2% of hire-purchase portfolio (31.12.2016: 1.0%).

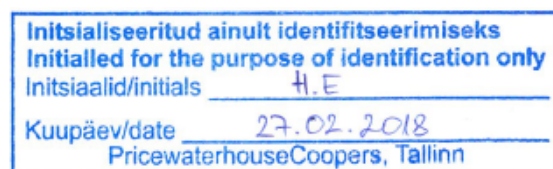
The Group offers hire purchase to private individuals in Lithuania. The creditworthiness of customers is assessed and provisions are made based on the same framework as for Lithuanian consumer loans. As of 31 December 2017, the group-based impairment reserve amounted to 1.6% of hire-purchase portfolio (31.12.2015: 3.7%).

j) Mortgage loans

In 2013 Group started to offer on a limited basis mortgage loans to customers in the Tallinn and Tartu region only. In autumn 2016, Group started offering the mortgage loan to a large scale of retail clients.

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

As of 31 December 2017, the group-based impairment amounted to 0.3% of mortgage portfolio (31.12.2016: 0.4%).



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

Loans and advances to customers

31.12.2017

(in thousands of euros)

	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total	Collective impairment	Individual impairment	Net
Loans to legal entities							
Corporate loans	443 822	3 766	9 160	456 748	-2 161	-1 518	453 069
Retail loans	13 049	581	26	13 656	-155	0	13 501
Overdraft	34 309	0	4 883	39 192	-122	-793	38 277
Hire-purchase	268	0	1	269	-3	-1	265
Leveraged loans	4 547	0	0	4 547	0	0	4 547
Leasing	31 603	2 170	67	33 840	-140	-614	33 086
Credit card loans	172	0	0	172	-4	0	168
Loans to individuals							
Consumer loans	31 120	0	3 354	34 474	-1 169	-86	33 219
Hire-purchase	50 101	6 772	454	57 327	-824	-30	56 473
Leveraged loans	2 621	0	0	2 621	0	0	2 621
Leasing	11 147	236	19	11 402	-19	-7	11 376
Mortgage loans	77 471	169	0	77 640	-243	0	77 397
Credit card loans	7 523	0	676	8 199	-231	-5	7 963
Overdraft	77	1	3	81	0	0	81
Total (Note 13)	707 830	13 695	18 643	740 168	-5 071	-3 054	732 043

Loans and advances to customers

31.12.2016

(in thousands of euros)

	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total	Collective impairment	Individual impairment	Net
Loans to legal entities							
Corporate loans	339 030	1 024	1 304	341 358	-1 758	-297	339 303
Retail loans	6 917	171	0	7 088	-101	0	6 987
Overdraft	31 248	0	85	31 333	-246	-37	31 050
Hire-purchase	264	0	1	265	-2	-1	262
Leveraged loans	4 383	0	0	4 383	0	0	4 383
Leasing	31 832	1 771	97	33 700	-143	-29	33 528
Credit card loans	130	0	0	130	-6	0	124
Loans to individuals							
Consumer loans	23 469	0	3 825	27 294	-1 568	-31	25 695
Hire-purchase	41 770	4 273	769	46 812	-1 187	-33	45 592
Leveraged loans	3 004	0	0	3 004	0	0	3 004
Leasing	7 394	294	6	7 694	-45	-2	7 647
Mortgage loans	35 451	0	0	35 451	-143	0	35 308
Credit card loans	4 773	0	15	4 788	-107	-5	4 676
Overdraft	82	0	0	82	0	0	82
Total (Note 13)	529 747	7 533	6 102	543 382	-5 306	-435	537 641

Overdue loan amounts include the total amount of the loans, not only the amount of overdue instalments.

There are several criteria for the loan to be considered individually impaired. Group's internal default definition is in line with the generally accepted definition of default criteria, such as payment delay more than 90 days on any material credit obligation, distressed restructuring of the credit

obligation, specific credit adjustment due to significant perceived decline in credit quality since inception, significant financial difficulties of the obligor or likely bankruptcy process, etc.

As part of risk analysis, the Group is regularly performing stress tests and sensitivity analysis regarding credit risk and its components (such as PD, LGD). Collective impairment

credit assessment of the Group is based on historical loss rate and credit rating. The Group has performed stress test scenarios when PD and LGD estimations will both increase by 10 percent (for example, from 1.0% to 1.1%). The impact of the described stress test to impairments is aggregated

in the table below. The table includes loans, which have collective impairment (therefore excluding leveraged loans) and which have material balances and potential impact.

Impact to impairment as at 31.12.2017

(in case PD and LGD levels will increase by 10%)
(in thousands of euros)

	Balance as at 31.12.2017	Impairment with increased PDs and LGDs	Impact to impairment booked
Loans to legal entities			
Corporate loans (incl. overdraft)	495 940	-5 056	-462
Leasing	33 840	-783	-29
Retail loans	13 656	-188	-33
Loans to individuals			
Consumer loans	34 474	-1 509	-254
Hire-purchase	57 327	-1 015	-161
Mortgage loan	77 640	-294	-51
Leasing	11 402	-31	-5
Credit card loans	8 199	-277	-41
Total	732 478	-9 153	-1 036

Impact to impairment as at 31.12.2016

(in case PD and LGD levels will increase by 10%)
(in thousands of euros)

	Balance as at 31.12.2016	Impairment with increased PDs and LGDs	Impact to impairment booked
Loans to legal entities			
Corporate loans (incl. overdraft)	372 691	-2 829	-491
Leasing	33 700	-206	-34
Loans to individuals			
Consumer loans	27 294	-1 923	-334
Hire-purchase	46 812	-1 488	-258
Mortgage loan	35 451	-173	-30
Leasing	7 694	-57	-10
Credit card loans	4 788	-135	-23
Total	528 430	-6 811	-1 180

The rating scale 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. 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.

Distribution of internal ratings of corporate loans:

- 1 – minimum credit risk. The rating is only assigned based on the ratings of rating agencies. The average of the ratings assigned by rating agencies must be the equivalent of at least AAA (Moody's Aaa).
- 2 – minimum credit risk. The rating is only assigned

based on the ratings of rating agencies. The average of the ratings assigned by rating agencies must be the equivalent of at least AA+ (Moody's Aa1).

- 3 – low credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least AA- (Moody's Aa3).
- 4 – low credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least A- (Moody's A3).
- 5 – low credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB+ (Moody's Baa1).
- 6 – low credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB (Moody's Baa2).

- 7 – average credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BBB- (Moody's Baa3).
- 8 – average credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BB (Moody's Ba2).
- 9 – heightened credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least BB- (Moody's Ba3).
- 10 – high credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average

rating of rating agencies must be the equivalent of at least B+ (Moody's B1).

- 11 – high credit risk. The rating is assigned based on the assessments of rating agencies or LHV. The average rating of rating agencies must be the equivalent of at least B- (Moody's B3).
- 12 – non-satisfactory rating. The rating is assigned based on the assessments of rating agencies or LHV. The Credit Analyst deems the company's financial position to be sufficiently weak indicating a very high probability of default. The average rating of rating agencies must be the equivalent of at least C (Moody's Caa3).
- 13 – the obligor is in default.

Distribution of corporate loans and overdraft by internal ratings 31.12.2017

(in thousands of euros)

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

Distribution of corporate loans and overdraft by internal ratings 31.12.2016

(in thousands of euros)

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

The Group considers the loan as non-performing and assesses impairment when the loan payments have not been collected by the due date and/or the expected cash flows from the realization of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments. The Group evaluates these loans indi-

vidually. In case of individual evaluation, the amount of the impairment loss is the difference between the carrying value of the receivable and expected cash flows discounted at the effective interest rate. In 2017, the Group provisioned corporate loans in the total amount of EUR 2 267 thousand (2016: EUR 932 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 179 572 thousand euros at 31.12.2017

(31.12.2016: 132 520 thousand euros), see Note 23.

In the following table there are presented unused portions of corporate loans and financial guarantee limits. No provisions have been made for off-balance sheet liabilities because the value of collateral exceeds the value of potential liabilities. In addition to that as at 31.12.2017 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans to individuals in total amount of EUR 48 899 thousand (31.12.2016: EUR 31 288 thousand). All uncommitted loans available to individuals have at least "Good" internal rating as at the end of each reporting period.

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

(in thousands of euros)

	31.12.2017	31.12.2016
5 low credit risk	5 632	793
6 low credit risk	13 135	8 569
7 medium credit risk	25 582	30 336
8 medium credit risk	57 446	52 354
9 heightened credit risk	28 932	10 440
10 high credit risk	4 176	3 980
11 high credit risk	342	202
13 payments are delayed	760	0
Non-rated (retail clients)	719	0
Total	136 724	106 674

Distribution of internal ratings for other loan products:

- Excellent – leveraged loans secured by debt or equity securities and loans with very low business risk.
- Very good – loans with lower business risks and no past due payments.
- Good – loans with lower business risks and past

due payments up to 30 days.

- Satisfactory – loans with average business risk and up to 60 days past due.
- Weak or doubtful – loans carrying higher business risk, past due more than 60 days and portfolio in proceedings by the bailiff.

As of 31.12.2017

(in thousands of euros)

	Retail loans	Leveraged loans	Credit cards	Leasing	Consumer loans	Hire-purchase	Over-draft	Mortgage loans	Total
Neither past due nor impaired									
Excellent	0	7 168	0	0	0	0	0	0	7 168
Good and very good	13 049	0	7 695	42 750	31 120	50 369	77	77 471	222 531
Past due but not impaired									
Good	481	0	0	1 725	0	5 202	0	169	7 577
Satisfactory	61	0	0	664	0	1 266	1	0	1 992
Weak or doubtful	39	0	0	17	0	304	0	0	360
Individually impaired									
Good	0	0	78	0	2 160	52	0	0	2 290
Satisfactory	0	0	221	0	623	51	0	0	895
Weak or doubtful	26	0	377	86	571	352	3	0	1 415
Total	13 656	7 168	8 371	45 242	34 474	57 596	81	77 640	244 228

As of 31.12.2016

<i>(in thousands of euros)</i>	Retail loans	Leveraged loans	Credit cards	Leasing	Consumer loans	Hire-purchase	Over-draft	Mortgage loans	Total
Neither past due nor impaired									
Excellent	0	7 387	0	0	0	0	0	0	7 387
Good and very good	6 917	0	4 903	39 226	23 469	42 034	82	35 451	152 082
Past due but not impaired									
Good	171	0	0	1 193	0	4 075	0	0	5 439
Satisfactory	0	0	0	731	0	139	0	0	870
Weak or doubtful	0	0	0	141	0	59	0	0	200
Individually impaired									
Good	0	0	0	0	2 413	0	0	0	2 413
Satisfactory	0	0	0	0	210	0	0	0	210
Weak or doubtful	0	0	15	103	1 202	770	0	0	2 090
Total	7 088	7 387	4 918	41 394	27 294	47 077	82	35 451	170 691

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 31.12.2017

<i>(in thousands of euros)</i>	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	7 168	0	0	0	0	7 168
Unlisted equity securities	36 603	0	0	0	0	0	36 603
Mortgages, real estate	233 876	0	0	0	0	77 640	311 516
Guarantee of KredEx and Rural							
Development Foundation	4 410	0	0	0	0	0	4 410
Pledges of rights of claim	15 163	0	0	0	0	0	15 163
Deposits	3 262	0	0	0	0	0	3 262
Leased assets	0	0	0	45 242	57 596	0	102 838
Others	90 915	0	81	0	0	0	90 996
Unsecured loans	125 367	0	42 845	0	0	0	168 212
Total	509 596	7 168	42 926	45 242	57 596	77 640	740 168

Loans against collateral as at 31.12.2016

<i>(in thousands of euros)</i>	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	7 387	0	0	0	0	7 387
Unlisted equity securities	70 354	0	0	0	0	0	70 354
Mortgages, real estate	214 121	0	0	0	0	35 451	249 572
Guarantee of KredEx and Rural							
Development Foundation	10 293	0	0	0	0	0	10 293
Pledges of rights of claim	8 182	0	0	0	0	0	8 182
Deposits	3 376	0	0	0	0	0	3 376
Leased assets	0	0	0	41 394	47 077	0	88 471
Others	34 451	0	82	0	0	0	34 533
Unsecured loans	39 002	0	32 212	0	0	0	71 214
Total	379 779	7 387	32 294	41 394	47 077	35 451	543 382

Unsecured loans in the years of 2017 and 2016 include credit card loans and Lithuanian consumer loans.

Collaterals for leveraged loans are monitored on daily basis and, if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31 December 2017 and as of 31 December 2016, all leveraged loans and repurchase loans are over-collateralized. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing, hire purchase, mortgage loans and overdraft to private individuals are all over-collateralized. The Group monitors customers in arrears of leasing, 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 totalling EUR 1 383 thousand (2016: EUR 399 thousand) euros with a collateral value of zero thousand (2016: EUR 316 thousand) euros.

Corporate loans, retail loans and corporate credit lines

(in thousands of euros)

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

The valuation of the market value of collaterals is based on the principle of conservatism, which takes into account the type of collateral, the location, the likelihood of realization and liquidity. Expert evaluations are used to evaluate immovables. In order to ensure that market values are up to

date, the individual assessments of commercial real estate are updated at least once a year. In the case of residential and other homogeneous types of real estate, statistical indexation models are also used for regular re-evaluation.

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

As at 31.12.2017

(in thousands of euros)

	Corporate loans (incl. overdraft)	Retail loans	Leasing	Hire-purchase	Overdraft to private individuals	Mortgage loan	Total
Past due receivables							
1-30 days	56	481	1 725	5 202	0	169	7 633
31-60 days	3 710	61	664	1 266	1	0	5 702
61-90 days	0	39	17	304	0	0	360
91-180 days	0	0	0	0	0	0	0
181-360 days	0	0	0	0	0	0	0
more than 360 days	0	0	0	0	0	0	0
Total	3 766	581	2 406	6 772	1	169	13 695

As at 31.12.2016

(in thousands of euros)

	Corporate loans (incl. overdraft)	Retail loans	Leasing	Hire-purchase	Overdraft to private individuals	Mortgage loan	Total
Past due receivables							
1-30 days	494	171	1 193	3 297	0	0	5 155
31-60 days	530	0	731	794	0	0	2 055
61-90 days	0	0	141	182	0	0	323
91-180 days	0	0	0	0	0	0	0
181-360 days	0	0	0	0	0	0	0
more than 360 days	0	0	0	0	0	0	0
Total	1 024	171	2 065	4 273	0	0	7 533

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

As at 31.12.2017 (in thousands of euros)	Corporate loans (incl. overdraft)	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Overdraft to private individuals	Total
No payments over deadline	0	0	0	0	0	12	37	0	49
Past due receivables									
1-30 days	0	0	0	78	0	40	2 123	0	2 241
31-60 days	0	0	0	221	0	51	623	0	895
61-90 days	0	0	0	115	0	35	268	0	418
91-180 days	12 664	26	0	176	78	161	159	3	13 267
181-360 days	0	0	0	60	7	37	88	0	192
More than 360 days	1 379	0	0	26	1	119	56	0	1 581
Total	14 043	26	0	676	86	455	3 354	3	18 643

As at 31.12.2016 (in thousands of euros)	Corporate loans (incl. overdraft)	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Overdraft to private individuals	Total
No payments over deadline	0	0	0	0	0	58	97	0	155
Past due receivables									
1-30 days	0	0	0	0	0	75	2 045	0	2 120
31-60 days	0	0	0	0	0	57	647	0	704
61-90 days	990	0	0	0	0	50	296	0	1 336
91-180 days	0	0	0	1	61	157	184	0	403
181-360 days	0	0	0	1	36	172	355	0	564
More than 360 days	399	0	0	13	6	201	201	0	820
Total	1 389	0	0	15	103	770	3 825	0	6 102

Credit quality of other receivables

(in thousands of euros)	31.12.2017	31.12.2016
Receivables neither past due nor impaired	9 392	3 182
Receivables past due but not impaired	408	297
incl. receivables from individuals	215	7
incl. receivables from legal entities	193	290
Total (Note 14)	9 800	3 479

As of 22 February 2018, other receivables of EUR 175 thousand euros are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 15) in amount EUR 2 289 thousand (31.12.2015: EUR 941 thousand) are guarantee deposits

on the Baltic stock exchanges held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions. The Group considers the counterparties credit risk as very low.

3.3 Market risk

Market risk arises from the Group's trading and investment activities in the financial markets from interest rate products, foreign exchange and stock markets as well as lending activities and collecting financial resources. Market risk is a potential loss, which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. Internal judgement is used to assess poten-

tial losses. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures.

LHV Varahaldus invests most of its available resources into his own managed pension funds. The management of LHV Varahaldus is responsible for monitoring of the market risk.

3.3.1 Foreign currency risk

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

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to 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)	2017	2016
USD exchange rate +/- 10%	+/-16	+/-2
SEK exchange rate +/- 10%	+/-4	+/-2
GBP exchange rate +/- 10%	+/-1	+/-2
CHF exchange rate +/- 10%	+/-1	+/-2

Open currency exposures

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

31.12.2017

(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	10	922 431	2 587	28 237	892	1 359	5 706	961 212
Financial assets at fair value	11, 12	21 998	0	0	4	34 603	29	56 634
Loans and advances to customers	13	730 165	0	4	14	1 832	28	732 043
Receivables from customers	14	9 357	7	204	11	145	76	9 800
Other financial assets	15	288	0	0	0	2 001	0	2 289
Total assets bearing currency risk		1 684 239	2 594	28 445	921	39 940	5 839	1 761 978
Liabilities bearing currency risk								
Deposits from customers and loans received	17	1 457 593	2 534	33 134	3 558	42 646	3 464	1 542 929
Financial liabilities at fair value	12	0	0	0	1	1	0	2
Accounts payable and other financial liabilities	18	63 596	66	259	82	54	2 775	66 832
Subordinated debt	20	30 900	0	0	0	0	0	30 900
Total liabilities bearing currency risk		1 552 089	2 600	33 393	3 641	42 701	6 239	1 640 663
Open gross position derivative assets								
at contractual value		699	0	4 959	2 763	3 615	450	12 486
Open gross position derivative liabilities								
at contractual value		11 787	0	0	0	699	0	12 486
Open foreign currency position		121 062	-7	10	43	155	51	121 315

31.12.2016*(in thousands of euros)*

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
Assets bearing currency risk								
Due from banks and investment companies	10	278 929	1 994	13 061	3 942	6 668	1 906	306 500
Financial assets at fair value	11, 12	34 505	0	0	1	41 243	441	76 190
Loans and advances to customers	13	535 747	4	4	2	1 873	11	537 641
Receivables from customers	14	3 255	1	43	6	171	3	3 479
Other financial assets	15	211	0	0	0	730	0	941
Total assets bearing currency risk		852 647	1 999	13 108	3 951	50 685	2 361	924 751
Liabilities bearing currency risk								
Deposits from customers and loans received	17	700 874	1 983	13 264	3 869	55 924	1 667	777 581
Financial liabilities at fair value	12	0	0	0	0	72	137	209
Accounts payable and other financial liabilities	18	8 116	2	1 226	65	5 341	1 227	15 977
Subordinated debt	20	30 900	0	0	0	0	0	30 900
Total liabilities bearing currency risk		739 890	1 985	14 490	3 934	61 337	3 031	824 667
Open gross position derivative assets								
at contractual value		1 675	0	1 398	0	11 548	1 263	15 884
Open gross position derivative liabilities								
at contractual value		13 440	0	0	0	876	1 568	15 884
Open foreign currency position		100 992	14	16	17	21	-975	100 084

3.3.2 Price risk

Financial instruments bearing price risk at Group are securities held in the trading portfolio and investment portfolio (Note 11, 12). At the Group, limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for debt securities in the investment portfolio. The risk management unit monitors the compliance with limits.

Pursuant to the Investment Funds Act, the minimum shares of LHV Varahaldus as the management company is 0.5% (according to the Investment Funds Act in force until 9 January 2017, it was 1%) of the number of units in each of the mandatory pension fund managed by it. Based on historical performance and volatility of the pension fund unit NAV changes, the price changes should remain +/- 10% in the next 12-month period with the most likely change +/-5% and the impact to statement of profit or loss is presented in the next table.

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

Bank does not hold significant amounts of equity securities in its position (see Note 12), due to which the sensitivity to change in the market value 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% (2016: 1.0%).

Sensitivity analysis of the impact to net result from the risk exposures of the Group's largest entity AS LHV Pank against reasonable possible change (in thousands euros):

Impact on statement of profit or loss

<i>(in thousands of euros)</i>	2017	2016
Equity securities +/-10%	+/-51	+/-27
Mandatory pension fund units		
+/-5%	+/-313	+/-543
Debt securities (FVTPL)		
+/-1.0% (+/-1.0%)	+/-491	+/-636

Impact on other comprehensive income

<i>(in thousands of euros)</i>	2017	2016
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-6	+/-6

3.3.3 Interest rate risk

Interest rate risk reflects the mismatch in the statement of financial position items and the off-balance sheet items when interest rate repricing periods, volumes or the underlying interest rate of assets, liabilities and derivatives do not correspond exactly. Group's interest rate risk management is based on risk policies, limits and internal procedures resulting in identification of all significant sources of interest rate risk and balanced risk taking. Interest rate risk is measured through various scenario analyses by calculating several net interest income scenarios and comparing the difference between these scenarios. The basic measures of interest rate risk uses two scenarios – an increase and a decrease of interest rates to measure the effect on the Group's net interest income for a 12-month period. Internal limits for interest rate risk management are set by AS LHV Pank's Risk and Capital Committee and the operational risk management is the Treasury's responsibility.

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

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

The balance sheet and margins on assets and deposits are assumed to be constant over time. The deposits interest rates did not change in 2017 remaining at the level of up to 1.0% (up to 1.0% in 2016).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2017, the interest rate on loans received for specific purposes was 1.0% (2016: 1.4%). The effective interest rate of subordinated debts entered into in 2014 was 7.44% and the effective interest rate of subordinated debts entered into in 2015 was 6.5%. The information about subordinated debt contractual interest rates is provided in Note 21.

As at 31.12.2017, stress tests were performed to the biggest interest sensitive subsidiary of the group: AS LHV Pank. An increase of 1 percentage point in interest rates would affect the Bank's annual net interest income and profit by EUR +5 584 thousand (2016: EUR +2 473 thousand). In the same time, a decrease of 1 percentage point in interest rates would affect the Bank's annual net interest income (profit)

by EUR -1 567 thousand (2016: EUR -1 119 thousand). A 1 percentage point increase in market interest rates would raise the Bank's economic value, i.e. equity, by EUR +7 520 thousand (2016: EUR +7 599 thousand). A 1 percentage point decrease in market interest rates would affect the Bank's economic value (equity) by EUR 16 639 thousand (2016: EUR -8 207 thousand). Effect on the Group's economic value is positive since the Group has invested in short-term assets, the loans granted to customers are largely based on the 6-month Euribor, the level of which does not fall below 0% according to loan agreements, and due to the longer-term nature of the demand obligations, the average duration of interest-bearing assets is shorter than the average duration of interest-bearing liabilities.

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

Demand deposits have a duration of 2 years due to their 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 Pank grouped by the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.

Interest rate risk

31.12.2017

(in thousands of euros)

	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair- ments	Total
Financial assets									
Due from banks and investment companies	10	961 212	0	0	0	961 212	0	0	961 212
Financial assets at fair value (debt securities)	11, 12	0	29 715	15 834	2 000	47 549	2 144		49 693
Loans and advances to customers	13	299 246	382 016	41 528	14 851	737 641	2 527	-8 125	732 043
Total		1 260 458	411 731	57 362	16 851	1 746 402	4 671	-8 125	1 742 948
Financial liabilities									
Deposits from customers and loans received	17	553 360	96 246	893 085	0	1 542 691	238		1 542 929
Subordinated debt *	20	0	0	0	30 900	30 900	210	0	31 110
Total		553 360	96 246	893 085	30 900	1 573 591	448	0	1 574 039
Net interest sensitivity gap		707 098	315 485	-835 723	-14 049	172 811			

Interest rate risk

31.12.2016

(in thousands of euros)

	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair- ments	Total
Financial assets									
Due from banks and investment companies	10	306 500	0	0	0	306 500	0	0	306 500
Financial assets at fair value (debt securities)	11, 12	6 947	34 789	16 560	3 332	61 628	2 768	0	64 396
Loans and advances to customers	13	243 015	245 086	52 792	461	541 354	2 028	-5 741	537 641
Total		556 462	279 875	69 352	3 793	909 482	4 796	-5 741	908 537
Financial liabilities									
Deposits from customers and loans received	17	58 760	82 914	635 393	0	777 067	514	0	777 581
Subordinated debt *	20	0	0	0	30 900	30 900	210	0	31 110
Total		58 760	82 914	635 393	30 900	807 967	724	0	808 691
Net interest sensitivity gap		497 702	196 961	-566 041	-27 107	101 515			

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

3.4 Liquidity risk

Liquidity risk relates to the solvency of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The Group's liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, the Group'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 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 the Group is fully compliant with as of 31.12.2017 and 31.12.2016. The aim of the LCR standard is to ensure that the Group has an adequate amount of unencumbered assets of high quality and liquidity that could be monetised without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The Group's liquidity coverage ratio level as at 31.12.2017 was 121% (2016: 222%).

The objective of the NSFR is to ensure that the Group 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 Group's NSFR level as at 31.12.2017 was 141% (2016: 152%). The net stable funding ratio will

be imposed as 100% minimum requirement from the year 2018.

The Treasury of the Bank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period, also the concentration of the Group's liabilities by maturities is monitored. To enable covering unexpected monetary outflows, the Group 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. The Group has a sufficient supply of liquid resources to enable issuing standby loans. As at 31.12.2017 and 31.12.2016, the Group does not have any debts past due.

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

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

31.12.2017*(in thousands of euros)*

	Note	On demand	Up to 3 months	3-12 Months	1-5 years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates								
Deposits from customers and loans received	17	1 409 662	37 104	90 332	3 335	2 864	1 543 297	1 542 929
Subordinated debt	20	0	532	1 596	8 511	35 554	46 193	30 900
Accounts payable and other financial liabilities	18	0	66 832	0	0	0	66 832	66 832
Unused loan commitments	23	0	179 572	0	0	0	179 572	0
Financial guarantees by contractual amounts	23	0	5 999	0	0	0	5 999	0
Foreign exchange derivatives (gross settled)		0	11 825	0	661	0	12 486	0
Financial liabilities at fair value	12	0	2	0	0	0	2	2
Total liabilities		1 409 662	301 866	91 928	12 507	38 418	1 854 381	1 640 663

Assets held for managing liquidity risk by contractual maturity dates

Due from banks and investment companies	10	961 212	0	0	0	0	961 212	961 212
Financial assets at fair value (debt securities)	11, 12	0	180	30 952	17 005	2 084	50 221	49 693
Loans and advances to customers	13	0	55 668	171 720	488 968	95 517	811 873	732 043
Receivables from customers	14	0	9 800	0	0	0	9 800	9 800
Other financial assets	15	2 289	0	0	0	0	2 289	2 289
Foreign exchange derivatives (gross settled)			11 825	0	661	0	12 486	0
Total assets held for managing liquidity risk		963 501	77 473	202 672	506 634	97 601	1 847 881	1 755 037
Maturity gap from assets and liabilities		-446 161	-224 393	110 744	494 127	59 183	-6 500	

31.12.2016*(in thousands of euros)*

	Note	On demand	Up to 3 months	3-12 Months	1-5 years	Over 5 years	Total	Carrying amount
Liabilities by contractual maturity dates								
Deposits from customers and loans received	17	624 219	67 007	83 814	3 357	0	778 397	777 581
Subordinated debt	20	0	532	1 596	8 511	37 682	48 321	30 900
Accounts payable and other financial liabilities	18	0	15 977	0	0	0	15 977	15 977
Unused loan commitments	23	0	132 520	0	0	0	132 520	0
Financial guarantees by contractual amounts	23	0	5 442	0	0	0	5 442	0
Foreign exchange derivatives (gross settled)		0	15 156	0	728	0	15 884	0
Financial liabilities at fair value	12	0	209	0	0	0	209	209
Total liabilities		624 219	236 843	85 410	12 596	37 682	996 750	824 667

Assets held for managing liquidity risk by contractual maturity dates

Due from banks and investment companies	10	306 427	73	0	0	0	306 500	306 500
Financial assets at fair value (debt securities)	11, 12	0	7 666	36 123	18 474	3 613	65 876	64 396
Loans and advances to customers	13	0	42 969	140 761	381 350	40 710	605 791	537 641
Receivables from customers	14	0	3 479	0	0	0	3 479	3 479
Other financial assets	15	941	0	0	0	0	941	941
Foreign exchange derivatives (gross settled)		0	15 156	0	728	0	15 884	0
Total assets held for managing liquidity risk		307 368	69 343	176 884	400 552	44 323	998 470	912 957
Maturity gap from assets and liabilities		-316 851	-167 500	91 474	387 956	6 641	1 720	

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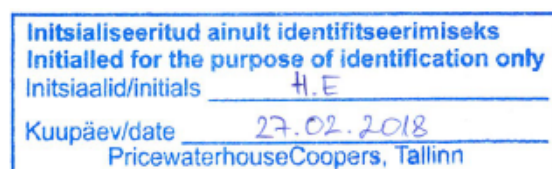
The following table presents the distribution of assets and liabilities by classification of current and non-current.

<i>(in thousands of euros)</i>	Note	31.12.2017	31.12.2016
Current assets			
Due from central bank	10	905 339	265 127
Due from credit institutions	10	40 498	33 300
Due from investment companies	10	15 375	8 073
Available-for-sale financial assets	11	555	579
Financial assets at fair value through profit or loss	12	30 427	43 559
Loans and advances to customers	13	239 615	183 684
Receivables from customers	14	9 800	3 479
Other assets	15	1 516	1 391
Total current assets		1 243 125	539 192
Non-current assets			
Available-for-sale financial assets	11	220	220
Financial assets at fair value through profit or loss	12	25 432	31 832
Loans and advances to customers	13	492 428	353 957
Other financial assets	15	2 289	941
Tangible assets	16	1 421	1 191
Intangible assets	16	4 327	4 500
Goodwill	6	3 614	3 614
Total non-current assets		529 731	396 255
Total assets	5	1 772 856	935 447
Liabilities			
Current liabilities			
Deposits from customers and loans received	17	1 536 883	773 608
Financial liabilities at fair value through profit or loss	12	2	209
Accounts payable and other liabilities	18	71 070	19 031
Total current liabilities		1 607 955	792 848
Non-current liabilities			
Deposits from customers and loans received	17	6 046	3 973
Subordinated debt	20	30 900	30 900
Total non-current liabilities		36 946	34 873
Total liabilities	5	1 644 901	827 721

3.5 Risk concentration

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2017, the loans issued to 8 customers (2016: total 7) 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 111% of NOF (2016: 87%). The Group has invested in the debt securities of 2 issuers (2016: 3) with a large risk exposure, totalling 33% of NOF (2016: 74%). Of customer deposits, the deposits of 3 customers have a high risk concentration, which amounts to 425% of NOF.

Unused loan commitments in the amount of EUR 168 228 thousand are for Estonian residents and in the amount of 11 345 for Lithuanian residents (2016: EUR 127 285 thousand for Estonian residents and EUR 5 235 thousand for Lithuanian residents).



31.12.2017

<i>(in thousands of euros)</i>	Note	Estonia	Latvia	Lithuania	Finland	Nether-lands	Ger-many	Other EU	USA	Other	Total
Due from banks											
and investment companies	10	919 599	47	2 528	0	0	0	3 051	28 152	7 835	961 212
Financial assets at fair value	11, 12	7 466	779	17 456	0	0	29 867	1 064	2	0	56 634
Loans and advances											
to customers	13	650 871	3 644	46 269	998	91	42	26 580	45	3 503	732 043
Receivables from customers	14	8 481	372	947	0	0	0	0	0	0	9 800
Other financial assets	15	109	0	0	0	0	0	0	2 180	0	2 289
Total financial assets		1 586 526	4 842	67 200	998	91	29 909	30 695	30 379	11 338	1 761 978
Deposits from customers											
and loans received	17	848 642	5 024	825	2 717	12 505	632	639 608	2 855	30 121	1 542 929
Subordinated debt	20	30 900	0	0	0	0	0	0	0	0	30 900
Accounts payable											
and other financial liabilities	18	60 382	3 047	3 360	27	0	0	13	3	0	66 832
Financial liabilities at fair value	12	2	0	0	0	0	0	0	0	0	2
Total financial liabilities		939 926	8 071	4 185	2 744	12 505	632	639 621	2 858	30 121	1 640 663

31.12.2016

<i>(in thousands of euros)</i>	Note	Estonia	Latvia	Lithuania	Finland	Nether-lands	Ger-many	Other EU	USA	Other	Total
Due from banks											
and investment companies	10	287 878	326	2 392	0	0	0	5 100	7 919	2 885	306 500
Financial assets at fair value	11, 12	12 316	2 737	18 788	0	0	33 660	8 657	2	30	76 190
Loans and advances											
to customers	13	484 578	1 880	25 383	512	7	46	14 508	51	676	537 641
Receivables from customers	14	3 110	14	352	0	0	0	3	0	0	3 479
Other financial assets	15	108	0	0	0	0	0	0	833	0	941
Total financial assets		787 990	4 957	46 915	512	7	33 706	28 268	8 805	3 591	914 751
Deposits from customers											
and loans received	17	666 870	1 617	2 024	1 072	1	201	71 983	746	33 067	777 581
Subordinated debt	20	30 900	0	0	0	0	0	0	0	0	30 900
Accounts payable											
and other financial liabilities	18	14 941	65	928	27	0	0	13	3	0	15 977
Financial liabilities at fair value	12	209	0	0	0	0	0	0	0	0	209
Total financial liabilities		712 920	1 682	2 952	1 099	1	201	71 996	749	33 067	824 667

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Distribution of loans granted by industry (gross):

<i>(in thousands of euros)</i>	31.12.2017	%	31.12.2016	%
Individuals	191 744	25.9%	125 125	23.0%
Real estate	197 697	26.7%	149 145	27.4%
Manufacturing	68 252	9.2%	43 541	8.0%
Art and entertainment	29 292	4.0%	29 143	5.4%
Financial services	78 113	10.6%	68 985	12.7%
Wholesale and retail	21 112	2.9%	14 721	2.7%
Administrative activities	33 947	4.6%	11 953	2.2%
Transport and logistics	5 876	0.8%	12 835	2.4%
Agriculture	8 717	1.2%	8 341	1.5%
Other servicing activities	15 485	2.1%	15 021	2.8%
Construction	19 421	2.6%	11 688	2.2%
Information and communication	8 439	1.1%	9 611	1.8%
Professional, scientific and technical activities	13 958	1.9%	12 451	2.3%
Education	2 218	0.3%	1 297	0.2%
Other areas at activities	45 897	6.2%	29 525	5.4%
Total (Note 13)	740 168	100%	543 382	100%

3.6 Fair value of financial assets and financial liabilities

<i>(in thousands of euros)</i>	Note	Level 1	Level 2	Level 3	31.12.2017
Financial assets at fair value through profit or loss					
Shares and fund units*	12	430	6 261	0	6 691
Available-for-sale debt securities	11	555	0	220	775
Debt securities at fair value through profit or loss	12	49 138	0	0	49 138
Interest rate swaps and foreign exchange forwards	12	0	30	0	30
Total financial assets		50 123	6 291	220	56 634
Financial liabilities at fair value through profit or loss					
Interest rate swaps and foreign exchange forwards	12	0	2	0	2
Total financial liabilities		0	2	0	2

<i>(in thousands of euros)</i>	Note	Level 1	Level 2	Level 3	31.12.2016
Financial assets at fair value through profit or loss					
Shares and fund units*	12	408	10 866	50	11 324
Available-for-sale debt securities	11	579	0	220	799
Debt securities at fair value through profit or loss	12	63 817	0	0	63 817
Interest rate swaps and foreign exchange forwards	12	0	250	0	250
Total financial assets		64 804	11 116	270	76 190
Financial liabilities at fair value through profit or loss					
Interest rate swaps and foreign exchange forwards	12	0	209	0	209
Total financial liabilities		0	209	0	209

*Shares and fund units include the Group's subsidiary AS LHV Varahaldus investment into pension fund units in the amount of EUR 6 261 thousand (31.12.2016: EUR 10 866 thousand) euros. Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 0.5% (until 09.01.2017 1%) of the number of units in each of the mandatory pension fund managed by it.

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 (e.g. discounted cash flow method) with judgemental inputs

Interest rate swaps and foreign exchange forwards are instruments where active markets supply observable inputs to the valuation model, which is used for establishing the fair value. The fair value for such over-the-counter derivatives is

calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.

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

As at 31.12.2017 the fair value of corporate loans is EUR 1 009 thousand (0.10%) higher than their carrying amount (31.12.2016: EUR 2 063 thousand, 0.51% lower). The loans have been issued at market conditions in the segment that the Group operates in and therefore their fair value is not much different from their carrying amount as at 31.12.2017 and 31.12.2016. The fair value level of corporate loans and overdraft is 3 as significant judgmental assumptions are used for the valuation process (discounted cash flow method with current market interest). Interest rate used is the average interest rate of corporate loans issued in last 6 months of the reporting period (2017: 3.71% and 2016: 4.54%).

EUR thousand	Carrying value	Fair value	Difference	Level
31.12.2017	454 441	454 874	0.10%	3
31.12.2016	343 994	342 227	-0.51%	3

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

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

Leveraged loans, hire purchase and credit cards granted to customers are of sufficiently short-term nature and

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

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

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

The subordinated debts were received in 2015 and in 2014. These loans carry approximately equal interest rates (6.5% and 7.25%) and considering the relatively short term between the loan received in October 2015 and the balance sheet date, it can be concluded that no material changes have occurred in interest rates as of the balance sheet date. Therefore, the fair value of loans does not differ significantly from their carrying amount. As significant management judgment is required to determine fair value, loans are classified as level 3 in the fair value hierarchy.

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

3.7 Operating risk

Operating risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the segregation of duties principle is used in 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 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 Compliance Officer is to evaluate the activities of the Group accordance with legislation, 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, improval of 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.

3.8. Compliance risk

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

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

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

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

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

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

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

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

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

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

3.9. Anti-money laundering

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

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

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

3.10. Other risks

3.10.1 Strategic and business risk

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

3.10.2 Risk on reputation

Risk on reputation is defined as a risk, which arises from a loss of reputation for clients, business partners, owners,

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

3.10.3 Country risk

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

3.11 Offsetting assets and liabilities

The group has offset the following assets and liabilities.

	Gross amounts before offsetting in the statement of financial position	Offsetting	Net amount of exposure presented in the statement of financial position	Related arrangements not set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral received	
31.12.2017						
Assets						
Prepayments to merchants for registered customer contacts	3 716	-3 449	267	0	0	267
Client receivables (leveraged loans, incl. repo loans) (Note 13)	7 168	0	7 168	-7 168	0	0
Due from investment companies	20 628	-20 625	3	0	0	3
Liabilities						
Payables to merchants	9 413	-3 449	5 964	0	0	5 964
Payables to investment companies	20 625	-20 625	0	0	0	0
31.12.2016						
Assets						
Prepayments to merchants for registered customer contacts	3 292	-3 119	173	0	0	173
Client receivables (leveraged loans, incl. repo loans) (Note 13)	7 387	0	7 387	-7 387	0	0
Liabilities						
Payables to merchants	3 738	-3 119	619	0	0	619

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NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the balance sheet date, and the reported amounts of income and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly

differ from these estimates. Management's estimates have been applied to valuation of loans, receivables and investments (Notes 10, 11, 12, 13 and 14) and the determination of useful lives of tangible and intangible assets (Note 16).

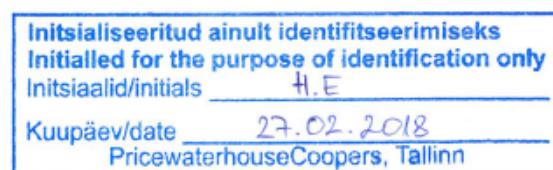
Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances. Changes in management's estimates are reported prospectively.

NOTE 5 Business segments

Bank divides its business activities by 3 main business segments: retail banking, private banking and corporate banking. The business segments form a part of the 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 balance sheet 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. Private banking covers high net worth customers, whose main product is investments. Retail banking segment covers all private individuals and small legal entities with credit exposure under EUR 250 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 250 thousand. The main products are credits and payments. Asset manage-

ment is the pension management segment covering pension second and third pillar. Hire-purchase units both in Estonia and in Lithuania are separate legal entities 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. 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 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 7 and 8. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.



31.12.2017 (in thousands of euros)	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
Interest income	7 509	1 018	19 567	2	8 201	6 061	4 640	-6 362	40 636
Interest expense	0	0	-3 720	-168	-1 095	-919	-5 593	6 362	-5 133
Net interest income	7 509	1 018	15 847	-166	7 106	5 142	-953	0	35 503
Fee and commission income	10 529	988	1 094	13 293	485	1 201	13	0	27 603
Fee and commission expense	-4 188	0	-301	0	-688	-11	-236	0	-5 424
Dividend income	0	0	0	0	0	0	3 803	-3 803	0
Net fee and commission income	6 341	988	793	13 293	-203	1 190	3 580	-3 803	22 179
Net income	13 850	2 006	16 640	13 127	6 903	6 332	2 627	-3 803	57 682
Net gains from financial assets	-22	0	0	294	0	0	707	0	979
Administrative and other operating expenses, staff costs	-10 353	-1 094	-4 995	-6 663	-1 668	-4 539	-2 771	0	-32 083
Operating profit	3 475	912	11 645	6 758	5 235	1 793	563	-3 803	26 578
Impairment losses on loans and advances	-719	0	-2 234	0	-631	431	0	0	-3 153
Income tax	0	0	0	-951	0	-297	0	0	-1 248
Net profit	2 756	912	9 411	5 807	4 604	1 927	563	-3 803	22 177
Total assets	1 061 023	99 630	565 451	19 128	43 255	54 154	97 496	-167 281	1 772 856
Total liabilities	1 189 006	256 916	190 442	2 586	33 149	45 427	31 198	-103 823	1 644 901

The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

31.12.2017 (in thousands of euros)	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
Interest income	5 005	974	17 405	16	7 066	6 474	3 697	-5 477	35 160
Interest expense	0	0	-3 844	-162	-1 130	-1 168	-4 357	5 477	-5 184
Net interest income	5 005	974	13 561	-146	5 936	5 306	-660	0	29 976
Fee and commission income	8 187	850	377	12 905	25	626	320	0	23 290
Fee and commission expense	-3 353	0	-98	0	-394	-61	-198	0	-4 104
Net fee and commission income	4 834	850	279	12 905	-369	565	122	0	19 186
Net income	9 839	1 824	13 840	12 759	5 567	5 871	-538	0	49 162
Net gains from financial assets	887	0	0	310	0	0	112	0	1 309
Administrative and other operating expenses, staff costs	-8 865	-889	-4 229	-6 941	-1 458	-4 034	-2 413	0	-28 829
Operating profit	1 861	935	9 611	6 128	4 109	1 837	-2 839	0	21 642
Income/loss from associates	0	0	0	0	0	0	1	0	1
Impairment losses on loans and advances	-119	0	-828	0	-820	287	0	0	-1 480
Income tax	0	0	0	0	0	-270	0	0	-270
Net profit	1 742	935	8 783	6 128	3 289	1 854	-2 838	0	19 893
Total assets	303 898	98 680	492 642	23 543	35 520	39 393	97 441	-155 670	935 447
Total liabilities	454 155	213 620	152 449	2 586	30 023	32 592	31 181	-88 885	827 721

The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

NOTE 6 Subsidiaries and goodwill

As at 31.12.2017, the Group's subsidiaries, which have been consolidated in these financial statements include:

- AS LHV Pank (Estonia, ownership interest 100%)
- AS LHV Varahaldus (Estonia, ownership interest 100%)
- Cuber Technology OÜ (Estonia, ownership interest 100%)
- UAB Mokilizingas (Lithuania, ownership interest 50% + 1 share)
- AS LHV Finance (Estonia, ownership interest 65% through AS LHV Pank)

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

As at 31.12.2017 and 31.12.2016, the Group does not have any associates.

As at 31.12.2017, goodwill in amount EUR 3 614 thousand in the consolidated financial statements of AS LHV Group consists of:

- positive goodwill which had arisen on the acquisition of the ownership interests in AS LHV Varahaldus in the amount of EUR 482 thousand;
- positive goodwill which had arisen after the conclusion of a purchase contract of AS LHV Varahaldus entered into in 2009 in the amount of EUR 562 thousand;
- positive goodwill which had arisen on the acquisition of the ownership interests in Danske Capital AS by AS LHV Varahaldus in the amount of EUR 2 570 thousand

Impairment tests were performed as at 31.12.2017 and as at 31.12.2016. The cash-generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

- the volume of assets under management is expected to increase by 15% per annum (2016: by 19%)
- increase of income of fund manager is expected to be average of 8% per annum (2016: 6%);
- due to the economic environment, growth of 6% in indirect costs is expected per annum (2016: 4%);
- the discount rate used is 15% (2016: 15%).

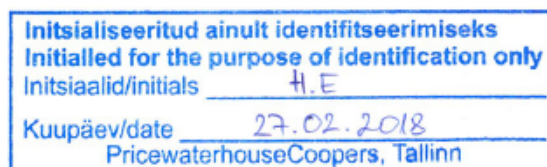
When using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations. Expectations are more conservative due to the changes in the market situation and legislation. Based on the results of the impairment test performed as at 31.12.2017 and 31.12.2016, the recoverable amount of cash generating unit is higher than its carrying amount, as a result of which no impairment losses have been recognized.

On May 2 2016, AS LHV Varahaldus acquired 100% shares of Danske Capital AS and took over the management of its managed funds. This purchase enabled LHV Varahaldus to increase significantly market share and also profitability. Immediately after conclusion of the transaction of purchase and sale of shares on May 2 2016, LHV launched the merger of the two management companies. The merger took effect on July 28 2016, with the balance sheet date of May 1 2016. The impact of revenue in 2016 was EUR 2 814 thousand and the impact of profit and loss is EUR 1 016 thousand

AS LHV Varahaldus recognised the acquisition of Danske Capital AS in accordance with requirements of IFRS 3 by carrying out purchase price allocation. In the course of the purchase price allocation, the value of assets of the Danske Capital AS was assessed and the assets were recognised in fair value on the transaction date (02.05.2016). Date of the financial information used for the purchase price allocation was 30.04.2016, which is the date closest to the transaction date with reliable financial information available. No significant transactions occurred between the financial information date and transaction date that had a significant impact on the value of net assets acquired. The goodwill is related with the expected synergies of managing acquired pension funds.

Acquisition-related costs of EUR 17 thousand have been charged to administrative expenses in the consolidated statement of profit or loss for the year ended 31 December 2016.

The total fair value of assets (cash, customer related intangible assets, pension fund units and other receivables) was 8 782 thousand euros. The total fair value of payables (payables to employees, tax payables and other payables) was 427 thousand euros.



<i>(in thousands of euros)</i>	Fair values recorded on acquisition
Cash and cash equivalents	1 027
Pension fund units	3 300
Other financial assets	425
Client agreements	4 030
Other financial liabilities	-427
Total net assets identified	8 355
Amount paid by LHV Varahaldus AS	10 925
Goodwill acquired by the Group	2 570
Outflow of cash and cash equivalents on acquisition	-9 898

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

Summarised statement of Financial Position	UAB Mokilizingas		AS LHV Finance	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Loans and advances to customers and other current assets	53 915	39 140	43 209	35 454
Non-current assets	239	253	46	66
Current liabilities	8 727	2 092	2 192	1 982
Non-current liabilities	36 700	30 500	30 957	28 041
Total net assets	8 727	6 801	10 106	5 497

Summarised statement of Profit or Loss and Other Comprehensive Income	UAB Mokilizingas		AS LHV Finance	
	2017	2016	2017	2016
Total net interest and fee income	6 332	5 871	6 902	5 566
Profit before income tax	2 224	2 124	4 604	3 289
Income tax expense	-297	-270	0	0
Net profit	1 927	1 854	4 604	3 289
Total comprehensive income	1 927	1 854	4 604	3 289

Profit and other comprehensive income allocated to non-controlling interests	963	927	1 612	1 151
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Summarised statement of Cash Flows	UAB Mokilizingas		AS LHV Finance	
	2017	2016	2017	2016
Cash generated from operations	-4 114	4 916	-1 788	-5 790
Interest paid	-919	-1 168	-1 103	-1 109
Income tax paid	-297	-270	0	0
Net cash generated from/(used in) operating activities	-5 330	3 478	-2 891	-6 899
Net cash generated from/(used in) investing activities	0	-211	-26	-18
Net cash generated from/(used in) financing activities	6 195	-2 511	2 917	6 917
Net increase/(decrease) in cash and cash equivalents	865	756	0	0
Cash and cash equivalents at beginning of year	1 859	1 103	0	0
Cash and cash equivalents at end of year	2 724	1 859	0	0

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NOTE 7 Net interest income

Interest income	Note	2017	2016
Corporate loans		20 784	17 606
incl. loans to related parties	24	27	36
Hire purchase		7 287	7 797
Consumer loans		6 358	5 296
Leasing		1 845	1 603
incl. loans to related parties	24	6	4
Private loans		1 161	539
Mortgage loans		640	346
Leveraged loans and lending of securities		147	505
From debt securities		206	380
incl. debt securities available-for-sale	11	24	27
incl. debt securities at fair value through profit or loss	12	182	353
Credit card loans		694	553
From balances with credit institutions and investment companies		41	74
Other loans		1 473	461
Total		40 636	35 160

Interest expense

Deposits from customers and loans received		-1 224	-2 248
incl. loans from related parties	24	41	46
From balances with central bank		-1 773	-811
Subordinated debt	20	-2 136	-2 125
incl. loans from related parties	24	-336	-386
Total		-5 133	-5 184

Net interest income **35 503** **29 976**

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

	2017	2016
Estonia	34 307	28 136
Latvia	0	102
Lithuania	6 082	6 468
Total	40 389	34 706

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

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NOTE 8 Net fee and commission income

Fee and commission income	2017	2016
Security brokerage and commission fees	3 081	3 086
incl. related parties	14 983	14 344
Asset management and related fees	13 275	12 367
Incl. funds managed by the Group*	977	1 109
Currency exchange fees	5 875	3 584
Fees from cards and settlements	0	45
Commission fees from partners	1 165	551
Fees from consumer loans and hire purchase	485	25
Other fee and commission income	1 037	546
Total	27 603	23 290
Fee and commission expense		
Security brokerage and commission fees paid	-64	-828
Expenses related to cards	-2 026	-1 059
Expenses related to acquiring	-1 982	-1 280
Transaction costs	-301	-227
Costs related to ATM-s	-203	-76
Other fee expense	-848	-634
Total	-5 424	-4 104
Net fee and commission income	22 179	19 186

* Commission fees from pension and investment funds are calculated as a fixed percentage of total assets of the fund and varies between 0.9% -2% p.a.

** Mokillzingas is providing portfolio administration services to Snoras Bank, to whom the portfolio was sold in 2011.

Fee and commission income by customer location:	2017	2016
Estonia	26 123	22 156
Latvia	50	23
Lithuania	1 228	902
Other	202	209
Total	27 603	23 290

NOTE 9 Operating expenses

(in thousands of euros)	2017	2016
Wages, salaries and bonuses	11 148	9 788
Social security and other taxes*	3 516	3 188
Total staff costs	14 664	12 976
IT expenses	1 920	1 807
Information services and banking services	720	751
Marketing expenses	4 939	4 653
Office expenses	548	541
Transportation and communication costs	323	277
Training and travelling expenses of employees	582	429
Other outsourced services	3 250	3 225
Other administrative expenses	2 141	1 602
Depreciation	1 472	1 419
Operating lease payments	1 170	973
Other operating expenses	208	263
Total other operating expenses	17 273	15 940
Total operating expenses	31 937	28 916

* Lump-sum payment of social, health and other insurances
 The average number of employees working for LHV Group in 2017 was 357 (2016: 337).

NOTE 10 Due from central bank, credit institutions and investment companies

<i>(in thousands of euros)</i>	31.12.2017	31.12.2016
Demand and term deposits with maturity less than 3 months *	40 498	41 373
Statutory reserve capital at central bank	15 375	7 736
Demand deposit from central bank *	905 339	257 391
Total	961 212	306 500
* cash and cash equivalents in the statement of cash flows	945 837	298 764

Distribution of receivables by countries is presented in Note 3.5. Mandatory banking reserve as at 31.12.2017 was 1% (2016: 1%) of all financial resources 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 11 Available-for-sale financial assets

The Group has available-for-sale debt and equity securities portfolio consisting of bonds in the amount of EUR 555 (31.12.2016: 579) thousand and VISA shares in the amount of EUR 220 (31.12.2016: 220) thousand. The balance of other reserves in equity as at 31.12.2017 is EUR 36 thousand (31.12.2016: EUR -40 thousand), see also Note 21.

In 2017 and 2016, no gains or losses arose from the sale of debt securities.

In 2016, VISA shares was revalued to EUR 889 thousand, on which profit on disposal was recycled to profit and loss statement during 2016.

Available-for-sale financial assets 31.12.2015	3 508
Proceeds from disposal and maturities of assets available-for-sale	-3 608
Interest income (Note 7)	27
Revaluation of available-for-sale assets	-17
Revaluation reclassified through profit or loss	889
Available-for-sale financial assets 31.12.2016	799
Proceeds from disposal and maturities of assets available-for-sale	-124
Interest income (Note 7)	24
Revaluation of available-for-sale assets	76
Available-for-sale financial assets 31.12.2017	775

NOTE 12 Financial assets and liabilities at fair value through profit or loss

Securities held for trading:	31.12.2017	31.12.2016
Shares and fund units	430	458
Debt securities	49 138	63 817
Designated as at fair value through profit or loss upon initial recognition:		
Fund units	6 261	10 866
incl. investments in managed pension funds	6 261	10 866
Foreign exchange forwards	30	250
Total financial assets	55 859	75 391
Interest rate swaps and foreign exchange forwards	2	209
Total financial liabilities	2	209
Financial assets at fair value through profit or loss 31.12.2015		106 608
Net changes of investment securities at fair value through profit or loss		-32 140
Interest income (Note 7)		353
Revaluation		570
Financial assets at fair value through profit or loss 31.12.2016		75 391
Net changes of investment securities at fair value through profit or loss		-19 962
Interest income (Note 7)		182
Revaluation		248
Financial assets at fair value through profit or loss 31.12.2017		55 859

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.6). In 2017, a gain of EUR 440 thousand was recognised on the revaluation of debt securities (2016: EUR 213 thousand). No profit or loss arose on the revaluation of interest rate swaps in 2017 (2016: loss EUR 0 thousand).

The volume of pension and investment fund assets managed by the Group as at 31.12.2017 was EUR 1 103 million (31.12.2016: EUR 974 million).

NOTE 13 Loans and advances to customers

<i>(in thousands of euros)</i>	31.12.2017	31.12.2016
Loans to legal entities	548 424	418 257
incl. corporate loans	456 748	341 358
incl. retail loans	13 656	7 088
incl. leasing	33 840	33 700
incl. overdraft	39 192	31 333
incl. leveraged loans	4 547	4 383
incl. hire-purchase	269	265
incl. credit card loans	172	130
Loans to individuals	191 744	125 125
incl. hire-purchase	57 327	46 812
incl. mortgage loans	77 640	35 451
incl. consumer loans	34 474	27 294
incl. leasing	11 402	7 694
incl. leveraged loans	2 621	3 004
incl. credit card loans	8 199	4 788
incl. overdraft	81	82
Total	740 168	543 382
incl. related parties (note 24)	2 820	1 774
Impairment provisions	-8 125	-5 741
Total	732 043	537 641

As at 31.12.2017, leverage loans included repo loans in the amount of EUR 778 (31.12.2016: EUR 3 022) thousand. The fair value of collaterals for repo loans as at 31.12.2017 was EUR 1 832 (31.12.2016: EUR 5 439) thousand.

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Changes in impairments in 2017	Corporate loans incl. overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leveraged loans	Other loans incl mortgage	Total
Balance as at 1 January	-2 338	-101	-1 599	-118	-1 223	-219	0	-143	-5 741
Impairment provisions set up during the year	-2 257	-54	-196	-157	-843	-570	0	-100	-4 177
Written off during the year	1	0	540	35	1 208	9	0	0	1 793
Balance as at December 31	-4 594	-155	-1 255	-240	-858	-780	0	-243	-8 125

Changes in impairments in 2016	Corporate loans incl. overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leveraged loans	Other loans incl mortgage	Total
Balance as at 1 January	-1 686	0	-1 092	-110	-1 366	-349	0	-77	-4 680
Impairment provisions set up during the year	-847	-101	-1 169	-42	-449	93	0	-66	-2 581
Written off during the year	195	0	662	34	592	37	0	0	1 520
Balance as at December 31	-2 338	-101	-1 599	-118	-1 223	-219	0	-143	-5 741

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

Net and gross investments on finance leases according to remaining maturity	Gross investment	Unearned future interest income	Impairment loss provision	Present value of lease payments receivable
up to 1 year	15 846	-1 274	-635	13 937
1-5 years	32 406	-1 756	-142	30 508
over 5 years	820	-20	-4	796
Total as at 31.12.2017	49 072	-3 050	-780	45 242
up to 1 year	13 413	-1 379	-67	11 967
1-5 years	30 862	-1 837	-149	28 876
over 5 years	573	-19	-3	551
Total as at 31.12.2016	44 848	-3 235	-219	41 394

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 3.5.

For interest income on loans granted, see Note 7

NOTE 14 Receivables from customers

(in thousands of euros)	31.12.2017	31.12.2016
Asset management fees from customers	1 179	1 238
incl. related parties (Note 24)	1 156	1 238
Other fees for providing services to customers	7 302	1 890
Payments in transit	6	15
Other receivables	1 313	336
Total	9 800	3 479

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

NOTE 15 Other assets

<i>(in thousands of euros)</i>	31.12.2017	31.12.2016
Financial assets		
Guarantee deposits of Baltic stock exchanges	9	8
Guarantee deposits of VISA and MasterCard	2 280	933
Subtotal	2 289	941
Non-financial assets		
Prepayments to Financial Supervision Authority	446	272
Tax prepayments	10	112
Repossessed assets	22	22
Prepayments to merchants for registered customer contracts	52	67
Other prepayments *	986	918
Subtotal	1 516	1 391
Total	3 805	2 332

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

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

NOTE 16 Tangible and intangible assets

<i>(in thousands of euros)</i>	Tangible assets	Intangible assets	Total
Balance as at 31.12.2015			
Cost	2 592	2 291	4 883
Accumulated depreciation and amortisation	-1 907	-1 602	-3 509
Carrying amount	685	689	1 374
Purchase of non-current assets	959	923	1 882
Acquisition of non-current assets	0	4 030	4 030
non-current assets sold	-13	0	-13
Depreciation/amortisation charge	-423	-1 108	-1 531
Write-off of non-current assets	-17	-34	-51
Balance as at 31.12.2016			
Cost	3 521	7 210	10 731
Accumulated depreciation and amortisation	-2 330	-2 710	-5 040
Carrying amount	1 191	4 500	5 691
Purchase of non-current assets	618	848	1 466
Depreciation/amortisation charge	-327	-1 021	-1 348
Non-current assets sold	-61	0	-61
Balance as at 31.12.2017			
Cost	4 078	8 058	12 136
Accumulated depreciation and amortisation	-2 657	-3 731	-6 388
Carrying amount	1 421	4 327	5 748

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

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

NOTE 17 Deposits from customers and loans received

<i>(in thousands of euros)</i>	Individuals	Legal entities	Public sector	31.12.2017 total
Demand deposits	278 430	1 124 946	6 203	1 409 579
Term deposits	51 075	70 221	5 816	127 112
Loans received	0	6 000	0	6 000
Accrued interest liability	144	87	7	238
Total	329 649	1 201 254	12 026	1 542 929
incl. related parties (Note 24)	2 022	20 973	0	22 995

<i>(in thousands of euros)</i>	Individuals	Legal entities	Public sector	31.12.2017 total
Demand deposits	202 725	413 141	8 260	624 126
Term deposits	63 749	81 945	6 469	152 163
Loans received	0	0	778	778
Accrued interest liability	209	285	20	514
Total	266 683	495 371	15 527	777 581
incl. related parties (Note 24)	1 165	6 265	0	7 430

In 2017, a loan received from the Rural Development Foundation in the amount of EUR 778 thousand was returned. 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 31.12.2017, the Bank had used EUR 6 000 thousand of the loan amount.

The nominal interest rates of most deposits from customers and loans received equal their effective interest rates as no other significant fees have been paid.

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

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

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

NOTE 18 Accounts payable and other liabilities

Financial liabilities

<i>(in thousands of euros)</i>	Note	31.12.2017	31.12.2016
Trade payables		8 507	2 686
Payables to merchants		439	330
Other short-term financial liabilities		1 878	1 551
Accrued interest on subordinated loans	20	210	210
Payments in transit		55 661	11 063
Financial guarantee contracts issued		137	137
Subtotal		66 832	15 977
Non-financial liabilities			
Performance guarantee contracts issued		159	228
Tax liabilities		700	886
Payables to employees		1 238	1 020
incl. related parties	24	84	92
Other short-term liabilities		2 141	920
Subtotal		4 238	3 054
Total		71 070	19 031

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 custo-

mers 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 19 Operating lease

The Group leases office premises under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period are

disclosed in the table below. In 2017, the operating lease payments for office premises in the amount of EUR 1 170 thousand (2016: EUR 973 thousand).

<i>(in thousands of euros)</i>	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as of 31.12.2017	1 195	2 152	3 347
Non-cancellable lease payables as of 31.12.2016	1 132	3 718	4 850

NOTE 20 Subordinated debts

According to the Group's bonds in the amount of EUR 555 (31.12.2016: EUR 579) thousand, and the Groups operations, only subordinated debts are recognized as loans received in the statement of cash flows, as other loans are received as part of ordinary business operations. The current note contains changes in subordinated debts, including monetary or non-monetary movements and effects of foreign exchange rates, if they have occurred during the reporting period or the reference period.

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 debts

<i>(in thousands of euros)</i>	Year of issue	Amount	Interest rate	Maturity date
	2014	15 900	7.25%	June 20, 2024
	2015	15 000	6.50%	October 29, 2025
Subordinated debt as at 31.12.2015		30 900		
Subordinated debt as at 31.12.2016		30 900		
Subordinated debt as at 31.12.2017		30 900		

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

Interest liability from subordinated debt

<i>(in thousands of euros)</i>	
Accrued interest on subordinated debts as at 31.12.2015 (Note 18)	205
Interest calculated for 2016 (Note 7)	2 125
Paid out during 2016	-2 120
Accrued interest on subordinated debts as at 31.12.2016 (Note 18)	210
Interest calculated for 2017 (Note 7)	2 136
Paid out during 2017	-2 136
Accrued interest on subordinated debts as at 31.12.2017 (Note 18)	210

NOTE 21 Shareholders' equity in the public limited company

Transactions with share capital and share premium	Time	Share price	Number of shares	Share premium	Total
Share capital as at 31.12.2015			23 356	33 992	
Paid in share capital	May 2016	6,95	2 000	11 900	13 900
Share capital as at 31.12.2016			25 356	45 892	
Paid in share capital	July 2017	2,0	411	412	823
Share capital as at 31.12.2017			25 767	46 304	

Share capital is paid in full through cash contributions. The nominal value of the shares is 1 euro and as at 31.12.2017 the number of shares amounted to 25 767 342 (31.12.2016: 25 356 005). Each share gives one vote to the shareholder at the general meeting.

According to AS LHV Group's articles of association, the minimum share capital is EUR 15 million and the maximum share capital is EUR 60 million (31.12.2016: EUR 15 and EUR 60 million).

Rain Lõhmus who owns 25.14% of the voting rights and Andres Viisemann who owns 9.87% of the voting rights in AS LHV Group have significant influence over the company (31.12.2016: 25.9% and 9.81%).

In the reporting year, the Group paid dividends to shareholders

of 0.15 EUR per share, amounting to a total of EUR 3 803 thousand.

As at 31.12.2017, the retained earnings of the Group totalled EUR 44 071 thousand (31.12.2016: EUR 28 335 thousand). As of 31.12.2017 it is possible to pay out dividends in amount EUR 35 257 (2016: 22 668) thousand and the related income tax charge would be EUR 8 814 (2016: 5 667) thousand.

Statutory reserve capital in equity is as follows:

(in thousands of euros)

Statutory reserve as at 31.12.2015	895
Transferred from 2015 net profit	685
Statutory reserve as at 31.12.2016	1 580
Transferred from 2016 net profit	891
Statutory reserve as at 31.12.2017	2 471

Other reserves in the consolidated statement of Changes in Equity consist of:

(in thousands of euros)	31.12.2017	31.12.2016
Revaluation reserve of available-for-sale securities	36	-40
Reserve of share options granted to staff	1 413	1 284
Total	1 449	1 244

The Group is granting share options to the members of the Management Board and employees considered as such and department managers and employees considered as such of group companies that are part of AS LHV Group.

	Number of shares	Strike price per share (EUR)	Exercise period	Number of people to whom the share options were granted
Outstanding amount of share options at 31.12.2013	0			
Granted amount during the period	411 336	2.0	01.07.2017-30.09.2017	35
Outstanding amount of share options at 31.12.2014	411 336			
Granted amount during the period	278 594	2.4	01.05.2018-31.07.2018	48
Outstanding amount of share options at 31.12.2015	689 930			
Granted amount during the period	270 330	3.0	01.05.2019-31.07.2019	48
Cancelled amount during the period	-62 183			
Outstanding amount of share options at 31.12.2016	898 077			
Granted amount during the period	364 990	4.65	01.05.2020-31.07.2020	69
Executed amount during the period	-411 336			
Outstanding amount of share options at 31.12.2017	851 731			

The Group may issue share options for the results of 2017. The vesting period for all share options in the option program is 3 years. The right to subscribe will occur on the first day of the exercising period. In 2017, share options issued in 2014 were fully exercised.

The members of the Management Board and employees do not have the possibility to take the specified amount in cash in lieu of the share options. Share options cannot

be exchanged, sold, pledged or encumbered. Share options can be inherited. The contract for share options will expire upon premature termination of the employment contract on the employee's initiative, for which exceptions can be made by the Supervisory Board of AS LHV Group or the Remuneration Committee based on the decision of the Supervisory Board, and upon extraordinary termination of the employment contract by the employer due

to reasons resulting from the employee. According to the Credit Institutions Act the Supervisory Board of AS LHV Group can reduce the number of share options issued or cancel the share options if the overall financial results of the Company have significantly deteriorated compared to the previous period, the member of the Management Board or employee no longer meets the performance criteria, the Company no longer meets the prudential regulations or the

Company's business risks are not adequately covered by Company's own funds or the performance fee has been determined based on information, which proved to be substantially misstated or incorrect.

Total expenses arising from share-based payment transactions amounted to EUR 959 (2016: 710) thousand.

NOTE 22 Assets under management

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

<i>(in thousands of euros)</i>	31.12.2017	31.12.2016
Cash balance of customers	10 266	11 657
Securities of customers	1 193 235	981 251
incl. shareholders of the parent company and related entities (Note 24)	168 637	76 803
Total	1 203 501	992 908

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 8).

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 23 Contingent assets and liabilities

Non-cancellable agreements	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2017	10 129	5 999	51	179 572	195 751
Liability in contractual amount 31.12.2016	12 695	5 442	0	132 520	150 657

Tax authorities have the right to review the company's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Group during 2016-2017. The Group's management estimates that in 2018 there are no such circumstances which may lead the tax authorities to

impose significant additional taxes on the Group.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the insured event (i.e. the failure to perform the contractual obligation by another party) occurs. The

key risks the Group faces are significant fluctuations in the frequency and severity of payments incurred on such contracts relative to expectations. The Group uses historical data and statistical techniques to predict levels of such payments. Claims must be made before the contract matures and most claims are settled within short term. This allows the Group to achieve a high degree of certainty about the estimated payments and therefore future cash flows. The Group manages such risks by constantly monitoring the level of payments for such products and has the

ability to adjust its fees in the future to reflect any change in claim payments experience. The Group has a claim payment requests handling process, which includes the right to review the claim and reject fraudulent or non-compliant requests. The exposure and concentration of performance guarantees expressed at the amounts guaranteed is as follows:

According to sectors	31.12.2017	31.12.2016
Construction	7 083	7 170
Water supplies	1 237	2 062
Manufacturing	212	1 594
Professional, scientific and technical activities	708	152
Other areas at activities	889	1 718
Total	10 129	12 695

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

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

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NOTE 24 Transactions with related parties

In preparing the financial statements of the Group, the following entities have been considered related parties:

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

Transactions	Note	2017	2016
Interest income	7	63	53
incl. management		27	17
incl. shareholders, their related entities and close relatives that have significant influence		36	36
Fee and commission income	8	8	5
incl. management		2	1
incl. shareholders, their related entities and close relatives that have significant influence		6	4
Interest expenses from deposits	7	41	46
incl. management		1	3
incl. shareholders, their related entities and close relatives that have significant influence		40	43
Interest expenses from subordinated debt	7	336	364
incl. management		7	34
incl. shareholders, their related entities and close relatives that have significant influence		329	330
Balances	Note	31.12.2017	31.12.2016
Loans and receivables as at the year-end		2 820	2 708
incl. management	14	1 736	1 596
incl. shareholders, their related entities and close relatives that have significant influence	14	1 084	1 112
Deposits as at the year-end		22 995	7 430
incl. management	18	283	236
incl. shareholders, their related entities and close relatives that have significant influence	18	22 712	7 194
Subordinated debt as at the year-end		4 999	4 799
incl. management	21	104	104
incl. shareholders, their related entities and close relatives that have significant influence	21	4 895	4 695

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.

Loans granted to related parties are issued at market conditions.

As at 31.12.2017 and 31.12.2016, the management did not have term deposits and the interest rate on demand

deposits corresponds to the terms applicable to customers.

The subordinated debts received in October 2015 have the interest rate of 6.5%. The subordinated debts received in June 2014 have the interest rate of 7.25%, refer to Note 20.

In 2017, salaries and other compensations paid to the management of the parent AS LHV Group and its subsidiaries totalled EUR 1 371 thousand (2016: EUR 1 198 thousand), including all taxes. As at 31.12.2017, remuneration for December and accrued holiday pay in the amount of EUR 84 thousand (31.12.2016: EUR 92 thousand) is reported as a payable to management (Note 18). The Group did

not have any long-term payables or commitments to the members of the management board and the supervisory board as at 31.12.2017 and 31.12.2016 (pension liabilities, termination benefits, etc.). In 2017, the remuneration paid to the members of the Group's supervisory board totalled EUR 39 thousand (2016: EUR 54 thousand).

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.

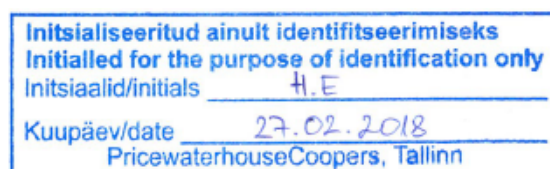
Management is involved with share option program. In 2017, the share options were granted to the members of the management board in the amount of EUR 420 thousand (2016: EUR 261 thousand).

Information on assets of related parties held as an account manager is presented in Note 22.

NOTE 25 Basic earnings and diluted earnings per share

In order to calculate basic earnings per share, net profit attributable to owners of the parent has been divided by the weighted average number of shares issued.

	2017	2016
Net profit attributable to owners of the parent (in thousands of euros)	19 603	17 798
Weighted average number of shares (in thousands of units)	25 562	24 856
Basic earnings per share (EUR)	0.77	0.72
Weighted average number of shares used for calculating the diluted earnings per shares (in thousands of units)	26 049	25 336
Diluted earnings per share (EUR)	0.75	0.70
Weighted average number of shares used as the denominator (in thousands of shares)	2017	2016
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	25 562	24 856
Adjustments for calculation of diluted earnings per share:		
Share options	488	480
Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share	26 049	25 336



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

<i>(in thousands of euros)</i>	2017	2016
Interest income	1 530	1 390
Interest expense	-2 136	-2 125
Net interest expense	-606	-735
Dividends received	3 803	0
Net gains/losses from investments to associates	0	1
Net gains/losses from financial assets	3 803	1
Operating expenses	-471	-601
Net loss for the year	2 726	-1 335
Total loss and other comprehensive loss for the year	2 726	-1 335

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Statement of financial position of the parent

<i>(in thousands of euros)</i>	31.12.2017	31.12.2016
Assets		
Due from banks and investment companies	11 018	7 638
Loans granted	22 286	22 285
Other receivables and assets	6	4
Investments in subsidiaries	64 955	67 617
Total assets	98 265	97 544
Liabilities		
Accrued expenses and other liabilities	60	43
Subordinated debt	31 110	31 110
Total liabilities	31 170	31 153
Equity		
Share capital	25 767	25 356
Share premium	46 304	45 892
Statutory reserve capital	2 471	1 580
Other reserves	1 413	1 283
Accumulated deficit	-8 860	-7 720
Total shareholders' equity	67 095	66 391
Total liabilities and equity	98 265	97 544

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Statement of cash flows of the parent

<i>(in thousands of euros)</i>	2017	2016
Cash flows from operating activities		
Interest received	1 530	1 390
Interest paid	-2 136	-2 125
Administrative and other operating expenses paid	-441	-598
Cash flows from operating activities before change in operating assets and liabilities	-1 047	-1 333
Adjustments		
Investments in subsidiaries from share options	-938	-712
Net increase/(decrease) in operating assets and liabilities:		
Net increase/(decrease) of other receivables	-2	26
Net increase/(decrease) of other liabilities	944	630
Net cash from/(used in) operating activities	-1 043	-1 389
Cash flows from investing activities		
Loans granted	0	-5 600
Capital repayments from subsidiaries and associates	6 600	2 700
Capital contributions to subsidiaries and associates	-3 000	-13 243
Net cash from/(used in) investing activities	3 600	-16 143
Cash flows from financing activities		
Paid in to share capital (incl. share premium)	823	13 900
Dividends received	3 803	0
Dividends paid	-3 803	0
Net cash from financing activities	823	13 900
Increase/(decrease) in cash and cash equivalents	3 380	3 632
Cash and cash equivalents at the beginning of the financial year	7 638	11 270
Cash and cash equivalents at the end of the financial year	11 018	7 638

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Statement of changes in shareholders' equity

<i>(in thousands of euros)</i>	Share capital	Share premium	Statutory reserve capital	Other reserves	Accumulated loss/retained earnings	Total
Balance as at 01.01.2016	23 356	33 992	895	575	-5 700	53 118
Paid in share capital	2 000	11 900	0	0	0	13 900
Transfer to statutory reserve capital	0	0	685	0	-685	0
Share options	0	0	0	708	0	708
Total loss and other comprehensive loss for 2016	0	0	0	0	-1 335	-1 335
Balance as at 31.12.2016	25 356	45 892	1 580	1 283	-7 720	66 391
Carrying amount of holdings under control and significant influence	0	0	0	0	-66 781	-66 781
Value of holdings under control and significant influence under equity method	0	0	0	-39	102 836	102 797
Adjusted unconsolidated equity as at 31.12.2016	25 356	45 892	1 580	1 244	28 335	102 407
Balance as at 01.01.2017	25 356	45 892	1 580	1 283	-7 720	66 391
Paid in share capital	411	412	0	0	0	823
Dividends paid	0	0	0	0	-3 803	-3 803
Transfer to statutory reserve capital	0	0	891	0	-891	0
Share options	0	0	0	130	827	957
Total other comprehensive income for 2017	0	0	0	0	2 727	2 727
Balance as at 31.12.2017	25 767	46 304	2 471	1 413	-8 860	67 095
Carrying amount of holdings under control and significant influence	0	0	0	0	-64 117	-64 117
Value of holdings under control and significant influence under equity method	0	0	0	36	117 048	117 084
Adjusted unconsolidated equity as at 31.12.2017	25 767	46 304	2 471	1 449	44 071	120 062

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

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Signatures of the management board to the consolidated annual report

The management board has prepared the management report and the consolidated financial statements of AS LHV Group for the financial year ended 31 December 2017.

The management board confirms that the management report on pages 4 to 35 provides a true and fair view of the business operations, financial results and financial condition of the parent company and the entities included in consolidation as a whole.

The management board confirms that according to their best knowledge the consolidated financial report on pages 36 to 101 presents a fair view of the assets, liabilities, financial position and profit or loss of the issuer and the entities involved in the consolidation as a whole according to the International Financial Reporting Standards as they are adopted by the European Union and contains a description of the main risks and doubts.

22.02.2018



Madis Toomsalu



Independent auditor's report

To the Shareholders of AS LHV Group

(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 Group and its subsidiaries (together the Group) as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

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

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of profit or loss and other comprehensive income for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

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

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59¹ of the Auditors Activities Act of the Republic of Estonia.

Our audit approach

Overview



Materiality

Overall group materiality is EUR 1,170 thousand, which represents 5% of profit before tax.

Audit scope

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

Key audit matters

- Impairment of loans and advances to customers

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

Materiality

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

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

Overall group materiality	EUR 1,170 thousand
How we determined it	5% of profit before tax
Rationale for the materiality benchmark applied	The use of profit before tax is considered appropriate as, in our view, profit before tax is stakeholders' primary measurement benchmark and key performance indicator for the Management and Supervisory Board.



Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
<p>Impairment of loans and advances to customers (refer to Note 2 “Summary of significant accounting policies”, Note 3.2 “Credit risk” and Note 13 “Loans and advances to customers” for further details).</p> <p>As at 31 December 2017 loans and advances to customers amounted to EUR 732 million and related impairment loss for 2017 amounted to EUR 3.2 million.</p> <p>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.</p> <p>For corporate loans, a portion of impairment is individually assessed by taking into consideration the credit rating of the customer and other known heightened risk factors. Credit rating is assigned considering a combination of financial and business risks associated with the customer. Individual impairment is calculated based on the exposure and realisable value of the collateral at the balance sheet date.</p> <p>In addition to individual assessment and impairment calculation of corporate loans, a significant portion of their impairment is calculated on a collective basis, taking into account customer rating, historical performance, the probability of default, loss given default and other factors.</p> <p>Loans to individuals and loans to legal entities (other than corporate loans) are grouped for impairment calculation purposes into sub-classes on the basis of homogeneous credit risk features. The major part of impairment for those sub-classes is calculated on a collective basis, taking into account historical performance, the probability of default, loss given default and other factors.</p>	<p>We assessed whether the Group’s accounting policies in relation to the impairment of loans and advances to customers are in compliance with IFRS.</p> <p>We assessed the design and operating effectiveness of the controls over impairment data and calculations. These controls included those over the identification of which loans and advances were individually impaired (overdue loans monitoring) and the calculation of the collective impairment provisions (including validation process of collective impairment model inputs).</p> <p>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.</p> <p>We performed detailed testing over:</p> <ul style="list-style-type: none">• the completeness and accuracy of data in the impairment model for collective impairment calculations;• the internal assignment of credit ratings for corporate loan customers;• the assumptions used for critical inputs in the collective impairment model, such as probability of default and loss given default. We have checked the calculations of probability of default and loss given default performed by management for material loan products, by evaluating the correctness of the calculation methodology and historical data used;• the correctness of information on collaterals and their values in the loan systems; and• the completeness of loans subject to individual impairment assessment and related calculations.



Areas that require the most significant judgments and estimates are:

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

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

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

How we tailored our audit scope

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

The Group comprises a number of subsidiaries that mostly operate in Estonia and Lithuania (refer to Note 6). A full scope audit was performed by PwC Estonia or other PwC network firms for the following Group entities covering substantially all of the Group's consolidated statements of financial position and profit or loss:

- AS LHV Group;
- AS LHV Pank, including its subsidiary AS LHV Finance;
- AS LHV Varahaldus; and
- UAB Mokilizingas.

Where the work was performed by other PwC network firms, we determined the level of involvement we needed to have to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole. The nature, timing and extent of the work performed by other PwC network firms impacting the Group audit opinion is set and monitored in Estonia.



Other information

The Management Board is responsible for the other information contained in the consolidated annual report in addition to the consolidated financial statements and our auditor's report thereon.

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

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

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

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Ago Vilu', with a long horizontal stroke extending to the left.

Ago Vilu

Certified auditor in charge, auditor's certificate no.325

A handwritten signature in blue ink, appearing to read 'Verner Uiho', with a large loop at the top and a horizontal stroke at the bottom.

Verner Uiho

Auditor's certificate no.568

27 February 2018

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

Proposal for profit distribution

The management board of LHV Group proposes to the General Meeting of Shareholders to distribute the profit of the financial year 2017 as follows:

- transfer EUR 980 thousand to statutory reserve capital;
- pay dividends EUR 0.16 per share in the total amount of EUR 4 123 thousand;
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 14 500 thousand to retained earnings.


Signatures of the supervisory board to the annual report

22.02.2018

Chairman of the supervisory board:

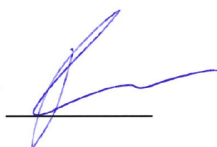
Rain Lõhmus

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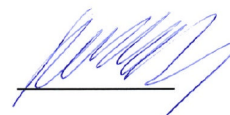


Members of the supervisory board:

Raivo Hein



Heldur Meerits

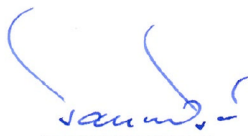


Tiina Mõis




Sten Tamkivi

Tauno Tats



Andres Viisemann



Allocation of income according to EMTA classifiers

Consolidated:

EMTAK	Activity	2017	2016
66121	Security and commodity contracts brokerage	4 010	4 250
64191	Credit institutions (banks) (granting loans)	49 091	39 692
64911	Finance lease	1 845	1 603
66301	Fund management	13 293	12 905
	Total income	68 239	58 450

Unconsolidated:

EMTAK	Activity	2017	2016
64201	Activities of holding companies	1 530	1 390
	Total income	1 530	1 390