AS LHV Group

Pillar 3 Report 2015

Main Pillar 3 disclosures in our Annual Report and our Pillar 3 Report

Pillar 3 disclosures topic with reference to CRR-Article	Primary location in our Annual report	Primary location in our Pillar 3 report
Scope of disclosure requirements (Article 431)	N/M	Introduction and disclosures
Risk management objectives and policies (Article 435)	Note 3 Risk Management	Risk strategy, risk appetite and risk
Scope of application (Article 436)	Introduction, Management report	Summary of LHV Group and financials
Own Funds (Article. 437)	Financial results, Consolidated Financial Statements	Capital structure and requirements
Capital requirements (Article 438)	Financial results	Summary of LHV Group and financials
Exposure to counterparty credit risk (Article 439)	Note 3 Point 3.2 Credit risk	Credit risk
Capital buffers (Article 440)	Note 3 Point 3.1 Capital management	Capital structure and requirements
Indicators of global systemic importance (Article 441)	N/M	Summary of LHV Group Financials
Credit risk adjustments (Article 442)	Note 3 Point 3.2 Credit risk	Credit risk
Unencumbered assets (Article 443)	Note 3 Point 3.4 Liquidity risk	Liquidity risk
Use of ECAIs (Article 444)	N/M	Credit risk
Exposure to market risk (Article 445)	Note 3 Point 3.3 Market risk	Market risk
Operational risk (Article 446)	Note 3 Point 3.7 Operational risk	Operational risk
Exposures in equities not included in the trading book (Article 447)	N/M	Additional disclosures
Exposure to interest rate risk on positions not included in the trading book (Article 448)	Note 3 Point 3.3 Market risk	Market risk including interest risk in banking book
Exposure to securitization positions (Article 449)	N/M	Additional disclosures
Remuneration policy (Article 450)	Note 25 Transactions with related parties, Governance of the Group	N/M
Leverage (Article. 451)	Financial Results	Capital structure and requirements
Use of the IRB Approach to credit risk (Article 452)	Financial Results	Credit risk
Use of credit risk mitigation techniques (Article 453)	Note 3 Point 3.2 Credit risk	Credit risk
Use of the Advanced Measurement Approaches to operational risk (Article 454)	N/M	Operational risk

Use of Internal Market Risk Models (Article 455)	N/M	N/M

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Summary of LHV Group and financials

AS LHV Group (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 (the Bank) and AS LHV Varahaldus (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, Tartu, Riga and Vilnius. Over 300 people work in LHV. Over 80 000 customers use banking services offered by LHV and the LHV's pension funds have over 147 000 clients.

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 (hereinafter: the Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia, Latvia, Lithuania and until 9th of January 2015 in Finland (discontinued operation). There are offices for client servicing in Tallinn, Tartu, Riga (till the end of March 2016) and Vilnius. The business activity of the AS LHV Pank branch office in Helsinki was sold in January 2015. AS LHV Finance (the subsidiary of AS LHV Pank) 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, hire-purchase and finance lease services in Lithuania.

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 mainly offers services of depositing and increasing monetary funds. For corporate clients LHV offers flexible and suitable financing and managing of everyday financial operations.

The products and services provided by 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.

All clients and partners of LHV may be owners of LHV in the future. LHV is a public company which is striving for listing its shares on the Tallinn Stock Exchange.

Disclosure

LHV Group's annual disclosures contain extensive information on risk as well as capital management. Per regulation it is not required to have Pillar 3 disclosures audited. As such the information provided in this Pillar 3 Report is unaudited.

The Pillar 3 report provides a detailed breakdown of LHV Group regulatory capital adequacy and how this relates to LHV Group risk management. In this report there are more detailed disclosures about risks and risk mitigation factors. This report should be read together with 2015 Financial Statements.

This Pillar 3 report has been prepared based on Financial Statements, which have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the years ended 31 December 2015, 31 December 2014 and 31 December 2013, 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. All these companies have been consolidated fully to Group report.

Summary financials and risk profile[1]

- Loan portfolio increased by EUR 94 million
- Deposits portfolio increased by EUR 176 million
- Volume of funds under management increased by EUR 66 million
- Risk weighted assets in capital adequacy calculation increased by EUR 99 million
- Own funds increased by EUR 28 million
- Net income increased by EUR 14.7 millio and cost to income ratio improved by 4.7 percentage points
- Liquidity coverage ratio improved to 271%

[1] Finnish business line was sold on 9th of January 2015. In all results this business unit's numbers are separated.

Regulatory environment

The purpose of this Report is to provide Pillar 3 disclosures of the Group as required by the global regulatory framework for capital and liquidity, established by the Basel Committee on Banking Supervision, also known as Basel 3. On European level these are implemented in the disclosure requirements as laid down in Part Eight of the "Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms" (Capital Requirements Regulation, or "CRR") and the "Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms" (Capital Requirements Directive 4, or "CRD 4").

Basel 3 and CRR/CRD 4

In the European Union, the Basel 3 capital framework was implemented by the "Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms" (Capital Requirements Regulation, or "CRR") published on June 27, 2013, and the "Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms" (Capital Requirements Directive 4, or "CRD 4") published on June 27, 2013. The CRR/CRD 4 framework replaced the laws implementing the international capital adequacy standards as recommended by the Basel Committee on Banking Supervision, commonly referred to as Basel 2 and Basel 2.5. As a single "rulebook", the CRR is directly applicable to credit institutions and investment firms in the European Union. Thus, the need for implementation of national regulatory legislation was eliminated in many instances. The determination of regulatory own funds, regulatory capital requirements, leverage and liquidity as well as other relevant regulations are now primarily regulated through the CRR.

The CRR/CRD 4 framework further introduced new liquidity standards. The Liquidity Coverage Ratio (LCR) aims to measure a bank's short-term resilience to a severe liquidity stress scenario during a stress period of 30 calendar days. Detailed rules for the calculation of the LCR are set out in the delegated act adopted in October 2014.

The LCR became a binding minimum requirement as of 1 January 2015.

The Net Stable Funding Ratio (NSFR) requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet exposures. It is expected that revised NSFR rules based on the final Basel framework will be published in 2016 and that a binding minimum ratio for the NSFR will apply from 2018.

There are still some interpretation uncertainties with regard to CRR/CRD 4 rules and some of the related binding Technical Standards are not yet available in their final version. Thus, we will continue to refine our assumptions and models in line with evolution of our knowledge as well as the industry's understanding and interpretation of the rules. Against this background, current CRR/CRD 4 measures may not be comparable to previous expectations.

Also, our CRR/CRD 4 measures may not be comparable with similarly labeled measures used by our competitors as our competitors' assumptions and estimates regarding such implementation may differ from ours.

Country based adjustments

LCR requirement for all banks in Estonia is set to 100%.

In addition to minimal capital requirements for credit institutions several additional buffers in own funds are used in Estonia. Capital conservation buffer of 2.5%, systemic importance buffer of 2.0% and starting from beginning of 2016 countercyclical capital buffer, what has set currently to 0%, but may vary between 0 to 2.5%. These buffers are additive to Tier 1 capital charge and so minimal Tier 1 capital requirement is 10.5% and total capital adequacy requirement is 12.5%. On top of that there also entity based Pillar 2 capital charge set by local financial authority based on SREP process.

ICAAP, ILAAP and SREP

The lnternal Capital Adequacy Assessment Process ("ICAAP") as stipulated in Pillar 2 of Basel 3 requires banks to identify and assess risks, maintain sufficient capital to face these risks and apply appropriate risk-management techniques to maintain adequate capitalization.

Our ICAAP is a group-wide process that involves various functions, policies, procedures, and methodologies. We calculate, assess, and monitor the capital adequacy position at the Group and for ICAAP relevant legal entities to ensure adequate capitalization against our defined risk appetite on an ongoing and forward looking basis both for actual and also stressed conditions.

The Internal Liquidity Adequacy Assessment Process ("ILAAP") similar to ICAAP focuses on maintaining sufficient liquidity risk management. We calculate, assess and monitor the liquidity and funding position for both Group and all ILAAP relevant Legal Entities to foster an adequate liquidity and funding management on an ongoing and forward looking basis. The assessment process takes account of the liquidity and funding risks to which the Group is exposed; how these risks are identified, monitored and measured. Within the Group, liquidity and funding risks are managed within a cohesive liquidity risk management and governance framework and the ILAAP aims to demonstrate how this framework operates to effectively manage risks.

The Supervisory Review and Evaluation Process ("SREP") refers to the common methodology and standards used by the European Central Bank (ECB) and local Financial Supervision Authority (FI). In accordance with Article 97 of the Capital Requirements Directive (CRD IV), supervisors regularly review the arrangement, strategies, process and mechanisms implemented by banks and evaluate: (a) the risks to which the institution might be exposed; (b) the risks the institution might pose to the financial system in general; and (c) the risks revealed by stress testing. The SREP process encompasses three main elements: a supervisory risk system (RAS); a comprehensive review of the bank's ICAAP and ILAAP framework; and finally, the evaluation of the bank's capital and liquidity needs. Under SREP, the ECB/FI may impose minimum capital requirements which are more stringent than the statutory requirements set forth in the CRR or the related regulations.

Business environment

A weaker recovery in advanced economies and a slowdown in emerging markets contributed to lower global growth during 2015. The euro area recovery was in line with expectations, and countries such as Spain and Italy performed better than expected. After two stable quarters, the US growth surprised the market on the downside, showing lower activity and capital spending not least in the oil sector. Despite lower-than-expected growth, US unemployment continued to decline, spurring expectations that eventually led the Federal Reserve to impose monetary policy tightening during late 2015, with the long-foreseen rate increase materializing in December. In addition, the year featured a substantial slowdown in emerging markets which can largely be attributed to a continued fall in commodity prices, not least the low oil price, and to lower-than-expected demand from China. Taken together, the expected monetary policy tightening in the US in combination with lower growth expectations in China contributed to volatile equity markets during the end of 2015. However, inflation surprised the market on the downside in most developed economies, despite accommodative monetary policy practices spurring expectations of continued low interest rates in the Eurozone and elsewhere.

LHV’s expectations for the next twelve months are moderately optimistic. Economic growth is accelerating, and the volume of investments will increase, albeit at a slowing pace. With the rate of growth in real wages and private consumption expected to decelerate, this is bound to affect the trade and real estate sector - the biggest contributors to economic growth in the last quarters. The situation on Estonia's key export markets is becoming increasingly important, along with dispersion of the export-related concentration risk.

Capital structure and requirements

The calculation of our regulatory capital incorporates the capital requirements following the "Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms" (Capital Requirements Regulation or "CRR") and the "Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms" (Capital Requirements Directive 4 or "CRD 4") as implemented into Estonian law.

The total regulatory capital pursuant to the effective regulations as of year-end 2015 comprises Tier 1 and Tier 2 (T2) capital.

Common Equity Tier 1 (CET 1) capital consists primarily of common share capital, retained earnings (including losses for the financial year, if any) and accumulated other comprehensive income, subject to regulatory adjustments (i.e. prudential filters and deductions). CET 1 capital deductions comprise (i) intangible assets, (ii) deferred tax assets that rely on future profitability, (iii) negative amounts resulting from the calculation of expected loss amounts. All items not deducted (i.e. amounts below the threshold) are subject to riskweighting.

Tier 2 (T2) capital comprises eligible capital instruments, the related share premium accounts and subordinated long term debt.

Overview about capital charge for LHV Group is presented in the following table:

Capital charge	CET 1	Tier 1	CAD
Minimum 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%
Countercyclical capital buffer	0.00%	0.00%	0.00%
Pillar 2 buffer (valid)			1.50%
Minimal regulatory capital charge	**9.00%**	**10.50%**	**14.00%**

Table 1. Capital charge of the Group

Failure to meet minimum capital requirements can result in supervisory measures such as restrictions of profit distributions or limitations on certain businesses such as lending. We complied with the regulatory capital adequacy requirements in 2015.

In addition to these minimum capital requirements, the following capital buffer requirements will be phased-in starting 2016 (other than the systemic risk buffer, if any, which is not subject to any phase-in) and will become fully effective from 2019 onwards. The buffer requirements must be met in addition to the minimum capital requirements, but can be drawn down in times of economic stress.

Development of regulatory capital

The Group's level of own funds as at 31.12.2015 was EUR 100,5 million (31.12.2014: EUR 72,5 million; 31.12.2013: EUR 44,9 million). The Group is well-capitalized as at the end of the reporting period with a capital adequacy level of 24.0% (31.12.2014: 22.8%; 31.12.2013: 23.0%) and Tier 1 capital ratio of 16.7% (31.12.2014: 17.6%; 31.12.2013: 15.3%).

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2015 was 7,5% (31.12.2014: 8,5%). 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).

Capital base (in EUR thousands)	31.12.2015	31.12.2014	31.12.2013
Paid-in share capital	23 356	23 356	19 202
Share premium	33 992	33 992	21 871
Statutory reserves transferred from net profit	895	435	223
Other reserves	-23	0	0
Accumulated deficit	-2 503	-11 244	-15 581
Intangible assets (subtracted)	-1 734	-1 574	-1 665
Net profit for accounting period	13 705	9 203	4 206
Non-controlling interests	1 945	1 727	1 695
Total Tier 1 capital	**69 633**	**55 895**	**29 951**
Subordinated debt	30 900	16 650	19 635
Total Tier 2 capital	**30 900**	**16 650**	**19 635**
Exceeding limitations of subordinated debts and preference shares	0	0	-4 660
Net own funds for capital adequacy calculation	**100 533**	**72 545**	**44 926**

Table 2. The Group's capital base

The Group has not issued new Tier 1 capital instruments during 2015 and the only change in Tier 1 is coming from 2015 profit. The Group has decided not to pay out dividends, to cover future growth.

During 2015 LHV Group issued EUR 15 million worth of 10-year subordinated bonds. In total the Group has outstanding EUR 30.9 million worth of subordinated bonds. The bonds are traded on Nasdaq Tallinn Stock Exchange under ISIN nr: LHVB065025A and LHVB072524A. All other Tier 2 capital instruments have been paid back.

Main changes in risk management

The following outlines the most important changes in the 2015 LHV's risk management processes.

2015 continued to shift attention on group-wide risk management. The Group has agreed on group-wide risk reporting and monitoring processes. Many documents have been adopted on the Group level, such as risk management policy, credit policy, the definition of default document outsourcing policy control and compliance policies. There are regular discussions held with the Group entities. Also, the group has formed the risk and capital committee composed of Rain Lõhmus, Tiina Mõis and Andres Viisemann.

In 2015 internal ratings (IRB) methodology preparation started. LHV has set a goal to implement by 2017 the RWA calculation on the IRB methodology. IRB implementation requires prior authorization by the Financial Supervision Authority and also different asset classes may be phased to different periods. According to the plan, the first asset classes moving to IRB methodology are corporate loans, which represent over 70% of the total loan portfolio of LHV Group. In February 2016 the Group submitted preliminary application to the Financial Supervision Authority. According to the project plan, the Group is planning to submit formal request to the Financial Supervision Authority in the third quarter.

The development of credit quality assessment toolscontinued. Prior to the issuance of credit all credit applications have to pass credit scoring and rating models, which evaluate the credit quality. In 2015, LHV Finance’s scoring models were validated and improved, at the beginning of 2016 a new leasing scoring model was developed. In collaboration with PWC, corporate lending rating system was validated.

Model results are the main input to the assessment of provisions. Based on the validation of provisioning models, provisioning rates were adjusted in LHV Finance, and in Mokilizingas. From 2016 also for leasing portfolios.

To emphasize the importance of the larger anti-money laundering activities in the field of risk management, a separate Prevention of Money Laundering unit was established and Aivar Paul started leading it in early 2016.

Risk strategy, risk appetite and risk profile

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

A clear structure has been established for committees that make the risk/related decisions. The main risk committees are presented in the following figure.

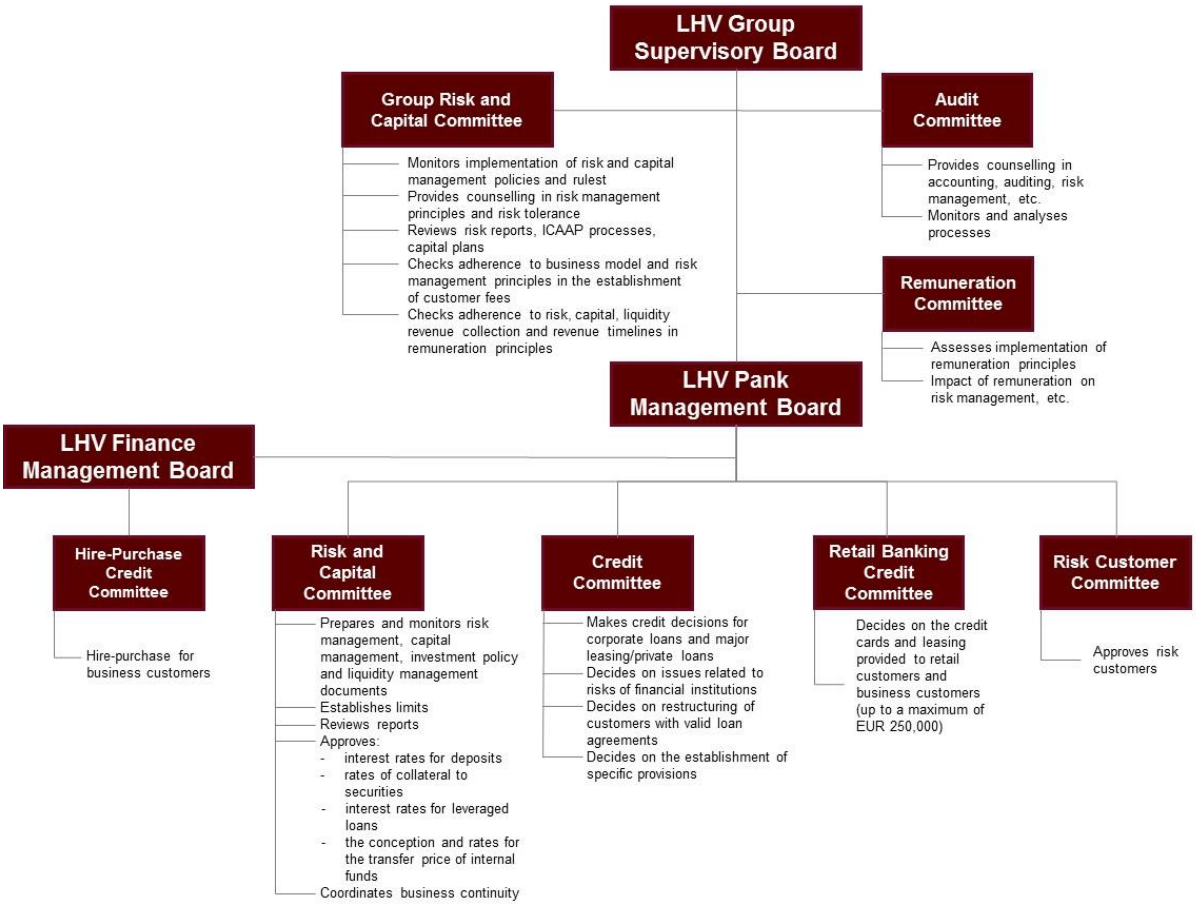

Figure 1. Overview of the Group's risk committees

LHV's strategic plan foresees an increasing of business volumes, while operating in Estonia and Lithuania. The risk appetite of LHV can be considered average in the current growth phase. At the same time, the capitalisation and risk management objectives and principles of LHV shall be based upon risk-taking. LHV's internal document „Capital objectives of LHV Group" stipulates that the minimum internal target capital adequacy level is 16.20%. The risk appetite of LHV is low in the categories of liquidity risk and operational risk, and average in the categories of credit risk and market risk. The objective of LHV in the next five years is to receive at least an investment grade credit rating from an international rating agency.

The description of risk appetite objectives for the main risk categories is provided below.

The objective related to **credit risk** is to achieve a diversified portfolio with a medium risk, in which the main part is formed by small and medium-sized enterprises, and private persons. In case of corporate clients, credit risk is mitigated by a very good knowledge of clients and strong securities. In case of financing of individuals, LHV operates in market segments, where the relationship between the risk and return is favourable. In combination with low operational expenses, flexible IT systems, convenient and analytical risk models it allows to operate profitably and sustainably. Each client shall undergo a thorough analysis - assessing their risk of insolvency and the value and liquidity of their collateral - before a credit decision is made. For making the credit decisions, the competence of account managers and committees has been defined in internal regulations.

The objectives related to **market risk** are earning profit from bond portfolio investments and providing services to clients. Risks can be taken only when they are priced correctly and understandable for the employees.

Methods have been established for measuring and monitoring the risks. Additionally, limits have been set and these are constantly monitored and regularly reported.

The objective of **liquidity risk** management is to maintain a sufficient liquidity buffer to ensure the performance of obligations. In order to manage the liquidity risk, principles have been established for assessing both the short-term liquidity risk and the structural financing risk, taking into account the new Basel III regulations. Furthermore, the Risk and Capital Committee has set limits for managing the liquidity risk. Stress-testing is performed on regular basis in order to maintain LHV's liquidity also in stressful conditions. The results of the tests are reported to the Risk and Capital Committee.

The objective regarding **operational risk** management is to limit potential losses. Duringrecent years the operational risk loss has remained below 60 thousand euros. AIG insurance is used for restricting potential large loss events due to operational risk.

The table below summarizes LHV's risk appetite and actual estimated risk levels for the main risk categories. Also the main methods for managing the risks are outlined: risk avoidance (A), risk limiting (L), risk mitigation (M), risk diversification (D).

	Actual risk level											
	Credit risk			Market risk			Liquidity risk			Operational risk		
	Low	Average	High	Low	Average	High	Low	Average	High	Low	Average	High
Desired risk level: Low							L, M				A, L, M	
Desired risk level: Average		L, M			D, M							
Desired risk level: High												

Table 3. The Group's actual and desired risk levels for the main risk categories

The level of operational risk is higher than the desired level of this risk. The main reason is that LHV is currently in the growth phase, where new products and services are introduced to the market.

Stress tests

Group-wide stress tests are an integral part of the Risk Management process and annual review of risk appetite. They aim to ensure that the Group's financial position and risk profile provide sufficient resilience to withstand the impact of severe economic stress or specific market/company related risks including IT risks.
The largest stress test is ICAAP process, which looks at severe but plausible and business relevant scenario. In addition to ICAAP stress, there are regularly performed stress tests against liquidity, IT security, business contingency etc risks.

Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability or unwillingness to meet its obligations to the Group.

LHV's credit risk arises mainly from the loan portfolio and the debt securities (bond portfolio). The loan portfolio includes corporate loans and overdrafts, consumer loans (in Estonia and in Lithuania), credit cards, mortgage loans, leveraged loans and leasing. LHV uses standardized approach to measure credit risk. In 2015 Group started developing IRB models and starting from 2016 is using IRB in parallel for internal capital allocation. Officially Group plans to start using IRB in nearest years.

Securities portfolio

During 2015 the market interest rates of the short and mid-term financial assets with the highest market liquidity and credit quality were still negative. In the 4th quarter of 2015 the European Central Bank (ECB) lowered the deposits interest rate by 10 basis points to the new level of -0.30%. This caused further price increase of the aforementioned financial assets. Considering this, LHV decided that it was unmeaningful to purchase this type of financial assets instead of holding the deposits in the ECB. Due to this, LHV's securities portfolio decreased in the 4th quarter of 2015. At the end of 2015 LHV's securities portfolio amounted to EUR 103 million and the share of securities with rating A- or higher was 96.8%.

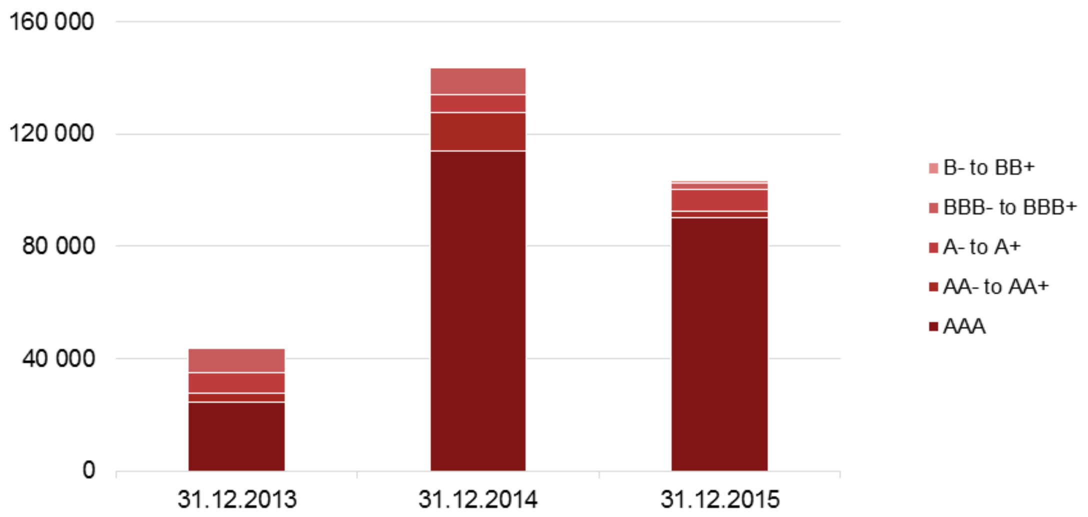

Figure 2. Securities portfolio (EUR thousands)

Loan portfolio

The gross volume of LHV's loan portfolio increased by EUR 93 million in 2015, i.e. by 29 %. The quickest growth was evident in the Estonian hire-purchase and small loan segment. The gross portfolio volume nearly doubled in 2015, amounting to EUR 25 million as at the end of the year. The gross volume of the new product launched in 2015 - small loan - totalled nearly EUR 6.4 million as at the end of the year. A bulk of the growth in the loan portfolio can be attributed to the growth in corporate loans (EUR 72 million). The leasing portfolio, the Lithuanian portfolios and other loan portfolios showed a more or less similar growth (EUR 8.6 million, 7.7 million and 7.7 million, respectively).

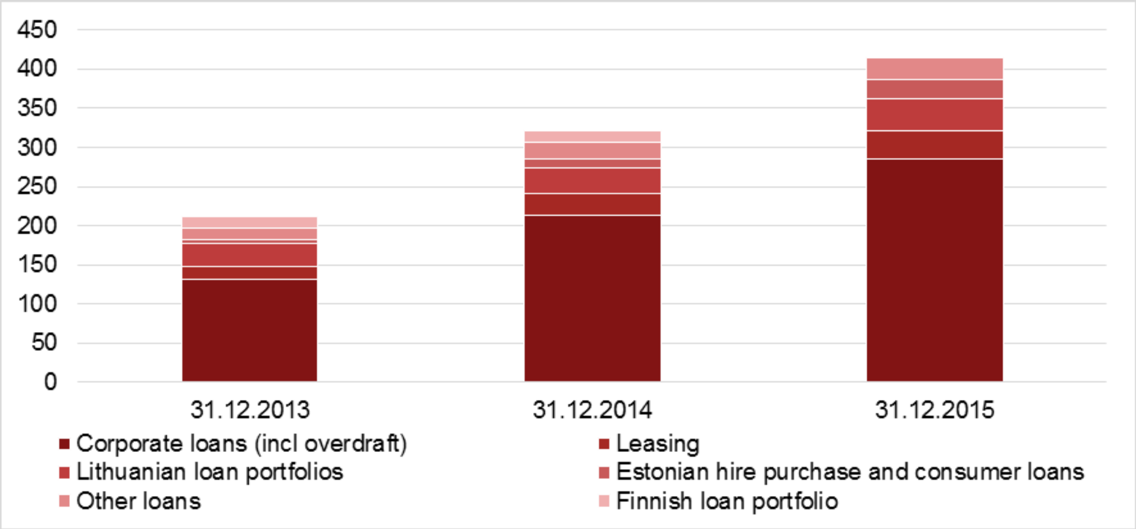

Figure 3. LHV loan portfolio split by product type (EUR million)

2015 saw a continued improvement in the credit quality of LHV's loan portfolios. The improvement was facilitated by specification of the objectives of portfolio management in the company's credit policy [1]. The credit quality was also positively influenced by business sales in Finland. Furthermore, LHV started to dispose of the portfolio of hire-purchase, small loan and credit card obligations overdue for more than 90 days.

As evident in the following table, the volume of overdue obligations in the portfolio decreased significantly in 2015. At the same time, LHV maintained its conservative provisioning principles - as at the end of the year, provisions covered nearly 300 % of the volume overdue for more than 90 days.

EUR thousands, % of total	31.12.2013	31.12.2014	31.12.2015
Loans granted,	212,289	321,412	414,676
Including past due:	8.0%	5.8%	2.5%
1-30 days	3.6%	2.6%	1.4%
31-60 days	1.3%	0.9%	0.5%
61-90 days	0.7%	0.5%	0.3%
91 days and over	2.4%	1.8%	0.4%
Loan impairments	(2.6%)	(1.7%)	(1.1%)
Share of impairments in loans over 90 days past due	110.0%	94.6%	296.0%

[1] Restrictions on portions of the portfolio with ratings of 9-12 and 10-12.

Table 4. Share of overdue loans and impairments in loans over 90 days past due

In 2015, the Group continued to standardise its provisioning rules and maintained a risk-based approach. The ratings-based provisioning method established in 2014 is used for the business loan portfolio. According to the above method, the highest provisioning rate is applied for the worst ratings (Figure 4). Rating 13 is established based on an indication of default specified in the internal rules of procedure. Where provisions need to be established, a specific provision is assigned for each customer. The provisioning parameters used for all loan categories are validated on a current basis, with the values changed where necessary.

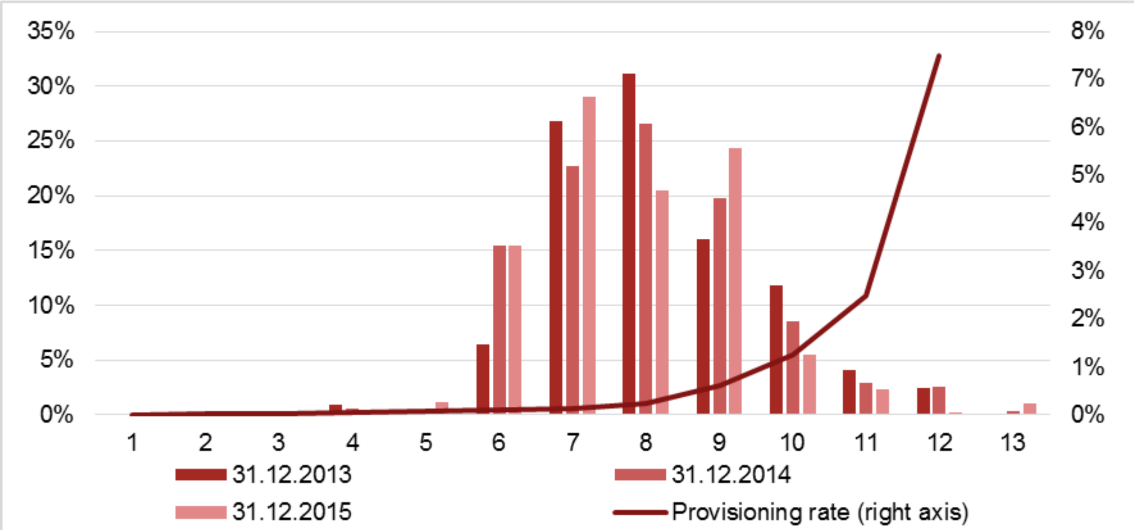

Figure 4. Corporate loans (including overdraft) distribution by rating class and respective general provisioning rates

Approximately 92 % of the total capital requirement for credit risk is associated with the loan portfolio (without considering the concentration risk). The remaining 8 % is divided between assets held with commercial banks, bonds, shares of LHV Varahaldus pension funds and other assets included in the balance sheet.

71 % of the capital requirement for the loan portfolio can be attributed to business loans, 10 % to Lithuanian consumer loans, 8 % to the leasing portfolio and 5 % to Estonian consumer loans (see Table 5 below). Internal assessments of the business loan, leasing and mortgage loan portfolios also takes account of the collateral (real estate and, in case of leasing, vehicles). Therefore, the internal capital requirements with regard to these portfolios are lower than those calculated under standardized rules. On the whole, the internal capital requirement of the loan portfolio is 28 % lower than the standardized capital requirement.

	Amount	Provisions	Regulative	Internal
Corporate banking	**300 234**	**1 686**	**258 075**	**181 298**
Corporate loans	287 012	1 686	253 512	177 203
Guarantees	13 222	-	4 563	4 094
Estonian retail banking	**62 904**	**528**	**40 768**	**31 037**
Leasing	36 452	341	26 340	20 313
Private banking	7 444	0	231	231
Credit cards	3 621	111	2 657	2 657
Retail loans	15 318	77	11 489	7 786
Overdraft	69	0	51	51
Lithuanian hire-purchase and consumer finance	**40 136**	**2 107**	**28 490**	**25 279**
LHV Finance hire-purchase and consumer finance	**25 486**	**358**	**18 846**	**12 196**
Total	**428 761**	**4 680**	**346 178**	**249 810**

Table 5. Loan portfolio risk weighted assets by loan products as at 31.12.2015 and comparison with regulative risk weighted assets (Group, EUR thousands)

The assessment of the regulatory capital requirement for bonds included in the banking portfolio is subject to a range of exceptions. Therefore, no regulatory capital requirement has been established (i.e. the risk weighting is set to zero) for the entire bond position (EEA central governments, European Investment Bank, etc.).

In internal calculations, an expert opinion was used for establishing a conservative risk weighting for such positions. A comparison of regulatory and internal risk weightings has been provided in Table 6.

Rating Agency			Class	Regulative	Internal	Amount
Moody's	S&P	Fitch				
Aaa	AAA	AAA	Prime	0%	1%	90 158
Aa1	AA+	AA+	High grade	0%	5%	0
Aa2	AA	AA		0%	10%	2 078
Aa3	AA-	AA-		0%	15%	0
A1	A+	A+	Upper medium grade	20%	20%	0
A2	A	A		20%	20%	0
A3	A-	A-		20%	30%	4 400
Baa1	BBB+	BBB+	Lower medium grade	50%	50%	2 548
Baa2	BBB	BBB		50%	50%	0
Baa3	BBB-	BBB-		50%	60%	994

Table 6. Regulative and internal risk weights for the securities in the securities portfolio as at 31.12.2015 (Group, EUR thousands)

Concentration risk

Concentration risk includs analysis of the concentration of economic sectors and counterparties.

Figure 5 (see below) serves to illustrate the sectoral breakdown of LHV's corporate loan portfolio (as the primary source of concentration risk), year-over-year. In the meantime, risk positions have been scaled down significantly as a result of real estate dynamics, growth in the manufacturing industry and other services. All counterparties considered (correspondent banks, counterparties of derivative transactions, bonds), the Herfindahl-Hirschman index, which is used for measuring the scale of the concentration risk, dropped from 21.3 % in 2014 to 19.1 % in 2015. Consequently, the capital requirement for sectoral concentration risk amounts to 4.63 % of the regulatory capital requirement (2014: 6 %).

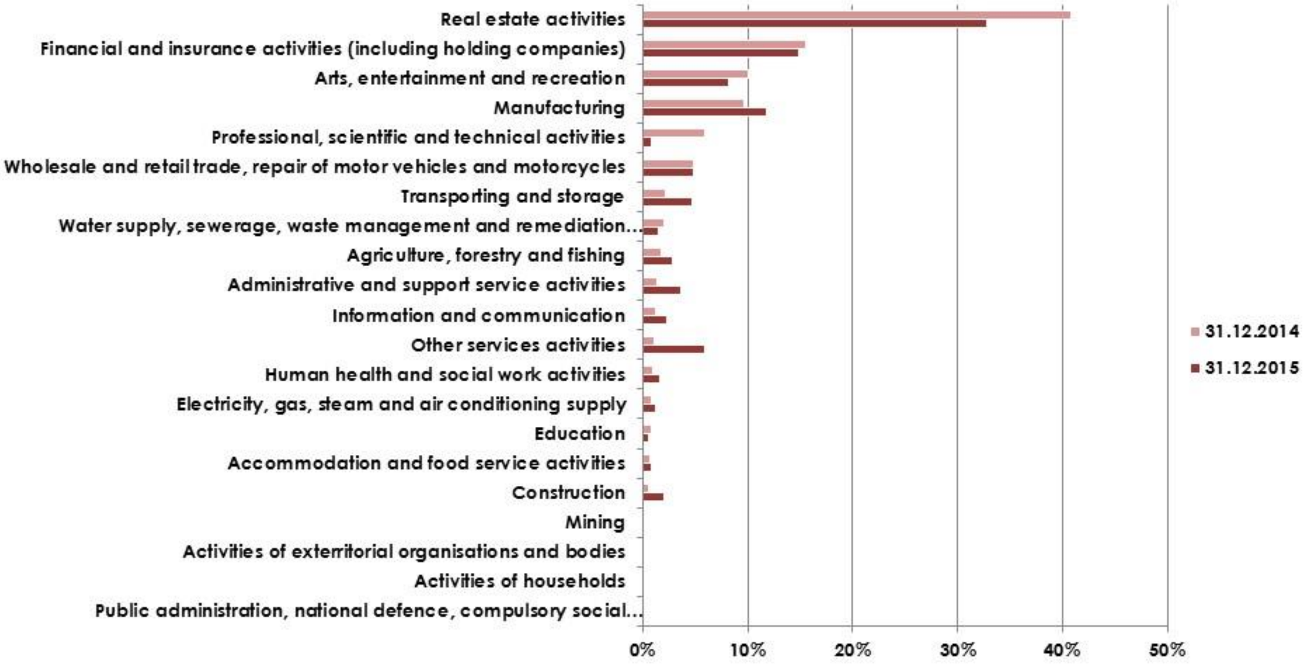

Figure 5. Loan portfolio breakdown by sector as at 31.12.2015 (LHV Pank, % of total loan portfolio)

** From 2016 onwards, LHV uses, in determining the capital requirement under the Herfindahl-Hirschman index, the supplementary method which, instead of 2 %-steps, increases smoothly against the increase in the value of the index, but retains the level of conservatism on the average.*

The following Figure 6 shows the breakdown of the corporate loan portfolio with regard to counterparties whose risk exposure exceeds EUR 1 million as at 31 December 2014 and 31 December 2015. Even though the number of counterparties has increased significantly, compared to the previous period, this increase does not exceed the growth of the loan portfolio as a whole, and is proportionally significantly lower than the rate of growth in capital.

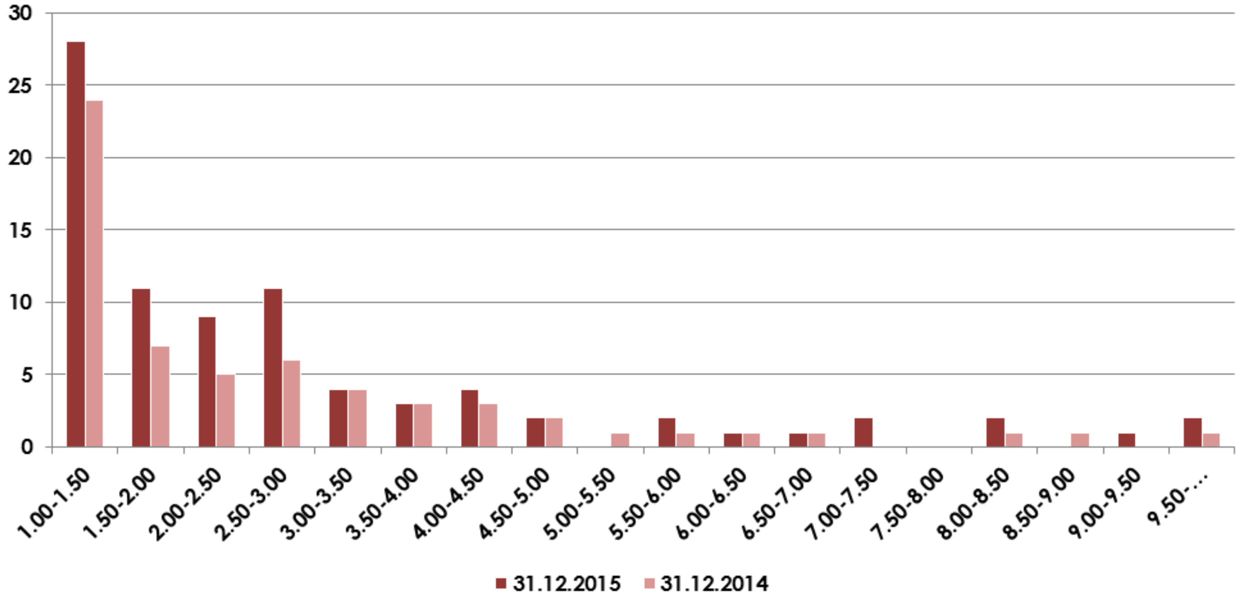

Figure 6. Number of counterparties whose exposure is higher than 1 million euros as at 31.12.2014 and 31.12.2015 (LHV Pank, number, EUR million)

Due to the high concentration of the bond portfolio with regard to EU and US bonds last year, the Herfindahl-Hirschman index, which measures concentration in terms of the bank's counterparties (correspondent banks, counterparties of derivative transactions, bonds), dropped from the level of 3.9 % in 2014 to 2.1 % in 2015. This means that the capital requirement for counterparty concentration risk amounts to 2.8 % of the regulatory capital requirement (2014: 4 %).

Market risk including interest risk in banking book

Market risk arises from LHV'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 potential losses. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures. Monitoring of the set limits is performed by the LHV Pank Risk Control Unit.

LHV Group has made decision not to take extensive positions including market risks. Main positions are rising from liquidity management, where LHV Bank holds sizable amount of it's liquidity in highly liquid bonds. Group does not take optionality risks and uses internal market risks models only in limited amount. For capitalization purposes only standard approach is used for calculating capital charges.

Foreign currency risk

Foreign currency risk may arise from acquisition of securities denominated in foreign currencies or foreign currency receivables and liabilities. The Risk Control Unit of LHV Pank is responsible for daily monitoring of open foreign currency positions. If the open currency position exceeds the internal or external limits set by the law, then measures are immediately implemented to close or reduce such positions (hedging the risk with relevant instruments, such as spot transaction, foreign currency forwards or futures).

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 ECB exchange rate prevailing at the balance sheet date. 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.

31.12.2015	**EUR**	**CHF**	**GBP**	**SEK**	**USD**	**Other**	**Total**
Assets bearing currency risk							
Due from banks and investment companies	218 849	1 638	1 101	587	7 338	988	**230 501**
Financial assets at fair value	71 894	0	0	1	38 213	8	**110 116**
Loans and advances to customers	408 804	0	0	79	1 070	44	**409 997**
Receivables from customers	1 945	0	0	0	81	0	**2 026**
Other financial assets	233	0	0	0	707	0	**940**
Total assets bearing currency risk	**701 725**	**1 638**	**1 101**	**667**	**47 409**	**1 040**	**753 580**
Liabilities bearing currency risk							
Deposits from customers and loans received	579 117	1 605	2 549	353	48 279	857	**632 760**
Financial liabilities at fair value	89	0	0	0	0	0	**89**
Accounts payable and other financial liabilities	4 015	45	2 902	308	9 219	799	**17 288**
Subordinated debt	30 900	0	0	0	0	0	**30 900**
Total liabilities bearing currency risk	**614 121**	**1 650**	**5 451**	**661**	**57 498**	**1 656**	**681 037**
Open gross position derivative assets at contractual value	0	0	4 360	0	10 127	0	**14 487**
Open gross position derivative liabilities at contractual value	14 487	0	0	0	0	0	**14 487**
Open foreign currency position	**73 117**	**-12**	**10**	**6**	**38**	**-616**	**72 543**

Table 7. The Group's open currency exposures (EUR thousands)

* 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.

Price risk

Financial instruments bearing price risk at the Group are mainly debt securities held in the trading portfolio and investment portfolio and available for sale portfolio. At the Group, limits are set for the size of the portfolios and acceptable credit quality ratings are specified for debt securities in the investment portfolio and trading portfolio. The Risk Control Unit monitors the compliance with limits. In addition, LHV Varahaldus mandatory shares in pension funds bear the price risk. Namely, pursuant to the Investment Funds Act, LHV Varahaldus as the management company has to own at least 1% of the number of units in each of the mandatory pension fund managed by it.

LHV Pank does not hold significant amounts of equity securities in its position, due to which the sensitivity to change in the market value of these positions is marginal. LHV Pank'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 as at 31.12.2015 should remain at around 1.0% according ot the performed stress-testing (2014: 0.9%.)

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

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

The deposits interest rates did not change in 2015 remaining at the level of up to 1.0%. The interest rates of deposits maintained their level in 2015, at a maximum of 1%.

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

The operational interest rate risk management is the Group's Treasury's responsibility.

31.12.2015	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest-earning assets					
Due from banks and investment companies	230 501	0	0	0	**230 501**
Financial assets at fair value (debt securities)	27 023	60 281	11 246	2 792	**101 342**
Loans and advances to customers	191 923	171 828	45 810	3 412	**412 973**
Total	**449 447**	**232 109**	**57 056**	**6 204**	**744 816**
Interest-bearing liabilities					
Deposits from customers and loans received	54 032	208 943	367 190	1 824	**631 989**
Subordinated debt	0	0	0	30 900	**30 900**
Total	**54 032**	**208 943**	**367 190**	**32 724**	**662 889**
Net interest sensitivity gap	**395 414**	**23 167**	**-310 134**	**-26 520**	**81 927**

Table 8. The Group’s interest-earning assets and interest-bearing liabilities structure based on the interest rate recalculation dates (EUR thousands)

Operational risk

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

LHV Group uses standard approach in measuring operational risk. At least once a year, a self-evaluation procedure is carried out with regard to risks and controls, aimed at identifying, evaluating and monitoring operational risks liable to affect the attainment of the business objectives. In 2015, the Group continued paying special attention to further development of business continuity processes. Critical business processes have now been mapped, along with the preparation of business continuity plans, so as to swiftly respond to potential business interruptions and continue providing the services under normal conditions.

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 rules of procedure, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of the Group is responsible for collecting information. The operational risk database contains structured information on incidents that have been classified as operational risk and have caused LHV potential or actual damage. An analysis of the cases included in the database allows to identify potential weaknesses in the rules of procedure, prevent errors in the future, and mitigate potential risks or specify the conditions of acceptability of such risks. Operational risk incidents have been classified according to their criticality. The following two figures provide an overview of the number an volume of incidents (critical and major) and loss events in LHV's largest business unit AS LHV Pank and its subsidiary AS LHV Finance, broken down by years.

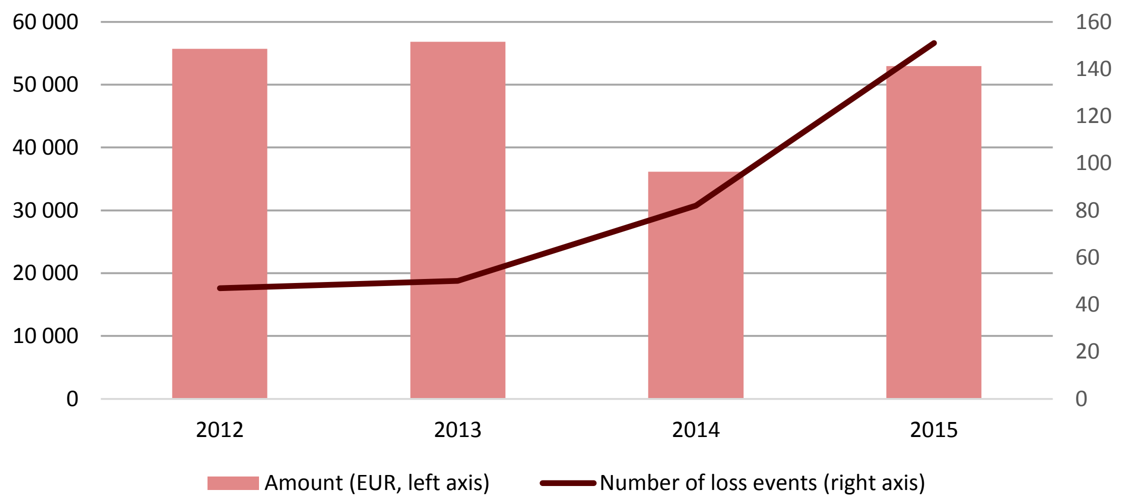

Figure 7. Number of loss events and total loss amount during years 2012-2015

In 2015, the number of loss events nearly doubled. Nonetheless, the extent of the damage incurred due to materialisation of operational risk did not exceed that of 2012 and 2013.

Even though the annual number of critical and major operational risk incidents decreased, the total number of incidents increased in 2015.

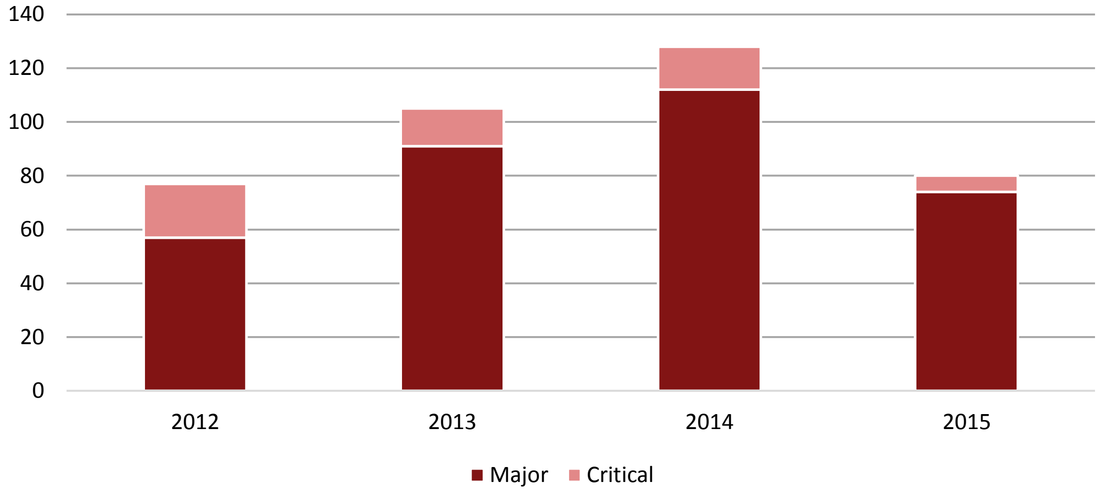

Figure 8. Number of incidents (critical and major) during years 2012-2015

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

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.

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. The Group's Treasury is responsible for the management of liquidity risk.

The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Group's 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. Also the concentration of the Group's liabilities by maturities is monitored.

Alongside daily monitoring of liquidity risk, LHV also carries out the assessment of liquidity risk as stipulated in the internal rules for the management of liquidity risk (stress testing), by taking account of the change in assets and liabilities within the framework of the ICAAP simulation. The risk assessment serves to determine the bank's resilience (survival period) in the case of a cross-market and idiosyncratic stress scenario. In order to measure the liquidity risk and identify the exposure to liquidity shortages, both contractual and behavioural positive and negative cash flows are examined without encumbering the value of liquid assets and their estimated changes. This allows to ascertain the bank's liquidity buffer for various time horizons. The accumulation of the figures allows to estimate the time period during which LHV Pank is able to maintain a positive liquidity buffer. In the event of a deep crisis, the liquidity position of LHV Pank is not expected to turn negative over a 12-month horizon as at 31 December 2015 (2014: no changes).

Internal metrics are complemented by the Basel III and banking regulation metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). For both ratios minimum is set to 100%, although according to the currently available information NSFR will be imposed as minimum requirement from the year 2018.

The LCR and NSFR as calculated based on the inputs valid on the date of calculations, are presented in the figure below.

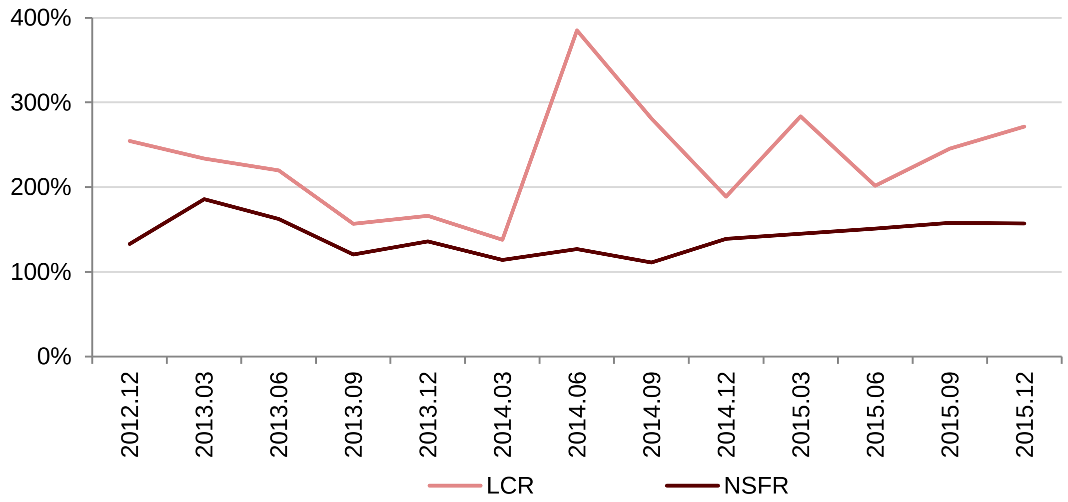

Figure 9. LHV Pank's LCR and NSFR during years 2012-2015

Starting from the 2nd quarter of 2014 changed inputs are used. The NSFR in 2014 and 2015 is calculated according to the Basel Committee on Banking Supervision guidelines and standard published in October 2014.

Asset encumbrance

Asset encumbrance arises from collateral pledged against secured funding and other collateralised obligations. Group has used TLTRO funding and it's secured with bond portfolio. The total amount of assets encumbered was 13 million eur. No other encumbered positions were held by Group as end of 2015.

Maturity structure

The following tables present the distribution of financial assets and liabilities, excluding derivatives, by due dates and by future contractual undiscounted cash flows. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows).

31.12.2015	On demand	Up to 3 months	3-12 Months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates						
Deposits from customers and loans received	433 027	66 578	110 230	23 284	716	**633 835**
Subordinated debt	0	532	1 596	8 511	39 810	**50 449**
Accounts payable and other financial liabilities	0	17 288	0	0	0	**17 288**
Unused loan commitments	0	118 696	0	0	0	**118 696**
Financial guarantees by contractual amounts	0	5 369	0	0	0	**5 369**
Foreign exchange derivatives (gross settled)	0	14 487	0	0	0	**14 487**
Financial liabilities at fair value	0	26	63	0	0	**89**
Total liabilities	**433 027**	**222 976**	**111 889**	**31 795**	**40 526**	**840 213**
Assets held for managing liquidity risk by contractual maturity dates						
Due from banks and investment companies	230 501	0	0	0	0	**230 501**
Financial assets at fair value (debt securities)	0	19 250	69 590	12 136	2 977	**103 953**
Loans and advances to customers	0	43 364	114 515	280 732	19 297	**457 908**
Receivables from customers	0	2 026	0	0	0	**2 026**
Other financial assets	940	0	0	0	0	**940**

Foreign exchange derivatives (gross settled)	0	14 487	0	0	0	**14 487**
Total assets held for managing liquidity risk	**231 441**	**79 127**	**184 105**	**292 868**	**22 274**	**809 815**
Maturity gap from assets and liabilities	**-201 586**	**-143 849**	**72 216**	**261 073**	**-18 252**	**-30 398**

Table 9. Group’s assets and liabilities distribution by maturity dates (EUR thousands)

Other risks

Strategic risk and business risk

For reasons of corporate growth, LHV's strategic risk is estimated to exceed the strategic risk of a bank positioned in a stable stage. At the same time, the strategic risk is mitigated via the preparation of carefully deliberated business plans and analyses. Furthermore, the management (both the Management Board and the Supervisory Board) of both AS LHV Pank and AS LHV Group has a long-term track record in banking and/or business ventures. Entries into new markets are always preceded by an in-depth analysis, engaging experts in the particular field, where necessary.

Reputation risk

Reputation risk is defined as a risk related to the deterioration of LHV's image in the eyes of customers, business partners, owners, investors or supervisory authorities. Reputation risk can, above all, be attributed to the materialisation of other risks (e.g. as a result of materialisation of operational risk or strategic risk). In each case, the risk may arise from failure to comply with either stated norms, which are likely to change over time, so and assessment of reputational risk can’t be static.

LHV mitigates reputation risk by carrying out regular risk management training as well as by continually improving the LHV-wide risk management framework, thus ensuring a strong risk culture.

Country risk

Similarly to reputation risk, country risk mainly occurs as a result of manifestation of other risks (operational risk, credit risk, strategic risk). In addition to Estonia, LHV also pursues business operations in Lithuania. The business operations in Finland were disposed at the beginning of 2015, with LHV having operated on the market since 2009. In 2013, in cooperation with a recognised local company (Razfin), LHV acquired a readily available and operational loan portfolio in Lithuania. As at the end of 2015, the gross Lithuanian portfolio amounted to EUR 39.7 million or 9.6 % of LHV's total loan portfolio.

Envirnonmental risk

The Group’s approach to environmental credit risk managementaddresses risk under any of two categories:

Direct Risk can arise when the Group takes commercial land as collateral. In many jurisdictions, enforcement of a commercial mortgage by the bank, leading to possession, potentially renders the Group liable for the costs of remediating a site if deemed by the regulator to be contaminated, including for pre-existing conditions. Group’s approach requires commercial land, if being pledged as collateral, to be subject to a screening mechanism.

Assessment of the commercial history of a piece of land and its potential for environmental contamination helps ensure any potentialenvironmental degradation is reflected in the value ascribed to that security. It also identifies potential liabilities which may be incurred by the Group, if realisation of the security were to become a possibility.

Indirect Risk can arise when environmental issues may impact the creditworthiness of the borrower. For instance, incremental costs maybe incurred in upgrading a business' operations to meet emerging environmental regulations or tightening standards. In other circumstances, failure to meet those standards may lead to fines.

Environmental impacts on businesses may also include shifts in the market demand for goods or services generated by our customers, or changing supply chain pressures. Environmental considerations affecting our clients can be varied.

Group follows all environmental regulations and decisions very closely and analyses their effects on the business.

Capital management

The objective of capital management in the Group 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 follows the general principles in its capital management:

- The Group and its subsidiaries must be adequately capitalized at all times, having the 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 the 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.

LHV tries to keep excess capital on Group level to have possibility to support subsidiaries in case there is need for that. LHV has developed also plan how to act during the capital shortage internally and what external items Group could use for lowering risk-weighted assets or increasing capital. The internal measures include reduction of granting new loans, cutting costs, optimizing capital usage among group. External measures include increasing additional Tier1 and Tier 2 capital, and selling of certain business lines.

Additional disclosures

Exposures to equities not included into trading book

Group is not taking equity positions outside trading book. There has been only one excemption – VISA shares. As a part of ordinary business issuing and acquiring cards, Group had to invest small position of VISA shares. The outstanding balance of the shares is 0,01 thousand EUR.

Securitization

Bank is not active in securitization and does not have neither assets or liabilities related to securitization.