AS LHV Pank
Consolidated Annual Report 2018

(Translation of the Estonian original)

Consolidated Annual Report	**01.01.2018 – 31.12.2018**
Legal name	AS LHV Pank
Commercial Registry no.	10539549
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
Fax	(372) 6800410
E-mail	lhv@lhv.ee
Main activities	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	Erki Kilu (Chairman)
	Andres Kitter
	Indrek Nuume
	Jüri Heero
	Meelis Paakspuu
	Martti Singi
	Kadri Kiisel
Supervisory Board	Madis Toomsalu
	Rain Lõhmus
	Andres Viisemann
	Tiina Mõis
	Raivo Hein
	Heldur Meerits
Auditor	
Auditors' legal name	AS PricewaterhouseCoopers
Auditors' Commercial Registry no.	10142876
Auditors' legal address	Pärnu mnt.15, 10141 Tallinn, Estonia

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Management report

LHV's mission is to help raise Estonian capital. LHV's vision is focused on Estonia where people and businesses dare to think big, engage in enterprise and invest in the future. LHV values: simplicity, support, performance.

LHV Bank (hereinafter the Bank) is the largest domestic bank. The Bank focuses on active and independent customers with an entrepreneurial mind-set. For private customers, the Bank mainly offers services related to the safeguarding and growing of savings. For business customers, the Bank offers flexible and appropriate financing, along with the management of daily financial affairs. The Bank's products and services are simple, transparent and relevant. Modern-day electronic means of communication are used for customer relations. The cost optimization is reflected in the affordable prices of the Bank's everyday services.

The Bank has representative offices in Tallinn, Tartu and London. The Bank has more than 350 staff members, with more than 160,000 customers using the Bank's services. The Bank consolidates a 65% subsidiary AS LHV Finance, engaged in consumer financing (hereinafter the Group).

Business activities

The number of new customers grew at an unprecedented speed in 2018. Customer numbers grew by 28,000, year-over-year, with the bank's customer base reaching 160,000. The year saw a record-breaking growth in customer activity. The bank participated in the IPO of the Port of Tallinn as co-organiser of the retail offer, with a half of the subscribers of the Port of Tallinn originating from LHV Bank.

Deposit volumes decreased by 7%, amounting to EUR 1,448 million by the end of the year. Standard customer deposits grew by 33% to EUR 1,250 million, with the deposits of financial institutions shrinking by 68% to EUR 194 million. A cooperation agreement was concluded with the deposit engagement platform Raisin, aiming at engaging longer-term deposits beyond the borders of Estonia. At the end of the year, the bank entered into a loan agreement with Nordic Investment Bank with the aim of expanding the eligible liabilities forming the basis for MREL.

The bank's loan stock grew by 28%, year-over-year, amounting to EUR 919 million. Corporate loans grew by 30% to EUR 651 million and retail loans by 44% to EUR 268 million. Housing loans remained the greatest contributor to retail loans, followed by leasing, private loans, small loans and hire-purchase.

The bank posted a profit of EUR 20.9 million, before taxes. Profit was positively affected by the increase in commission fees from the realisation of institutional banking transactions, and negatively by the impairment of a corporate loan. New credit loss principles were fully adopted at the beginning of the year in accordance with IFRS 9. This had a minor impact on the impairment of loans. The bank was subjected to the advance income tax liability in April, charged directly to expenses. Net profit for the year amounted to EUR 18.4 million.

The Financial Supervision Authority submitted its annual supervisory assessment and the additional own funds requirement in the capital adequacy calculations. Changes were introduced in both the composition of and the requirements for additional own funds, compared to last year. Considering the larger systemic risk buffer imposed on the bank as of 1 January 2019, the Supervisory Board decided to set the minimum own funds ratio at 15.50%. At the beginning of the year, the bank's share capital was increased by EUR 10 million. At the end of the year, the bank issued new subordinated bonds of AS LHV Group in the total amount of EUR 10 million, with the aim of strengthening the bank's capital base for expanding business volumes.

Moody's Investors Service gave the bank an investment grade rating of Baa1, with a stable outlook. It was the first time ever for the bank to receive a credit rating from an international rating agency. In establishing the rating, Moody's took account of the bank's strong capitalisation and profitability, which balances the bank's aggressive growth and the relatively recent loan portfolio. The credit rating will help international business pursuits, facilitating correspondent relations with other banks, cooperation with international institutions in the provision of financing solutions or guarantees to customers, and enhancing the options of trade financing.

At the end of the quarter, the bank and AS Versobank (under liquidation) entered into a contract, pursuant to which the bank will acquire EUR 18.4 million worth of AS Versobank's loan stock. The exact price will be determined based on the claims outstanding as as of 1 January 2019. The price depends on outcome of due diligence process. The price will be paid in lump sum upon completion of the transaction. The loan portfolio will be acquired as a loan stock company, consisting of loan and collateral agreements and two employees associated with the portfolio. The claims arising from the loan portfolio against Estonian corporate customers amount to nearly EUR 17 million, and the claims against Estonian-resident private customers to nearly EUR 3 million. Pursuant to the contract, the acquisition transaction is scheduled to be completed on 15 February 2019, with the satisfactory results of the audit of the loan portfolio serving as the precondition for completion of the transaction.

The auditor has provided contractual services to the Group companies in 2018, including audits of the annual reports and reviews of profits of the Bank's quarterly interim reports, translation and tax advisory services, and other assurance services as required by the Credit Institutions Act and the Securities Markets Act.

All services provided were previously approved by the Audit Committee and are non-audit services permitted under the EU Regulation.

Development activities

Major new products included the launch of factoring services in the first half of the year and the provision of Youth Bank services in the second half of the year, consisting of the purchase-insured debit card with discounts of various partners, the state-secured student loan and micro-investment services.

At the end of the year, the bank joined the EBA Clearing Instant Payments real-time euro payment system, adopting the transcript payments system and real-time incoming euro payments. Real-time outgoing euro payments will be adopted at the beginning of next year.

Minor innovations included launch of the small payment option, the option of withdrawing cash with a bank card in stores, e-identification of adult private customers for opening a bank account with an ID-card, Mobile-ID or Smart-ID via the internet bank, the LHV car insurance in cooperation with Compensa, consisting of the LHV motor third party liability insurance, LHV casco insurance and LHV super casco insurance, as well as the purchase and sale of Baltic shares via mobile bank.

Organisation

The bank's organisational structure was divided into three major business areas: retail banking, corporate banking and financial institutions, and three major supporting areas: IT, financial management and support services, and risk management. Human resource management, and marketing and communication were the activities pursued across the bank.

In the middle of the year, a new member was introduced in the bank's management board, in charge of the retail banking area. The former head of the retail banking area moved on to manage the financial institutions area and head the UK branch. Consequently, the bank's organisational structure was changed, especially with regard to retail banking and financial institutions.

Four major product management areas were created during the year: customers and channels, investment, financing and payment services. The aim of creating the product management areas was to centralise the management of similar products at a level lower than the management, and to improve the cooperation between product management and development in specific product groups.

On January 28 2018, the UK financial supervision authority made a positive decision with regard to the establishment of the branch in United Kingdom. The UK branch was officially opened in London on March 19. In February 2019, The Estonian Financial Supervision and Resolution Authority (Finantsinspektsioon) granted approval for AS LHV Pank to establish a branch in the United Kingdom of Great Britain and Northern Ireland as a third country. LHV Bank is also applying to the UK Financial Supervisory Authority to continue with its branch operations as a financial institution from a third country. With the UK leaving the EU, we initiated the process of registering the branch as a branch of a third-country bank in the financial supervision authorities of both Estonia and United Kingdom.

Year-over-year, the Group's employee numbers grew by 57 to 377 (including passive and part-time staff members), including 35 staff members of LHV Finance. In full time equivalents, the number of active employees amounts to 345, compared to 288 in end of 2017.

The bank received several recognitions during the year. At the beginning of the year, the bank's private banking service won international acclaim, with Euromoney declaring LHV Bank the best private banking service provider in Estonia. In the middle of the year, Euromoney declared LHV Bank the best bank in Estonia.

Sponsorship

The bank takes its social responsibility seriously. Within the limits of our available resources, we support enterprises and initiatives that contribute to the development of the Estonian society. When it comes to sponsorship projects, the bank prefers long-term dedication and cooperation. The bank stands ready to contribute to the pursuit of innovative ideas which help to advance Estonian life.

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

Financial results

In 2018, the net profit of the Group increased by 19% compared to the previous year, amounting to EUR 18.4 million (2017: EUR 15.5 million). Net interest income increased by 25% and net fee and commission income increased by 44%. Financial income decreased by 32% compared to the previous year.

The increase of the net interest income is attributable to the increase of the lending and regular customer deposit volumes.

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

Operating expenses grew by 26% year-on-year, which was expected given the current phase of high growth and new business development.

Loan losses were 36% higher compared to the previous year.

The total volume of the Bank's loan portfolios at the end of December amounted to EUR 919 million (31.12.2017: EUR 719 million). The portfolio volume grew by 28% year-on-year. The majority of the loan portfolio consists of loans for companies, which grew by 30% year-on-year to EUR 651 million (31.12.2017: EUR 505 million). The portfolio of loans issued to private individuals increased by 44% to EUR 268 million (2017: EUR 141 million).

The volume of deposits of the Bank decreased by 7% year-on-year and reached EUR 1 448 million by year-end (31.12.2017: EUR 1 551 million).

As a result of the overall low interest rate environment, a change has occurred in the deposit structure. The proportion of demand deposits has stayed at the same level, accounting for 92% of all deposits as at the end of December (31.12.2017: 91%).

Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Bank, calculated according to the definitions of the Basel Committee, was 144% at the end of December (31.12.2017: 121%). The Bank includes cash and bond portfolios, accounting for 44% of the balance sheet total, among its liquidity buffer (31.12.2017: 58%). The Bank’s loan-to-deposit ratio at the end of 2018 was 63% (31.12.2017: 46%).

The debt security portfolio decreased by 22% during 2018 due to low interest rates. Low interest rate levels do not support holding the Bank’s liquidity buffer in debt securities, and it is held in the European Central Bank instead.

AS LHV Pank concluded an unsecured 10-year loan agreement with the Nordic Investment Bank (NIB) for EUR 20.0 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2018, the loan amount taken into use by the Bank amounted to EUR 10 million.

As a result of the issue of shares by the Bank's parent company, AS LHV Group, the Bank's share capital was increased by EUR 10 million.

The Bank's level of own funds as at 31.12.2018 was EUR 118.6 million (31.12.2017: EUR 110.4 million). The Bank is well capitalized as at the end of the reporting period with a capital adequacy level of 17.71% (31.12.2017: 16.8%).

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

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

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2018 was 6.56% (31.12.2017: 4.99%). Leverage ratio is calculated as bank’s total Tier 1 own funds divided by its total risk exposure measure (including risk position on assets and off the balance sheet liabilities). As at the end of the reporting period, the leverage ratio is arithmetic mean of the monthly leverage ratios over the last quarter.

Statement of profit or loss, *(EUR million)*	**2018**	**2017**	**change**
Net interest income	39.02	31.13	25%
Net fee and commission income	11.10	7.70	44%
Other financial income	0.47	0.69	-32%
Total net operating revenues	50.59	39.52	28%
Other income	0.95	0.01	94%
Operating expenses	-25.74	-20.42	26%
Income tax expense	-2.51	0.0	-
Loan losses	-4.88	-3.58	36%
Net profit	18.41	15.53	19%

Volumes, *(EUR million)*	**31.12.2018**	**31.12.2017**	**change**
Loan portfolio	918.8	719.4	28%
Bond portfolio	39.0	50.0	-22%
Deposits	1 448.0	1 551.0	-7%
Equity	125.6	99.5	26%
Number of customers holding assets in bank	161 357	133 655	21%

Key figures, *(EUR million)*	**2018**	**2017**	**change**
Net profit	18.4	15.5	19%
Net profit attributable to owners of the parent	16.6	13.9	19%
Average equity	112.6	89.8	25%
Return on equity (ROE) %*	14.8	16.0	-1.2
Average assets	1,693	1,320	28%
Return on assets (ROA) %	1.1	1.1	0.0
Net interest income	39.0	31.1	25%
Average assets exposed to interest risk	1,688	1,314	28%
Net interest margin (NIM) %	2.31	2.37	-0.06
Spread %	2.29	2.33	-0.04
Cost / Income ratio %	51%	52%	-1%

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

Explanations

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

Return on equity (ROE) = Net profit (attributable to owners of the parent) / Average equity (attributable to owners of the parent) * 100

Average assets = (Assets of current year end + Assets of previous year-end) / 2

Return on assets (ROA) = Net profit / Average assets * 100

Net interest margin (NIM) = Net interest income / Average interest earning assets * 100

Spread = Yield on interest earning assets – Cost of interest bearing liabilities

Cost / Income ratio = Total Operating expenses / Total Income * 100

Risk Management

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

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

Capital base *(EUR thousand)*	**31.12.2018***	**31.12.2018**	**31.12.2017**
Paid-in share capital	69 500	69 500	59 500
Statutory reserves paid in from net profit	2 269	2 269	1 528
Accumulated profit/deficit	31 442	31 442	19 891
Intangible assets (subtracted)	-1 286	-1 286	-951
Net profit for accounting period	16 642	16 642	13 909
Dividend offer (with tax)	-5 125	0	0
Total Tier 1 capital	**113 442**	**118 567**	**93 877**
Subordinated debt	30 000	30 000	20 000
Total Tier 2 capital	**30 000**	**30 000**	**20 000**
Net own funds for capital adequacy calculation	**143 442**	**148 567**	**113 877**
Capital requirements			
Central governments and central banks under standard method	939	939	945
Credit institutions and investment companies under standard method	5 213	5 213	5 886
Companies under standard method	579 886	579 886	465 202
Retail claims under standard method	133 053	133 053	107 197
Public sector under standard method	124	124	185
Housing real estate under standard method	39 903	39 903	20 039
Overdue claims under standard method	10 381	10 381	20 915
Other assets under standard method	9 065	9 065	10 169
Total capital requirements for covering the credit risk and counterparty credit risk	**778 555**	**778 555**	**630 539**
Capital requirement against foreign currency risk	305	305	409
Capital requirement against interest position risk	32	32	412
Capital requirement against equity portfolio risks	704	704	585
Capital requirement against credit valuation adjustment risks under standard method	41	41	15
Capital requirement for operational risk under base method	59 434	59 434	47 754
Total capital requirements for adequacy calculation	**839 071**	**839 071**	**679 714**
Capital adequacy (%)	**17.10**	**17.71**	**16.75**
Tier 1 Capital Ratio (%)	**13.52**	**14.13**	**13.81**

*audited numbers including the dividend offer

Management and compensation policy

AS LHV Pank is a public limited company and its governing bodies are the General meeting of shareholders, the Supervisory Board and the Management Board.

General meeting

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

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

The Management Board calls General meetings of shareholders. The annual General meeting of shareholders held for approval of the annual report is held at least once per annum.

The sole shareholder of LHV Pank is AS LHV Group. Shareholders with significant ownership interest in AS LHV Group are Rain Lõhmus and persons related to him with 24.9% and Andres Viisemann and persons related to him with 9.8%.

Supervisory Board

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

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

Management Board

The Management Board is a governing body of AS LHV Pank that represents and manages AS LHV Pank. The Management Board has three to seven members. The term of the Management Board member's powers is five years, unless otherwise decided by the Supervisory Board. The Chairman of the Management Board organizes the work of the Management Board. The company may be represented by two Management Board members jointly in each transaction.

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

Committees

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

Audit Committee

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

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

The Audit Committee is responsible for making proposals to the Supervisory Board of AS LHV Group and provide recommendations for the appointment or removal of the auditor, appointment or removal of the internal auditor, prevention or elimination of problems or ineffectiveness in the organization and compliance with legislation and good professional practice.

Compensation Committee

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

The Compensation Committee supervises the compensation of Management Board members and employees of companies within AS LHV Group, evaluates the implementation of compensation policy at least annually and, if necessary, proposes to update the compensation policy and prepares draft resolutions related to compensation for the Supervisory Board of AS LHV Group.

Compensation policy

The policy of compensating members of the Management Board and employees of AS LHV Pank is set and its implementation is evaluated by the Compensation Committee established on the level of AS LHV Group.

A monthly base salary is paid to members of the Management Board and employees of AS LHV Pank. A supplementary monthly incentive salary is paid to a small number of employees directly engaged in sales and new customer acquisition. The Supervisory Board determines the base salaries of members of the Management Board and the Management Board determines the base salaries of employees. The Chairman of the Management Board is employed based on a service contract; everyone else is employed under employment contracts.

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

Share options

In 2014, the General meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the Management Board members and equivalent employees and department managers and equivalent employees of group companies that are part of AS LHV Group. The aim of issuing share options is to align the interests of Management Board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labor market that is equal to competitors and comprehensive. Similarly to 2014, the share options were issued in 2015, in 2016, in 2017 and in 2018. In 2017, the options issued in 2014 were fully exercised and in 2018, the options issued in 2015 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 2018, share options were granted to seven members of the Management Board of AS LHV Pank and fifty-six employees in the total amount of EUR 1 166 thousand. In the beginning of 2017, share options were granted to six members of the Management Board of AS LHV Pank and fifty-four employees in the total amount of EUR 1 204 thousand. In 2016, share options were granted to six members of the Management Board of AS LHV Pank and thirty-six employees in the total amount of EUR 598 thousand. In 2015, share options were granted to five members of the Management Board of AS LHV Pank and thirty-five employees in the total amount of EUR 510 thousand. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options. Share options issued in 2014 were exercised in 2017, when shares with nominal value of EUR 1 could be acquired for EUR 2 per share. Share options issued in 2015 were exercised in 2018, when shares with nominal value of EUR 1 could be acquired for EUR 2.4 per share. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of EUR 1 can be acquired for EUR 3.0 per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share. Share options issued in 2018 can be exercised between the period of 01.05.2021-31.07.2021 and shares with nominal value of EUR 1 can be acquired for EUR 5.33 per share. Similarly to previous years, share options are most probably issued also in 2019.

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

Wages and salaries

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

Calculated gross salaries and wages *(EUR thousand)*	**Base salary**	**Incentive salary**	**Total**	**Number of employees**
Retail banking	2 888	121	3 009	*166*
Private and corporate banking	1 274	0	1 274	*35*
Support services	3 306	0	3 306	*126*
Information technology	2 234	0	2 234	*83*
Total	**9 702**	**121**	**9 823**	**410**

Business environment

According to the forecast published by the Organisation for Economic Co-operation and Development in November 2018, global economic growth will decelerate to 3.5% in 2019 and 2020. The upturn of trading, which has so far supported the recovery, has stopped and the global purchasing managers' index (PMI), which recognises the evaluation of the operating environment of the companies, is decreasing. The plunge of the oil price which began towards the end of 2018, is negatively affecting countries dependant on the export of the commodity, providing relief for the importers affected by the appreciation of the US dollar. The situation continues to improve on the labour market and the pace of wage growth is finally rising. Economic growth is less balanced compared to recent years – there are clearly major economies distinguishing, where the upward cycle has already peaked.

The values of increased assets illustrate the current expansive monetary policy, in which the investors have accepted an increasingly lower expected long-term rate of return. The central banks of developed countries led by the US are changing course, as a result of which there are new signs of a turning liquidity offer. The volatility of stock markets has significantly increased, as well as the differences in the interest rates of bonds with varying degrees of risk. The currencies of developing countries are under pressure. Risks with a negative impact on the global economy, led by a protectionist economic policy, have increased. Altogether, we may expect a slowdown of economic growth in the developed countries during the next year close to the long-term sustainable level, which is clearly lower compared to the decade preceding the financial crisis.

Eurozone economic growth decelerated in the second quarter to 2.1%. The economic growth based on domestic demand was broad-based, however we can still spot some weakness in export over recent quarters. The growth of industrial production has entangled compared to the beginning of the year, the problems in the automotive industry have had a negative impact. A decline of sentiment may be noticed in indicators that reflect the confidence of various sectors. The big picture of the economy is still good and the growth positive regarding all countries. The economies of Finland and Sweden, the countries that are independently the biggest export targets for Estonia, grew 2.4% and 1.6% in the third quarter respectively. This year, the deceleration of Finnish economic growth is expected which is mainly due to the decrease of external demand. The growth rate of import will, on the contrary, remain basically at the same level as the previous year, which is still in favour of Estonian trade. The economic and import growth of Sweden is also decelerating but remains favourable to Estonia. Riksbank (the central bank of Sweden) has also taken a direction towards the increase of interest rates, which cools the economy but could have a positive effect on Estonian exporters through the appreciated Swedish krona.

The growth of the Eurozone's consumer prices has remained, for more than six months, at the level of 2.0% set by the European Central Bank, even though the core inflation is the lowest. According to the current plan, the exit from the current expansive monetary policy will be extremely slow – the bond purchasing programme was terminated in December 2018 and the interest rates shall not be increased before autumn of next year. According to the consensus expectations, the economic growth of the Eurozone shall drop to 1.9% in 2019. Since there are various headwinds blowing from export markets, the role of domestic demand and private consumption will become even more important. Consuming is supported positively by an increase in the labour force participation rate and the continuing decrease in the unemployment rate, which is also speeding up wage growth. At the same time, a looser budget policy is expected from the governments. Risks inside and outside the union have increased – the impact of the normalisation of monetary policy on stock and bond markets, the protective economic policy of the USA, the uncertainty accompanying the current Brexit process, increasing discontent and the populism in Italy and France. Next spring we will see the European Parliament elections, which will add even more tension.

Estonian economic growth accelerated in the third quarter of 2018 to 4.2%. The result was rather exceptional in the big picture since the indicators characterising the growth of economic activity weakened during the same period in Estonia and elsewhere. However, the economic picture was not as strong on a broad basis any more. Export growth decelerated significantly and the growth was led by domestic demand. As for the areas of activity, the growth was relatively uneven – almost half of the economic growth came from the construction and real estate sector. From the positive side, the investments showed signs of recovery, led by the investments of companies which is important for maintaining competitiveness. The inflationary pressure, which affects consumers negatively, is one of the highest of the Eurozone.

The bigger picture still remains good, which is also confirmed by the new outlook of the economic environment published by the Estonian Institute of Economic Research in October 2018. Estonian experts assess the economic climate to be good and outlook stable. The Economic Sentiment Index has slightly declined, however it remains higher compared to the long-term average. The picture is also strong by sectors, with only the service sector having a more negative attitude compared to the long-term average. Lack of skilled labour, but also little innovation and decreasing international competitiveness are pointed out as the main factors obstructing business. Private consumption is strong, supported by high confidence and the improved financial situation of families.

According to the forecast published by the Bank of Estonia, the economic growth of Estonia will decelerate to 3.2% in 2019. Further rapid economic growth is hindered by the high conjuncture related supply-side restrictions (lack of available resources) but also the deceleration of external demand. The main growth engine is domestic demand, led by private consumption and investments. Private consumption is still supported by the strong growth of salary and employment. In addition, the inflation rate should marginally decrease, which is aided by the stabilisation of energy prices and the major impact of tax increases remaining in the earlier years. The positive contribution of investments is also restored, which was negatively influenced by a high comparison base last year. The volume of research and development activity is growing fast and capital investment into products related to the right of use of intellectual property is becoming increasingly important. From the risks, we could consider the most important to be developments in the external environment, which could be negatively influenced above all by declined demand caused by trade restrictions and the related insecurity when making investments and the impacts related to the tightening of monetary policy. Within Estonia, it is primarily necessary to deal with the improvement of competitiveness and favour the re-learning of employees and the movement to sectors offering higher added value. There are still a lot of industries with low production in Estonia which will most likely disappear with the continual increase of employment expenses in the next few years.

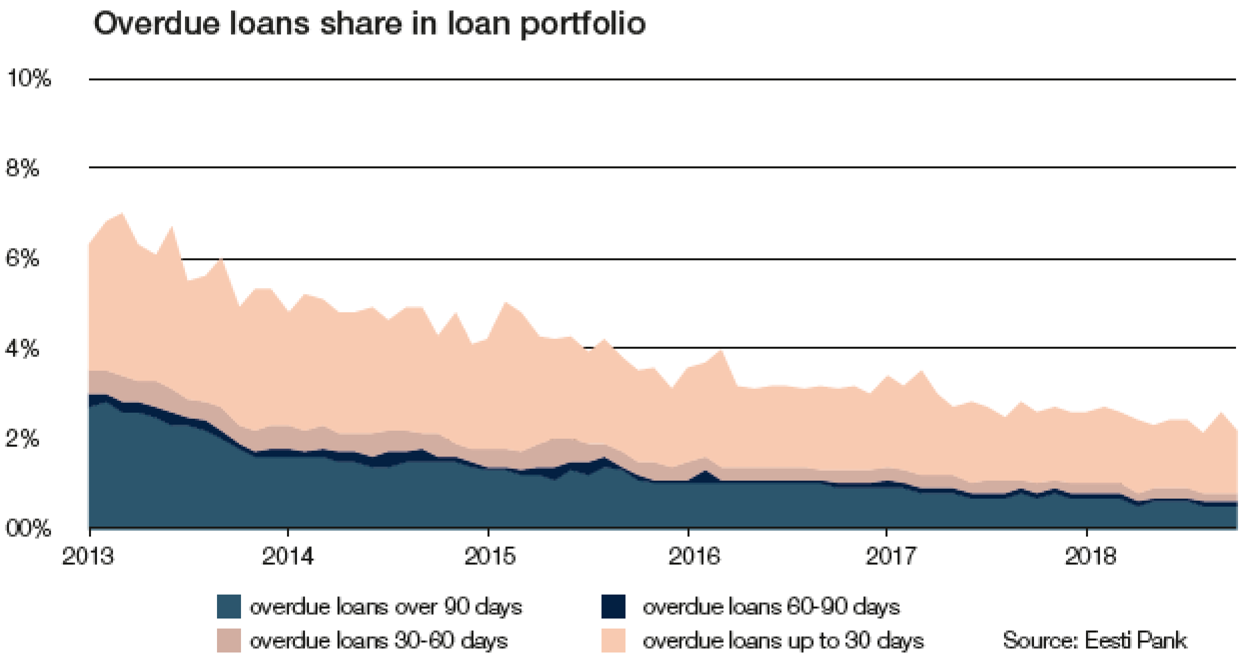
Over the next twelve months, LHV is expecting a continuation of positive trends in the Estonian economy. Economic growth will decelerate close to the long-term sustainable potential level. The shortage in available resources will continue to increase the significance of the ability of businesses to adapt and be successful in raising productivity, which is why it is necessary to vigorously continue making additional investments. First and foremost, it is important to achieve long-term sustainable economic growth that is in balance between the various sectors.

In terms of economic sectors, the risks are above average and might overheat in the building sector, accommodation and catering sector, and transport and storage. LHV is still conservative with regard to the housing market, monitoring the local and Scandinavian market, with increased attention on developments in Sweden. Regarding rental cash flow projects, there is a risk that there will not be enough demand to absorb the volumes being developed in the near future, so that corrections will take place in rental prices or vacancy rates.

As a positive note, we could highlight the still favourable financing environment, which will be influenced most in the coming years by the tightening monetary policy of developed countries. The increase of the amount outstanding from credit institutions still remains rapid. The demand for loans of households is strong, led by housing loans and car leasing. For new housing loans, the average interest rate which has started to increase is standing out. Due to poor investment activity and relatively high own funds, the loans taken by corporates are more modest than that of households. The ratio of loans to deposits and the proportion of overdue loans in the loan portfolio are at the post-crisis low levels. Historically low interest rates and strong competition between banks offer possibilities to local enterprises and they should be taking advantage of them more. LHV wishes to make a big and effective contribution to the finding and supporting of new growth sources, offering entrepreneurs long-term co-operation and value-creating involved thinking.

						Eesti Pank forecast		
Key economic indicators of Estonia*	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Nominal GDP (EUR billion)	18.89	19.76	20.25	21.10	23.62	25.62	27.38	28.89
GDP volume**	1.4%	2.8%	1.4%	2.1%	4.9%	3.6%	3.2%	2.3%
Private consumption expenditures***	3.8%	3.3%	4.7%	4.4%	2.6%	4.3%	3.9%	3.2%
Government consumption expenditures	1.9%	2.7%	3.4%	1.9%	0.6%	-0.5%	1.2%	0.3%
Fixed capital formation	-2.8%	-8.1%	-3.3%	-1.2%	12.5%	1.3%	5.3%	3.2%
Exports	2.3%	3.1%	-0.6%	4.1%	3.5%	1.5%	1.8%	3.5%
Imports	3.2%	2.2%	-1.4%	5.3%	3.6%	6.1%	3.9%	3.6%
CPI	2.8%	-0.1%	-0.5%	0.1%	3.4%	3.5%	2.6%	2.1%
Unemployment rate (% of the labour force)	8.6%	7.4%	6.2%	6.8%	5.8%	5.8%	6.7%	6.9%
Current account (% of GDP)	-0.4%	0.9%	2.2%	1.9%	3.3%	0.5%	-1.0%	-1.0%
Budget balance (% of GDP)****	-0.2%	0.7%	0.1%	-0.3%	-0.4%	0.5%	0.5%	0.3%

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


Overdue loans share in loan portfolio
10%
8%
6%
4%
2%
00%
2013
2014
2015
2016
2017
2018
overdue loans over 90 days
overdue loans 60-90 days
overdue loans 30-60 days
overdue loans up to 30 days
Source: Eesti Pank

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of profit or loss and other comprehensive income

(EUR thousand)	Note	2018	2017
Interest income		45 622	35 492
Interest expense		-6 601	-4 358
Net interest income	5	**39 021**	**31 134**
Fee and commission income		18 902	13 096
Fee and commission expense		-7 799	-5 401
Net fee and commission income	6	**11 103**	**7 695**
Net gains from financial assets measured at fair value	10	404	420
Foreign exchange rate gains/losses		64	265
Net gains from financial assets		**468**	**685**
Other income		951	6
Staff costs	7	-13 878	-11 287
Administrative and other operating expenses	7	-11 865	-9 128
Profit before credit losses		**25 800**	**19 105**
Impairment losses on loans and advances	11	-4 879	-3 584
Profit before income tax		**20 921**	**15 521**
Income tax expense		-2 514	0
Profit for the year		**18 407**	**15 521**
Other comprehensive income/loss:			
Items that may be reclassified subsequently to profit or loss:			
Changes in the fair value of available-for-sale financial assets	9a	0	76
Changes in the fair value of debt instruments measured at FVOCI	9b	-36	0
Items that will not be reclassified to profit or loss:			
Net gains on investments in equity instruments designated at FVOCI	9b	78	0
Net profit and other comprehensive income for the year		**18 449**	**15 597**
Net profit attributable to:			
Owners of the parent		16 642	13 909
Non-controlling interest		1 765	1 612
Net profit for the year		**18 407**	**15 521**
Net profit and other comprehensive income attributable to:			
Owners of the parent		16 684	13 985
Non-controlling interest		1 765	1 612
Net profit and other comprehensive income for the year		**18 449**	**15 597**

Notes on pages 18 to 103 are an integral part of the consolidated financial statements.

Consolidated statement of financial position

(EUR thousand)	**Note**	**31.12.2018**	**31.12.2017**
Assets			
Due from central bank	8	639 862	920 714
Due from credit institutions	8	24 979	20 991
Due from investment companies	8	17 005	14 186
Available-for-sale financial assets	9a	0	775
Equity instruments at FVOCI	9b	298	0
Financial assets at fair value through profit or loss	10	38 913	49 239
Loans and advances to customers	11	918 761	719 390
Receivables from customers	12	2 509	7 357
Other financial assets	13	2 936	2 289
Other assets	13	1 341	836
Tangible assets	14	1 122	1 225
Intangible assets	14	1 286	952
Total assets		**1 649 012**	**1 737 954**
Liabilities			
Deposits from customers and loans received	15	1 469 561	1 556 573
Financial liabilities at fair value through profit or loss	10	11	2
Accounts payable and other liabilities	16	23 861	61 858
Subordinated debt	18	30 000	20 000
Total liabilities		**1 523 433**	**1 638 433**
Equity			
Share capital	19	69 500	59 500
Statutory reserve capital	19	2 191	1 492
Other reserves	9	78	36
Retained earnings		49 687	34 963
Total equity attributable to owners of the parent		**121 456**	**95 991**
Non-controlling interest		4 123	3 530
Total equity		**125 579**	**99 521**
Total liabilities and equity		**1 649 012**	**1 737 954**

Notes on pages 18 to 103 are an integral part of the consolidated financial statements.

Consolidated statement of cash flows

(EUR thousand)	Note	2018	2017
Cash flows from operating activities			
Interest received		45 435	35 133
Interest paid		-6 482	-4 642
Fees and commissions received		18 902	13 107
Fees and commissions paid		-7 799	-5 412
Other income received		950	6
Staff costs paid		-13 077	-10 386
Administrative and other operating expenses paid		-10 700	-8 254
Income tax paid		-1 970	0
Cash flows from operating activities before change in operating assets and liabilities		**25 259**	**19 552**
Net increase/(decrease) in operating assets:			
Net acquisition/disposal of trading portfolio		-115	278
Loans and advances to customers		-199 259	-196 515
Mandatory reserve at central bank	8	1 094	-7 639
Security deposits	13	-647	-1 348
Other assets		-449	-92
Net increase/(decrease) in operating liabilities:			
Demand deposits of customers	15	-93 323	791 270
Term deposits of customers	15	-9 316	-25 052
Loans received	15	16 250	6 000
Repayments of loans received	15	-722	-779
Financial liabilities held for trading at fair value through profit or loss		8	-207
Other liabilities		-38 414	45 226
Net cash from/(used in) operating activities		**-299 634**	**630 694**
Cash flows from investing activities			
Purchase of tangible and intangible assets	14	-1 395	-1 277
Proceeds from disposal and redemption of investment securities	9	520	124
Net changes of investment securities at fair value through profit or loss	10	10 845	15 075
Net cash from/(used in) investing activities		**9 970**	**13 922**
Cash flows from financing activities			
Paid in share capital	19	10 000	3 000
Proceeds from subordinated debt	18	10 000	0
Dividends paid		-3 350	0
Net cash from financing activities		**16 650**	**3 000**
Effect of exchange rate changes on cash and cash equivalents		**64**	**265**
Net increase/(decrease) in cash and cash equivalents		**-272 950**	**647 881**
Cash and cash equivalents at the beginning of the year	8	940 516	292 635
Cash and cash equivalents at the end of the year	**8**	**667 566**	**940 516**

Notes on pages 18 to 103 are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

(EUR thousand)	Share capital	Statutory reserve capital	Other reserves	Retained earnings	Total	Non-controlling interest	Total equity
	Attributable to owners of the parent						
Balance as at 01.01.2017	**56 500**	**888**	**-40**	**20 902**	**78 250**	**1 918**	**80 168**
Transfer to statutory reserve capital (Note 19)	0	604	0	-604	0	0	**0**
Paid in share capital (Note 19)	3 000	0	0	0	3 000	0	**3 000**
Share options (Note 19)	0	0	0	756	756	0	**756**
Net profit of the year	*0*	*0*	*0*	13 909	13 909	1 612	**15 521**
Other comprehensive income	*0*	*0*	*76*	0	76	0	**76**
Net profit and other comprehensive income for 2017	0	0	76	13 909	13 985	1 612	**15 597**
Balance as at 31.12.2017	**59 500**	**1 492**	**36**	**34 963**	**95 991**	**3 530**	**99 521**
Balance as at 01.01.2018	**56 500**	**1 492**	**36**	**34 963**	**95 991**	**3 530**	**99 521**
Transfer to statutory reserve capital (Note 19)	0	699	0	-699	0	0	**0**
Paid in share capital (Note 19)	10 000	0	0	0	10 000	0	**10 000**
Paid dividends	0	0	0	-2 178	-2 178	-1 172	**-3 350**
Share options (Note 19)	0	0	0	959	959	0	**959**
Net profit of the year	*0*	*0*	*0*	16 642	16 642	1 765	**18 407**
including changes on initial application of IFRS 9 (Note 2.1 (0))	*0*	*0*	*0*	*-712*	*-712*	*0*	***-712***
Other comprehensive income	*0*	*0*	*42*	0	42	0	**42**
Net profit and other comprehensive income for 2018	0	0	42	16 642	16 684	1 765	**18 449**
Balance as at 31.12.2018	**69 500**	**2 191**	**78**	**49 687**	**121 456**	**4 123**	**125 579**

Notes on pages 18 to 103 are an integral part of the consolidated financial statements.

Notes to the consolidated financial statements

NOTE 1 General information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2018 for AS LHV Pank (hereinafter the Bank) and its subsidiary AS LHV Finance (together hereinafter: the Group or LHV). AS LHV Pank holds 65% interest in AS LHV Finance.

AS LHV Pank (Bank) provides banking, financial advisory and securities brokerage services to customers in Estonia. There are offices for client servicing in Tallinn and Tartu. In 2018, a new office in United Kingdom was opened. LHV is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt. 2, Tallinn. As at 31.12.2018, the Group employed 377 people, including 32 non-active employees (31.12.2017: 291 people, 16 non-active employees). LHV Finance offers hire-purchase services to merchants and consumer loans.

The Management Board approved the consolidated annual report (incl. financial statements) on 13 March 2019. The consolidated annual report will be presented for approval to the sole shareholder AS LHV Group. Rain Lõhmus, who owns 24.9% of the voting rights and Andres Viisemann, who owns 9.8% of the voting rights (see also Note 19), have significant influence over AS LHV Group.

The consolidated annual report approved by the Management Board shall be authorized for approval by the Supervisory Board and shareholders. The shareholders have the right not to approve the consolidated annual report while the Supervisory Board does not have that right.

NOTE 2 Summary of significant accounting policies

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

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2018 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as “financial assets and liabilities at fair value through profit or loss”, including derivatives and assets held for trading.

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 2018 and ended at 31 December 2018. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements, which became mandatory for the Group’s reporting periods beginning on or after 1 January 2018. The overview of these standards and the Group management’s estimate of the potential impact of applying the new standards and interpretations are stated below.

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

The following new or revised standards and interpretations became effective for the Group from 1 January 2018.

IFRS 9, Financial instruments (effective for annual periods beginning on 1 January 2018). LHV has not restated the comparative figures for 2017 in the 2018 annual report as simplified application of IFRS 9 was implemented by management. Key features of the new standard are as follows:

- Financial assets are required to be classified into three measurement categories;

- assets to be measured subsequently at amortised cost (AC);
- assets to be measured subsequently at fair value through other comprehensive income (FVOCI);
- assets to be measured subsequently at fair value through profit or loss (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 was on LHV's financial position, financial performance or equity in the period of initial application from classification and measurement changes. See also transition table below.

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 dividend 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 transferred to stage 2.

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

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

Impairment calculations under IFRS 9 will require more experienced credit judgement by the reporting entities than required by IAS 39 previously 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:

(EUR thousand)	**Note**	**Measurement category**		**Carrying value per IAS 39 (closing balance at 31 December 2017) (a)**	**Impairment allowance per IAS39 (closing balance at 31 December 2017) (b)**	**Effect** Remeasurement (c)	**Carrying value per IFRS 9 (opening balance at 1 January 2018) (a+c)**	**Impairment allowance per IFRS 9 (opening balance at 1 January 2018) (b+c)**
		IAS 39	**IFRS 9**			**ECL**		
Due from credit institutions	8	L&R	AC	20 911	0	0	20 911	0
Due from investment companies	8	L&R	AC	14 186	0	0	14 186	0
Due from central bank	8	L&R	AC	920 714	0	0	920 714	0
Total cash and cash equivalents				**955 811**	**0**	**0**	**955 811**	**0**
Debt instruments	9	AFS	FVOCI (mandatory)	555	0	0	555	0
Debt instruments	10	FVTPL	FVTPL (mandatory)	49 239	0	0	49 239	0
Total debt instruments				**49 794**	**0**	**0**	**49 794**	**0**
Equity instruments	9	AFS	FVOCI (voluntary)	220	0	0	220	0
Total equity instruments				**220**	**0**	**0**	**220**	**0**
Loans and advances to customers	11	L&R	AC	719 390	-6 900	-656	718 734	-7 556
Receivables from customers	12	L&R	AC	7 357	0	0	7 357	0
Other financial assets	13	L&R	AC	2 289	0	0	2 289	0
Total financial assets				**1 734 861**	**-6 900**	**-656**	**1 734 205**	**-7 556**
Loan commitments	21			0	0	-20	0	-20
Financial guarantees	21			0	0	-36	0	-36

Prepayment Features with Negative Compensation, Amendments to IFRS 9 (effective for annual periods beginning on 1 January 2018) 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 an 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 applied the amendment to the standard together with IFRS 9. The guidance for changing the standard has been taken into account when assessing whether the cash flows from financial assets meet SPPI requirement.

IFRS 15, Revenue from contracts with customers (effective for annual periods beginning on 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. The new standard did not have material impact on the Group's financial statements.

Revenue from Contracts with Customers - Amendments to IFRS 15 (effective for annual periods beginning on 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 did not have material impact on the Group's financial statements.

There were no other new or revised standards or interpretations that are effective for the first time for the financial year beginning on 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 2019, and which the Group has not early adopted.

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. Starting from 1 January 2019, EUR 4 042 thousand will be recognized on the Group's statement of financial position as assets and liabilities, thus increasing the total of the statement of financial position of the Group.

Annual Improvements to IFRSs 2015-2017 cycle (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU).

The narrow scope amendments impact four standards. IFRS 3 was clarified that an acquirer should remeasure its previously held interest in a joint operation when it obtains control of the business. Conversely, IFRS 11 now explicitly explains that the investor should not remeasure its previously held interest when it obtains joint control of a joint operation, similarly to the existing requirements when an associate becomes a joint venture and vice versa. The amended IAS 12 explains that an entity recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, eg in profit or loss or in other comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits. The revised IAS 23 now includes explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowings costs eligible for capitalisation only until the specific asset is substantially complete. The Group is currently assessing the impact of the new amendments.

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

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

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

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

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

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

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 2018 consolidated financial statements include the financial statements of AS LHV Pank (parent company) and its subsidiary AS LHV Finance.

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

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

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

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

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

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

Non-controlling interest

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

2.3 Foreign currency translations

(a) Functional and presentation currency

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

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the balance sheet date.

Non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the fair value measurement date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of profit or loss under the line “Foreign exchange rate gains/losses".

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

2.4 Cash and cash equivalents

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

2.5 Financial assets

Accounting policies from 1 January 2018

Initial recognition and derecognition

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

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

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

Subsequent measurement

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

Debt instruments (Loans and debt securities)

The classification is based on a combination of assessing the business model for managing the financial assets and whether the contractual cash flows consist of solely payments of principal and interest (‘SPPI’). The business model assessment is performed for homogenous portfolios/products identified based on how the business is managed in the divisions of the Group. The assessment is based on reasonable scenarios taking into consideration how the portfolio is evaluated and reported to management; the risks affecting the performance of the portfolio and how these risks are managed; how managers are compensated; and the frequency, value and timing of sales including the reasons for the sales. In determining if the cash flows consist solely of principal and interest, the principal is defined as the fair value of the debt instrument at initial recognition, which can change over the life if there are repayments or capitalisation of interest. Interest cash flows are consistent with components per a basic lending arrangement including consideration for time value of money, credit risk, liquidity risk as well as administrative costs and profit margin. If there are contractual features introducing an exposure to other risks or volatility, it is not considered to consist of solely payments of principal and interest. SPPI tests are performed as a part of new product approval tests. In implementation of IFRS 9 SPPI was applied to 22 larger products carried at amortised cost. All products except one remained in accounting with same treatment. With remaining one – margin loan, the product conditions were changed before 1 January 2018 so that one functionality was taken out of the product and then product also passed SPPI. Therefore, all the LHV products remained with same accounting treatment as before.

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

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

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

Amortised cost: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to hold assets to collect contractual cash flows and (b) the contractual cash flow characteristics consist of solely payments of principal and interest. The gross carrying amount of these assets is measured using the effective interest method and adjusted for expected credit losses.

Equity instruments

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

Derivatives

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

Modification

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

Reclassification

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

Write-off

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

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

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

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

IFRS 9 category		Class (applied by the Group)		31.12.2018
Financial assets	Amortised cost	Loans and advances to banks and investment companies		681 846
		Loans and advances to customers	Loans to legal entities	705 186
			Loans to individuals	213 575
		Other receivables		2 509
		Other financial assets		2 936
	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	Shares	157
			Listed bonds	38 697
			Derivatives	59
	Equity instruments at fair value through other comprehensive income	Investment securities	Unlisted shares	298

Accounting policies until 31 December 2017

The Group classifies its financial assets into the following categories:

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

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

	IAS 39 category	Class (applied by the Group)		31.12.2017
Financial assets	Loans and receivables	Loans and advances to banks and investment companies		955 891
		Loans and advances to customers	Loans to legal entities	579 588
			Loans to individuals	139 802
		Other receivables		7 357
		Other financial assets		2 289
	Financial assets at fair value through profit or loss	Securities held for trading	Shares	71
			Listed bonds	49 138
			Derivatives	30
	Available-for-sale financial assets	Investment securities	Listed bonds	550
			Unlisted shares	220

a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

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

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

Regular way purchases and sales of financial investments are recognized at the trading date in the statement of financial position. Financial instruments included in this category are initially recognized at fair value; transaction costs are taken directly to the profit or loss. After initial recognition, financial assets in this category are measured at fair value. Interest income is calculated based on financial assets' amortized cost using the effective interest rate method and is recorded within interest income in the statement of profit or loss. Changes in fair values of these financial assets are recognized consistently, either as a profit or loss in the statement of profit or loss of the reporting period under "Net gains/losses from financial assets measured at fair value". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognized in the line "Dividend income" of the statement of profit or loss when the right to receive dividends by the Group is established.

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

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

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

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

Refer to Note 3.5 for fair value of financial assets.

b) Held-to-maturity financial investments

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

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

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

c) Available-for-sale financial assets

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

d) Loans and receivables

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

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

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

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

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

2.6 Impairment of financial assets carried at amortized cost

Accounting policy from 1 January 2018

Measurement

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

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

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

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

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

Significant increase in credit risk

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

Definition of default

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

Quantitative criteria

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

Qualitative criteria

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

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

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

Modelling

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

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

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

Forward-looking information

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

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

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

Individual assesments and Management´s judgement

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

Accounting policy until 31 December 2017

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

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

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

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

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

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

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

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

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

2.7 Tangible fixed assets

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

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

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

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

2.8 Intangible assets

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

At the end of each reporting period, the appropriateness of amortization rates, methods and residual values is assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset’s fair value less costs to sell and value in use.

2.9 Impairment of assets

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

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

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

Impairment losses are recognized in profit or loss.

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

2.10 Loan commitments, financial guarantees and performance guarantees

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

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

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. Performance guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the contract. At the end of each reporting period, the performance guarantee contracts are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the contract at the end of each reporting period, discounted to present value. Where

the Group has the contractual right to revert to its customer for recovering amounts paid to settle the performance guarantee contracts, such amounts will be recognised as loans and receivables upon transfer of the loss compensation to the guarantee's beneficiary.

2.11 Financial liabilities

The Group classifies financial liabilities either:

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

Recognition of a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.6.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.

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

2.12 Payables to employees

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

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

2.13 Share-based payments

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

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

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

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

2.14 Provisions and contingent liabilities

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

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

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

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

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

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

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

2.16 Revenues and expenses

Accounting policy from 1 January 2018

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

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

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

Fee and commission income

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

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

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

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

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

The major types of fees are described below.

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

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

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

Net financial income

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

Dividend income

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

Accounting policy until 31 December 2017

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

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

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

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

2.17 Asset management services

The Group is engaged in providing asset management services (Note 20). Such assets have been given to the Group to be managed by third parties and these assets are recorded off-balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

2.18 Leases - Group as the lessee

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

Payments made under operating leases are charged to the statement of profit or loss on a straight-line basis over the lease term. The Group primarily uses an operating lease for renting the premises. A rental expense is recognized in the statement of profit or loss as "Administrative and other operating expenses". In addition, since 1 January 2019 the IFRS 16 Leases will apply to the Group's financial reporting.

IFRS 16, applicable to annual periods beginning on 1 January 2019 or after that date, eliminates the classification of leases as either operating leases or finance leases, as required by IAS 17, and, instead, introduces a single lease accounting model. Impact of IFRS 16 on the financial statements is disclosed in note 2.1 (b).

2.19 Taxation and deferred income tax

Corporate income tax in Estonia

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

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

Corporate income tax in other countries

In accordance with the local income tax laws, the net profit of companies located in United Kingdom 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	2018	2017
Latvia	20%	15%
Lithuania	15%	15%
United Kingdom	19%	19%

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

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

2.20 Offsetting

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

2.21 Statutory reserve capital

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

NOTE 3 Risk management

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

3.1 Capital management

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

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

The amount of capital that the Group managed as at 31.12.2018, was EUR 148 567 thousand (31.12.2017: EUR 113 877 thousand). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

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

Own funds	**31.12.2018**	**31.12.2017**
Paid-in share capital	69 500	59 500
Statutory reserves transferred from net profit	2 269	1 528
Accumulated profit/deficit	31 442	19 891
Intangible assets (subtracted)	-1 286	-951
Net profit for accounting period	16 642	13 909
Total Tier 1 own funds	**118 567**	**93 877**
Subordinated debt	30 000	20 000
Total Tier 2 own funds	**30 000**	**20 000**
Total Net own funds	**148 567**	**113 877**

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

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

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

In Estonia, in addition to the baseline capital requirements, credit institutions have been subjected to capital maintenance and systemic risk buffers, which are 2.5% (imposed by the Financial Supervisory Authority) and 1.0% (imposed by Estonian Central Bank), respectively. As the aforementioned buffers are incremental to the Tier 1 and the total baseline capital requirements, the minimum Tier 1 requirement in Estonia is 9.50% and the total capital requirement is 11.50%. The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions.

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

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

Capital requirements valid until October 2018 are provided in the table below:

Capital requirements	CET1	Tier 1	CAD
Base capital requirement	4.50%	6.00%	8.00%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemic risk buffer	0.92%	0.92%	0.92%
Minimal regulatory requirement	**7.92%**	**9.42%**	**11.42%**

Capital requirements valid until August 2017 are provided in the table below:

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

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

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

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

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

3.2 Credit risk

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

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

3.2.1 Distribution of credit risks

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

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

b) debt securities and derivatives

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

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

e) retail credit portfolio, including
   - mortgage loans (home and private loans)
   - consumer loans without collateral
   - hire-purchase
   - credit cards and overdrafts to individuals
   - leasing
   - retail loans and overdrafts to SMEs

- financial guarantees to SMEs
- unused loan commitments

Maximum exposure to credit risk *(EUR thousand)*	**31.12.2018**	**31.12.2017**
Due from banks and investment companies (Note 8)	681 846	955 891
Financial assets at fair value (debt securities) (Note 10)	38 913	49 239
Available-for-sale financial assets (Note 9a)	0	775
Debt instruments at FVOCI (Note 9b)	298	0
Loans and advances to customers (Note 11)	918 761	719 390
Receivables from customers (Note 12)	2 509	7 357
Other financial assets (Note 13)	2 936	2 289
Total financial assets	**1 645 263**	**1 734 941**
Exposures related to off-balance sheet items (Note 21), excluding performance guarantees	198 210	177 578
Total Maximum exposure to credit risk	**1 843 473**	**1 912 519**

3.2.2 Credit risk measurement

For all loan products, except leverage loans, LHV uses either rating or scoring systems to assess customer credit risk, as outlined in the table below. 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).

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

(a) Due from banks and investment companies

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

Rating	Credit institutions	Investment companies	Total 31.12.2018	Credit institutions	Investment companies	Total 31.12.2017
Central bank (The Bank of Estonia)	639 862	0	639 862	920 714	0	920 714
AA- to AA+	195	0	195	1 306	0	1 306
A- to A+	10 554	0	10 554	6 352	0	6 352
BBB to BBB+	5 661	16 505	22 166	6 294	14 116	20 410
B to B+	0	500	500	0	0	0
Non-rated	8 569	0	8 569	7 039	70	7 109
Total (Note 8)	**664 841**	**17 005**	**681 846**	**941 705**	**14 186**	**955 891**

LHV

Non-rated credit institutions are local Estonian or subsidiaries of large EU banks or financial institutions without external credit rating, however management considers their credit quality to be good based on available market information. Management has assessed that the ECL from credit institutions and investment companies exposures is immaterial due to the strong ratings of corresponding parties, their financial position and also due to the positive economic outlook in short-term perspective, as the Group holds only very liquid positions with the counterparties. See also note 3.2.4.3 for additional information.

(b) Debt securities and derivatives

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

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

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

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

Ratings distribution	**FVTPL**					
(EUR thousand)	**Investment portfolio**	**Liquidity portfolio**	**Trading portfolio**	**Foreign exchange forwards**	**FVOCI**	**Total 31.12.2017**
AAA	0	29 869	0	0	0	29 869
A- to A+	18 223	0	1 046	0	555	19 824
Non-rated	0	0	0	30	0	30
Total (Note 9, 10)	**18 223**	**29 869**	**1 046**	**30**	**555**	**49 723**

(c) Other receivables

Credit quality of other receivables *(EUR thousand)*	**31.12.2018**	**31.12.2017**
Receivables (not overdue)	2 286	9 238
Receivables (overdue)	223	408
incl. receivables from individuals	196	215
incl. receivables from legal entities	27	193
Total (Note 12)	**2 509**	**9 646**

As at 11 March 2019, other receivables of EUR 371 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 2 936 thousand (31.12.2018: EUR 2 289 thousand) are guarantee deposits on the Baltic stock exchanges held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions. The Group considers the counterparties credit risk as very low.

(d) ***Leveraged loans***

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

(e) Corporate loans and overdraft

Corporate credit portfolio customers are evaluated on individual basis. Each customer is assigned a credit rating between 1 and 13, where 1 means the lowest probability of default and 13 indicates insolvency. Credit rating is assigned to a customer considering combination of financial status and business risk.

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

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

(f) *Retail loans to SME's*

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

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 process is carried out at the time of loan application and it is one of the criteria for issuing the loan.

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

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

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

(g) Consumer loans without collateral and hire-purchase

Group offers consumer loans and hire-purchase through its subsidiary LHV Finance in Estonia. The maximum loan amount is up to EUR 15 000 and hire purchase up to EUR 20 000. Hire purchase service is offered through merchant partners. Scoring model are used to assess the customer's credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a credit.

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

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

(h) Credit cards

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

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

(i) Student loans

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

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

(j) Mortgage loans

In 2013, Group started to offer on a limited basis mortgage loans (private loans) to customers in the Tallinn and Tartu region only.

In autumn 2016, Group started offering the mortgage loan (home loans) to a large scale of retail clients without regional limits within Estonia. The maximum loan amount is in line with the regulations set by Central Bank of Estonia.

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

(k) Leasing

The Bank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using a rating model for clients with exposure of more than EUR 250 thousand and scoring models for clients with exposure of less than EUR 250 thousand. Rating model is the same which used for assessment of creditworthiness of corporate credit portfolio customers.

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

Risk concentration

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

a) The share of small financing in the LHV Pank's total credit portfolio
b) The share of financing non-domicile customers in the LHV Pank's total credit portfolio
c) The share of shadow banking financing compared to net owned funds
d) The share of ten largest credit customers compared to net owned funds
e) The share of financing the higher risk rating classes compared to the total corporate credit portfolio
f) The share of financing the catering and construction sector compared to the total corporate credit portfolio
g) Th share of financing outside of Estonia (incl. financing in EU countries and UK).

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2018, the loans issued to 14 customers (2017: total 15) 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 199% of NOF (2017: 215%).

The LHV Pank has invested in the debt securities of 2 issuers (2017: 2) with a large risk exposure, totalling 25% of NOF (2017: 42%). Of customer deposits, the deposits of 5 (2017: 5) customers have a high risk concentration, which amounts to 132% (2017: 551%) of NOF. Group has drastically reduced the larger depositor's volumes and replaced these deposits with retail deposits. There are 6 clients holding more than 1% of all deposits (2017: 5). Their total deposits amount was EUR 189 million (2017: 615). Share of Top 20 depositors was 20.5% as of 31.12.2018 compared to more than 50% as end of 2017.

31.12.2018	**Estonia**	**Latvia**	**Lithuania**	**Finland**	**Nether-lands**	**Ger-many**	**Other EU**	**USA**	**Other**	**Total**
Due from banks and investment companies (Note 8)	649 509	0	0	0	0	0	13 599	16 541	2 197	**681 846**
Financial assets at fair value (Note 9,10)	449	772	17 242	0	0	1	20 704	43	0	**39 211**
Loans and advances to customers (Note 11)	886 881	52	10 561	1 524	1	6	18 432	175	1 129	**918 761**
Receivables from customers (Note 12)	2 494	1	5	0	0	0	0	0	9	**2 509**
Other financial assets (Note 13)	111	0	0	0	0	0	0	2 825	0	**2 936**
Total financial assets	**1 539 444**	**825**	**27 808**	**1 524**	**1**	**7**	**52 735**	**19 584**	**3 335**	**1 645 263**
Deposits from customers and loans received (Note 15)	1 179 791	10 041	951	3 414	576	13 274	220 173	3 085	38 256	**1 469 561**
Subordinated debt (Note 18)	30 000	0	0	0	0	0	0	0	0	**30 000**
Accounts payable and other financial liabilities (Note 16)	20 901	0	4	27	0	0	13	3	0	**20 948**
Financial liabilities at fair value (Note 10)	11	0	0	0	0	0	0	0	0	**11**
Total financial liabilities	**1 230 703**	**10 041**	**955**	**3 441**	**576**	**13 274**	**220 186**	**3 088**	**38 256**	**1 520 520**

31.12.2017	Estonia	Latvia	Lithuania	Finland	Nether-lands	Germany	EU	USA	Other	Total
Due from banks and investment companies (Note 8)	916 853	0	0	0	0	0	3 051	28 152	7 835	**955 891**
Financial assets at fair value (Note 9,10)	846	779	17 456	0	0	29 867	1 064	2	0	**50 014**
Loans and advances to customers (Note 11)	650 871	42	37 218	998	91	42	26 580	45	3 503	**719 390**
Receivables from customers (Note 12)	7 351	1	5	0	0	0	0	0	0	**7 357**
Other financial assets (Note 13)	109	0	0	0	0	0	0	2 180	0	**2 289**
Total financial assets	**1 576 030**	**822**	**54 679**	**998**	**91**	**29 909**	**30 695**	**30 379**	**11 338**	**1 734 941**
Deposits from customers and loans received (Note 15)	862 286	5 024	825	2 717	12 505	632	639 608	2 855	30 121	**1 556 573**
Subordinated debt (Note 18)	20 000	0	0	0	0	0	0	0	0	**20 000**
Accounts payable and other financial liabilities (Note 16)	60 079	0	4	27	0	0	13	3	0	**60 126**
Financial liabilities at fair value (Note 10)	2	0	0	0	0	0	0	0	0	**2**
Total financial liabilities	**942 367**	**5 024**	**829**	**2 744**	**12 505**	**632**	**639 621**	**2 858**	**30 121**	**1 636 701**

Distribution of loans granted by industry (gross):

(EUR thousand)	**31.12.2018**	**%**	**31.12.2017**	**%**
Individuals	214 702	23.1%	141 199	19.4%
Real estate	246 930	26.6%	197 695	27.2%
Financial services	95 697	10.3%	114 888	15.8%
Manufacturing	98 073	10.6%	68 251	9.4%
Professional, scientific and technical activities	18 779	2.0%	13 948	1.9%
Wholesale and retail	24 378	2.6%	21 081	2.9%
Other servicing activities	25 669	2.8%	15 480	2.1%
Art and entertainment	34 582	3.7%	29 289	4.0%
Transport and logistics	11 076	1.2%	5 869	0.8%
Agriculture	20 231	2.2%	8 717	1.2%
Administrative activities	39 808	4.3%	33 941	4.7%
Construction	35 808	3.9%	19 414	2.7%
Education	2 391	0.3%	2 217	0.3%
Information and communication	4 115	0.4%	8 430	1.2%
Other areas at activities	56 798	6.1%	45 871	6.3%
Total (Note 11)	**929 037**	**100%**	**726 290**	**100%**

Loans and advances (incl. loan commitments and guarantees)

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

Credit risk grading

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

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

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

Retail

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

Corporate

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

Treasury

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

As LHV doesn't have a significant market risk portfolio then LHV measures concentration in other two key areas: liquidity risk and credit risk.

Liquidity Risk

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

Credit Risk

The Group's rating method used for evaluating the PD of corporate loans consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk. 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.

The master scale assigns each rating category a specified range of probabilities of default, which is stable over time.

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

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

LHV rating	LHV description	PD%	S&P	Moody's
1		0,03	AAA	Aaa
2		0,05	AA+	Aa1
3		0,10	AA, AA-	Aa2, Aa3
4		0,20	A+,A,A-	A1,A2,A3
5	Investment grade	0,30	BBB+	Baa1
6		0,40	BBB	Baa2
7		0,50	BBB-	Baa3
8		1,00	BB+,BB	Ba1,Ba2
9		2,50	BB-	Ba3
10	Non-investment grade	5,00	B+	B1

11		10,00	B,B-	B2,B3
12		30,00	CCC/C	Caa
13	Default	100,00	D	C

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

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

3.2.3 Expected credit loss measurement

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

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

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

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

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

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

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

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

Change in credit quality since initial recognition

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

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

3.2.3.1 Significant increase in credit risk

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

Quantitative criteria

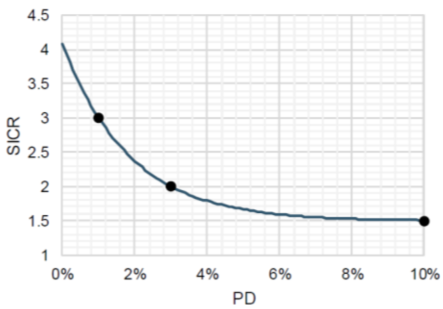
Quantitative criteria is applied to all credit contracts initiated in 2018 in the current portfolio and Wholesale legacy portfolio, for which a rating based Lifetime PD is used.

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

Current portfolio – contracts initiated from 1st January 2018

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

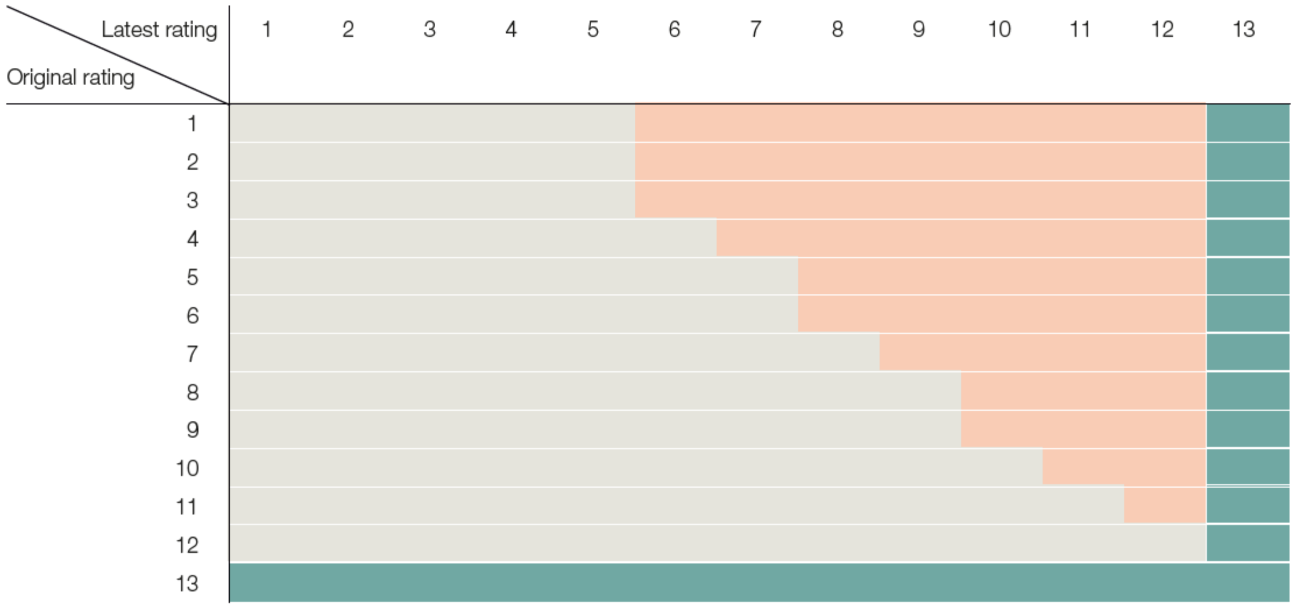
To illustrate the formula, see SICR curve graphic below. In addition to the curve, the PD increase has to be at least 100 bps.



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

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

Legacy portfolio – corporate contracts initiated before 1st January 2018



These thresholds have been determined by assessing how the Lifetime PD moves prior to an instrument becoming delinquent. The Lifetime PD movements on instruments which do not subsequently become delinquent have also been assessed, to identify the „natural“ movement in Lifetime PD, which is not considered indicative of a significant increase in credit risk. The average maturity of the corporate portfolio is short, namely 2.7 years.

Qualitative criteria

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

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

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

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

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

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

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

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or

- The customer has had more than one payment alert or has had at least four incidents of tax debt in the amount of over 640 euros over the last 12 months.

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

Backstop

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

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

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

Product *(EUR thousand)*	**+10% change in SICR**	**-10% change in SICR**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	-3	3
Hire-purchase	0	0
Credit cards	0	1
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

Product *(EUR thousand)*	**SICR with 0.5% threshold**	**SICR with 1.5% threshold**
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

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

3.2.3.2 Definition of default and credit-impaired assets

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

Quantitative criteria

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

Qualitative criteria

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

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

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

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

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

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

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

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

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

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

The Group's ECL model follows widely accepted sum of marginal losses approach, whereby ECLs are calculated as the sum of the marginal losses occurring in each time period (month) from the reporting date. The marginal losses are derived from individual risk parameters (PD, LGD, EAD) that estimate exposures and losses in the case of default and the marginal probability of default for each period (the probability of a default in time period X conditional upon an exposure having survived to time period X).

ECL calculations are based on four components:

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

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

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

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

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

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

Where:

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

PDt – marginal PD for month t;

LGDt – LGD as estimated for month t;

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

dt – discount factor for month t.

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

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

	31/01/2018	28/02/2018	31/03/2018	30/04/2018	31/05/2018	30/06/2018	31/07/2018	31/08/2018	30/09/2018
(1) Exposure (EAD)	4000	3500	3000	2500	2000	1500	1000	500	0
(2) Marginal PD	0.40%	0.38%	0.36%	0.34%	0.32%	0.30%	0.28%	0.26%	0.24%
(3) Collateral value	2000	2000	2000	2000	2000	2000	2000	2000	2000
(4) Potential loss amount [Max (0;1-3)}	2000	1500	1000	500	0	0	0	0	0
(5) Expected marginal loss [2*4]	8	5.7	3.6	1.7	0	0	0	0	0
(6) Expected marginal loss, discounted	7.97	5.65	3.56	1.67	0	0	0	0	0
Lifetime ECL at 31.12.2017 [Sum(6)]	18.85								

Note. Discounting is done, assuming current reporting date 31.12.2017 and a 5% discount rate.

For the defaulted exposures, ECL is computed as:

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

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

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

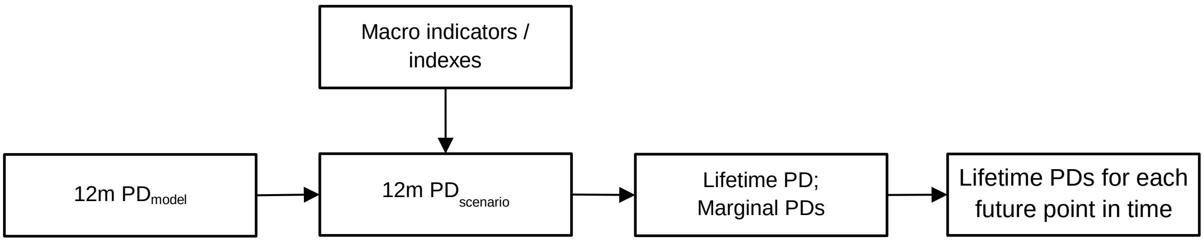
IFRS 9 parameters	
Definition of Default	• 90 days past due • Unlikely to pay without the bank turning to recourses such as selling collateral
PD	• 12-month PD; lifetime PD broken down further into marginal probabilities for sub-periods • Forward looking PiT estimate, reflecting assessment of current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

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

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

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

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



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

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

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

3.2.3.3.2 'Feeding' LGDs from underlying models into ECL model

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

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

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

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

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

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

3.2.3.4 Forward-looking information incorporated in the ECL model

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

Mathematically:

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

Where:

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

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

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

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

Where:

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

3.2.3.4.1 Selected indicators for private person credit portfolios

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

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

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

3.2.3.4.2 Selected indicators for companies

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

1) broad industry sector level based on letter codes / alphabetical branch of the NACE Rev.2 classification; and

2) sub-sectors based on lower level numerical codes of the NACE Rev.2 classification.

The following conclusions were drawn from the analysis:

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

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

GDP growth which explains the general state of economy,

Change in turnover,

Change in number of persons employed.

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

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

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

Population growth and income growth for residential real estate;

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

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

Observed correlation with the considered proxies for default rates;

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

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

Economic variable assumptions

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

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

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

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

Valid at 31.12.2018	**Base scenario**		**Downside scenario**		**Upside scenario**	
General macro-financial indicators	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Real GDP growth, %	3.0%	2.9%	1.0%	0.9%	4.0%	3.9%
Household consumption, %	3.9%	3.0%	2.0%	1.0%	4.5%	3.5%
Government consumption, %	0.8%	0.7%	0.7%	0.6%	1.2%	1.0%
Gross fixed capital formation, %	4.4%	4.2%	2.0%	1.9%	8.0%	8.0%
Exports of goods and services, %	3.8%	3.8%	0.5%	0.3%	4.3%	4.3%
Imports of goods and services, %	4.0%	3.9%	1.0%	0.7%	4.8%	4.8%
Nominal GDP, EURm	27 051	28 614	26 161	26 919	27 722	29 875
GDP deflator, % change	3.2%	2.8%	2.5%	2.0%	3.9%	3.7%
Consumer price growth, %	3.0%	2.6%	2.1%	1.7%	3.5%	3.5%
Unemployment rate, %	4.6%	4.5%	5.5%	5.9%	4.5%	4.5%
Change in employment, %	0.8%	-0.1%	0.0%	-0.3%	1.1%	0.3%
Net monthly wage growth, % (nominal)	6.0%	5.2%	3.0%	2.5%	7.5%	6.0%
House price index growth, %	3.4%	3.2%	-4.0%	-4.1%	4.4%	4.2%
Euribor 6m	-0.2%	0.2%	-0.2%	0.2%	-0.1%	0.3%
Bank lending margins on new loans	2.0%	2.0%	2.3%	2.5%	2.0%	2.0%

Nominal growth	**Base scenario**		**Downside scenario**		**Upside scenario**	
Gross value added by sectors, y-o-y growth rates	**2019E**	**2020E**	**2019E**	**2020E**	**2019E**	**2020E**
Total - all NACE activities	6.3%	5.7%	3.5%	3.1%	8.0%	7.8%
Agriculture, forestry and fishing	10.0%	10.0%	5.0%	5.0%	14.0%	14.0%
Industry (except construction)	5.0%	4.3%	2.8%	2.2%	6.2%	5.5%
Industry, except construction and manufacturing (mostly energy related)	5.0%	3.0%	4.8%	2.8%	6.0%	4.0%

Manufacturing	5.0%	4.7%	2.1%	2.0%	6.3%	6.0%
Construction	9.0%	5.0%	-6.0%	-4.0%	12.0%	11.0%
Wholesale and retail trade, transport, accomodation and food service activities	5.0%	4.8%	1.5%	0.5%	6.5%	6.5%
Information and communication	14.1%	14.0%	14.1%	14.0%	15.8%	15.8%
Financial and insurance activities	6.0%	6.0%	3.5%	3.5%	9.0%	9.0%
Real estate activities	3.3%	3.3%	-1.0%	-5.0%	3.8%	3.8%
Professional, scientific and technical activities; administrative and support service activities	7.0%	6.0%	5.0%	4.0%	9.0%	8.0%
Public administration, defence, education, human health and social work activities	6.0%	6.0%	9.0%	9.0%	8.0%	8.0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	7.0%	6.5%	4.5%	4.0%	9.0%	8.5%

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

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

The most significant period-end assumptions used for the ECL estimate as at 1 January 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

Valid at 01.01.2018	**Base scenario**		**Downside scenario**		**Upside scenario**	
General macro-financial indicators	**2018E**	**2019E**	**2018E**	**2019E**	**2018E**	**2019E**
Real GDP growth, %	2.5%	2.5%	0.4%	0.4%	3.8%	3.8%
Household consumption, %	3.0%	3.0%	2.0%	2.0%	4.0%	4.0%
Government consumption, %	1.0%	1.0%	1.0%	1.0%	2.0%	2.0%
Gross fixed capital formation, %	6.0%	6.0%	0.0%	0.0%	8.0%	8.0%
Exports of goods and services, %	5.0%	5.0%	2.0%	2.0%	7.0%	7.0%
Imports of goods and services, %	6.0%	6.0%	3.0%	3.0%	8.0%	8.0%
Nominal GDP, EURm	24 434	25 949	23 621	24 297	24 832	26 804
GDP deflator, % change	3.8%	3.6%	2.5%	2.5%	4.2%	4.0%
Consumer price growth, %	3.3%	3.3%	2.0%	2.0%	3.5%	3.5%
Unemployment rate, %	5.4%	5.4%	6.0%	7.0%	5.0%	5.0%
Change in employment, %	0.2%	0.0%	0.0%	0.0%	0.5%	0.5%
Net monthly wage growth, % (nominal)	6.0%	6.0%	4.0%	4.0%	7.0%	7.0%
House price index growth, %	3.0%	3.0%	-10.0%	-10.0%	5.0%	5.0%
Euribor 6m	-0.3%	-0.1%	-0.3%	-0.3%	-0.2%	0.0%
Bank lending margins on new loans	1.8%	1.8%	2.4%	2.6%	1.8%	1.8%

Nominal growth	**Base scenario**		**Downside scenario**		**Upside scenario**	
Gross value added by sectors, y-o-y growth rates	**2018E**	**2019E**	**2018E**	**2019E**	**2018E**	**2019E**
Total - all NACE activities	6.3%	6.4%	2.8%	3.1%	8.2%	8.2%
Agriculture, forestry and fishing	1.8%	2.0%	-9.1%	0.3%	5.4%	5.7%
Industry (except construction)	11.9%	8.0%	6.5%	4.5%	14.7%	9.5%
Industry, except construction and manufacturing (mostly energy related)	10.0%	9.6%	10.2%	10.0%	11.8%	11.4%
Manufacturing	7.4%	7.5%	0.4%	2.5%	10.4%	8.9%
Construction	2.5%	2.3%	-10.0%	-10.0%	4.2%	5.6%
Wholesale and retail trade, transport, accomodation and food service activities	6.2%	6.9%	2.4%	2.4%	8.4%	9.1%
Information and communication	10.6%	10.2%	10.6%	10.2%	12.4%	12.0%
Financial and insurance activities	7.4%	8.4%	-2.5%	-5.2%	10.4%	11.3%
Real estate activities	3.0%	3.0%	-5.0%	-5.0%	5.0%	5.0%
Professional, scientific and technical activities; administrative and support service activities	7.2%	7.0%	2.4%	2.4%	9.0%	7.7%
Public administration, defence, education, human health and social work activities	6.2%	5.9%	13.8%	10.4%	6.7%	6.7%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	6.2%	5.9%	2.4%	2.4%	6.4%	6.1%

The weightings assigned to each economic scenario at 1 January 2018 were as follows:

Valid at 01.01.2018	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis in Risk and Capital Committee.

Sensitivity analysis

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

Retail portfolio

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

Corporate portfolio

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

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

(EUR thousand)	**65-5-30** (base/up/down)	**65-15-20** (base/up/down)
Change in scenario weights	265	-265

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

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

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

(EUR thousand)	Impact on loss allowances
LGD negative 0.88	260
LGD negative 1.0	-246
Average PiT PD -0.5%	-843
Average PiT PD +0.5%	814

3.2.4 Credit risk exposure

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

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

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

Corporate Credit portfolio

As at 31.12.2018, the group-based impairment reserve makes up 1.4% of corporate loans and overdraft and the related interest receivables (31.12.2017: 0.5%).

Distribution of corporate loans and overdraft by internal ratings 31.12.2018

(EUR thousand)	Total	Grading

4 low credit risk	1 162	
5 low credit risk	31 936	
6 low credit risk	103 019	
7 medium credit risk	155 855	
8 medium credit risk	180 376	
9 heightened credit risk	116 164	Investment grade
10 high credit risk	38 407	
11 high credit risk	3 121	
12 non-satisfactory rating	5 807	Special monitoring
13 insolvent	12 425	Default
Total	**648 271**	

* in very limited cases, customer's with rating in investment grade are selected for special monitoring. There were no such customers as at 31.12.2018.

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	471 744	603	0	0	**472 348**
Special monitoring	135 723	27 775	0	0	**163 498**
Default	0	0	12 045	380	**12 425**
Gross carrying amount	607 468	28 378	12 045	380	**648 271**
Loss allowances	1 973	1 107	5 486	186	**8 751**
Carrying amount	605 495	27 272	6 560	194	**639 520**

For off-balance sheet exposures related with corporate credit portfolio, a provision of EUR 128 thousand was recorded as of 31.12.2018.

Corporate factoring

As at 31.12.2018, the group-based impairment reserve makes up 3.3% of corporate factoring portfolio and the related interest receivables.

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	2 654	0	0	0	**2 654**
Special monitoring	0	412	0	0	**412**
Default	0	0	0	0	**0**
Gross carrying amount	2 654	412	0	0	**3 067**
Loss allowances	21	79	0	0	**100**
Carrying amount	2 633	333	0	0	**2 966**

Retail loans

As at 31.12.2018, the group-based impairment reserve makes up 1.1% of retail loans and related claims (31.12.2017: 1.1%). Credit decision is done by the majority decision of the Retail Banking Credit Committee.

Retail loans to SMEs

	2018				
	ECL staging				
(EUR thousand)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	14 966	1 043	0	0	**16 009**
Special monitoring	0	0	0	0	**0**
Default	0	0	191	0	**191**
Gross carrying amount	14 966	1 043	191	0	**16 200**
Loss allowances	31	54	98	0	**184**
Carrying amount	14 935	988	93	0	**16 016**

For off-balance sheet exposures related with retail credit portfolio, a provision of EUR 19 thousand was recorded as of 31.12.2018.

Private loans

	2018				
	ECL staging				
(EUR thousand)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	35 248	2 516	0	0	**37 764**
Special monitoring	0	0	0	0	**0**
Default	0	0	146	16	**163**
Gross carrying amount	35 248	2 516	146	16	**37 927**
Loss allowances	8	0	1	0	**10**
Carrying amount	35 239	2 516	145	16	**37 917**

Student loans

	2018				
	ECL staging				
(EUR thousand)	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Credit grade					
Investment grade	76	0	0	0	**76**
Special monitoring	0	0	0	0	**0**
Default	0	0	0	0	**0**

Gross carrying amount	76	0	0	0	**76**
Loss allowances	0	0	0	0	**0**
Carrying amount	76	0	0	0	**76**

Consumer loans

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

As at 31.12.2018, the group-based impairment reserve makes up 1.7% of consumer loans and the related interest receivables (31.12.2017: 3.4%).

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	29 427	4 372	0	0	**33 799**
Special monitoring	0	0	0	0	**0**
Default	0	0	190	0	**190**
Gross carrying amount	29 427	4 372	190	0	**33 989**
Loss allowances	213	267	88	0	**568**
Carrying amount	29 214	4 105	102	0	**33 421**

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

Hire purchase

Similarly, to other homogenous portfolios, provisions are made based on the same framework as consumer loans.

As of 31 December 2018, the group-based impairment reserve amounted to 0.8% of hire-purchase portfolio (31.12.2017: 1.2%).

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	16 507	1 191	1	0	**17 699**
Special monitoring	0	0	0	0	**0**
Default	0	1	50	0	**51**
Gross carrying amount	16 507	1 192	51	0	**17 750**
Loss allowances	55	46	39	0	**140**
Carrying amount	16 452	1 146	12	0	**17 610**

Credit cards

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework is based on PD, LGD and EAD indicators. As of 31 December 2018, the group-based impairment reserve amounted to 0.4% of credit card loans and related receivables (31.12.2017: 1.9%).

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	6 221	605	7	0	**6 833**
Special monitoring	1	7	0	0	**7**
Default	1	10	2	0	**12**
Gross carrying amount	6 223	621	9	0	**6 853**
Loss allowances	6	18	3	0	**27**
Carrying amount	6 217	603	6	0	**6 826**

For off-balance sheet exposures related with credit cards portfolio, a provision of EUR 1 thousand was recorded as of 31.12.2018.

Mortgage loans

The provisions are made based on the same framework as for consumer loans. As of 31 December 2018, the group-based impairment amounted to 0.03% of mortgage portfolio (31.12.2017: 0.3%).

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

Leasing

The leasing provisioning is done based on Leasing scoring models. The provisions are made based on the same framework as for consumer loans. As of 31 December 2018, the group-based impairment reserve amounted to 0.8% of leasing portfolio (31.12.2017: 0.3%).

	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**

Investment grade	53 810	3 874	0	0	**57 684**
Special monitoring	0	2 198	0	0	**2 198**
Default	0	0	284	0	**284**
Gross carrying amount	53 810	6 071	284	0	**60 165**
Loss allowances	92	312	63	0	**467**
Carrying amount	53 717	5 760	221	0	**59 698**

Levaraged loans

The Bank had no impaired leveraged loans as at 31.12.2018 and 31.12.2017.

The impairment reserve amounted to 0.08% of the leveraged loans portfolio

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	2018				
	ECL staging				
(EUR thousand) **Credit grade**	**Stage 1** 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased or Initiated Credit Impaired	**Total**
Investment grade	3 730	0	0	0	**3 730**
Special monitoring	0	0	0	0	**0**
Default	0	0	0	0	**0**
Gross carrying amount	3 730	0	0	0	**3 730**
Loss allowances	3	0	0	0	**3**
Carrying amount	3 726	0	0	0	**3 726**

3.2.4.2 Credit quality of financial assets as of 31.12.2017

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

Loans and advances to customers 31.12.2017	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total	Collective impairment	Individual impairment	Net
Loans to legal entities							
Loans to other subsidiaries of the parent company	36 775	0	0	**36 775**	0	0	**36 775**
Corporate loans	443 822	3 766	9 160	**456 748**	-2 161	-1 518	**453 069**
Retail loans	13 049	581	26	**13 656**	-155	0	**13 501**
Overdraft	34 309	0	4 883	**39 192**	-122	-793	**38 277**
Hire-purchase	268	0	1	**269**	-2	-2	**265**
Leveraged loans	4 547	0	0	**4 547**	0	0	**4 547**
Leasing	31 534	2 141	57	**33 732**	-132	-614	**32 986**
Credit card loans	172	0	0	**172**	-4	0	**168**
Loans to individuals							
Consumer loans	23 468	0	1 209	**24 677**	-733	-86	**23 858**
Hire-purchase	18 463	496	63	**19 022**	-201	-30	**18 791**
Leveraged loans	2 621	0	0	**2 621**	0	0	**2 621**
Leasing	11 091	210	19	**11 320**	-17	-7	**11 296**
Mortgage loans	77 471	169	0	**77 640**	-243	0	**77 397**
Credit card loans	5 673	0	165	**5 838**	-75	-5	**5 758**
Overdraft	77	1	3	**81**	0	0	**81**
Total loans and advances to customers (Note 11)	**703 340**	**7 364**	**15 586**	**726 290**	**-3 845**	**-3 055**	**719 390**

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 criteria for definition of default: 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.

Distribution of corporate loans and overdraft by internal ratings as at 31.12.2017 *(EUR thousand)*	**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 internal ratings for other loan products:

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

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

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

As at 31.12.2017 *(EUR thousand)*	**Corporate loans (incl. overdraft)**	**Retail loans**	**Leasing**	**Hire-purchase**	**Overdraft to private individuals**	**Mortgage loan**	**Total**
Past due receivables							
1-30 days	56	481	1 686	361	0	169	**2 753**
31-60 days	3 710	61	654	96	1	0	**4 522**
61-90 days	0	39	11	39	0	0	**89**
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**	**2 351**	**496**	**1**	**169**	**7 364**

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

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

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

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

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

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

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

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

3.2.4.4 Collateral

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

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

The principal collateral types for loans and advances are:

- Mortgage
- Guarantee of KredEx Fund or Rural Development Foundation
- Deposit
- Marketable securities
- Rights of claims
- Commercial pledge
- Pledge of shares
- Pledge of claim
- Surety of private person or legal entity
- Machinery and equipment

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

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

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

Mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in low loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is EUR 101 009 as at 31 December 2018.

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

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

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

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

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

Collaterals for leveraged loans are monitored on a daily basis and, if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31 December 2018 and as of 31 December 2017, all leveraged loans are over-collateralized. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing and mortgage loans are all over-collateralized. The Group monitors customers in arrears of leasing, hire purchase, mortgage loans and overdraft to private individuals on regular basis.

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

Under-collateralized loans include contracts with more than 90 days overdue totalling EUR 13 592 thousand (2017: EUR 1 383 thousand) with a collateral value of EUR 7 172 thousand (2017: EUR 0 thousand).

	Over-collateralized loans		Under-collateralized loans	
(EUR thousand)	Carrying value	Fair value of collateral	Carrying value	Fair value of collateral
As at 31.12.2018	**364 598**	**616 532**	**564 439**	**294 379**
Corporate and retail loans (including overdraft)	236 687	397 060	430 851	239 326
Leveraged loans	3 730	6 293	0	0
Credit cards, consumer loans, overdraft to private individuals	37 846	100 820	40 999	74
Leasing	0	0	60 165	41 033
Hire-purchase	0	0	17 750	0
Mortgage loans	86 335	112 359	14 674	13 946
As at 31.12.2017				
Corporate loans and overdraft	**208 356**	**552 362**	**301 002**	**175 873**

3.2.5 Loss allowance

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

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

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

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

From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	115	0	**115**
Loss allowance as at 31 December 2018	**2 271**	**1 122**	**5 299**	**186 284**	**8 879**

Retail loans to SMEs	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Loss allowance as at 1 January 2018	131	0	0	0	**131**
Movements with P&L impact	-148	49	99	0	0
Transfers:					
From Stage 1 to Stage 2	-49	49	NA	0	0
From Stage 1 to Stage 3	-99	NA	99	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	20	1	0	0	21
Changes in PDs/LGDs/EADs	46	3	-1	0	48
Changes to model assumptions and methodologies	1	1	0	0	2
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[(a)]	0	0	1	0	1
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-81**	**54**	**99**	**0**	**72**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	25	0	**25**
Loss allowance as at 31 December 2018	**50**	**54**	**99**	**0**	**203**

	Stage 1	**Stage 2**	**Stage 3**

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Consumer loans	**12-month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Loss allowance as at 1 January 2018	442	0	0	0	**442**
Movements with P&L impact	-219	133	86	0	0
Transfers:					
From Stage 1 to Stage 2	-133	133	NA	0	0
From Stage 1 to Stage 3	-86	NA	86	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	212	32	1	0	245
Changes in PDs/LGDs/EADs	-223	102	2	0	119
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[(a)]	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-230**	**267**	**89**	**0**	**126**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**212**	**267**	**89**	**0**	**568**

Hire-purchase	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Loss allowance as at 1 January 2018	99	5	3	0	**108**

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Movements with P&L impact	-38	21	17	0	0
Transfers:					
From Stage 1 to Stage 2	-21	21	NA	0	0
From Stage 1 to Stage 3	-17	NA	17	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	70	8	11	0	89
Changes in PDs/LGDs/EADs	-77	11	9	0	-57
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[(a)]	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-44**	**40**	**36**	**0**	**32**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	-8	8	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**55**	**46**	**39**	**0**	**140**

Mortgage loans	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Loss allowance as at 1 January 2018	32	0	0	0	**32**
Movements with P&L impact	0	0	0	0	0
Transfers:					
From Stage 1 to Stage 2	0	0	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0

From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	42	3	0	0	45
Changes in PDs/LGDs/EADs	-58	5	0	0	-53
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount[(a)]	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-16**	**9**	**0**	**0**	**-7**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**17**	**9**	**0**	**0**	**26**

Leasing	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Loss allowance as at 1 January 2018	233	0	0	0	**233**
Movements with P&L impact	-268	238	30	0	0
Transfers:					
From Stage 1 to Stage 2	-238	238	NA	0	0
From Stage 1 to Stage 3	-30	NA	30	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	43	7	0	0	50
Changes in PDs/LGDs/EADs	85	67	33	0	185
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0

Unwind of discount[(a)]	0	0	0	0	0
FX and other movements	0	0	0	0	**0**
Total net P&L charge during the period	**-140**	**312**	**63**	**0**	**235**
Other movements with no P&L impact					
Transfers:					
From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	**0**
Loss allowance as at 31 December 2018	**92**	**312**	**63**	**0**	**467**

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

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

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

Corporate loans and overdraft	**Stage 1**	**Stage 2**	**Stage 3**		
	12-month ECL	**Lifetime ECL**	**Lifetime ECL**	**Purchased Credit Impaired**	**Total**
(EUR thousand)					
Gross carrying amount as at 1 January 2018	**456 747**	**25 150**	**14 043**	**0**	**495 940**
Movements with P&L impact					
Transfers:					
From Stage 1 to Stage 2	-11 244	11 244	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 3	NA	-3 415	3 415	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
From Stage 2 to Stage 1	2 208	-2 208	NA	0	0
Financial assets derecognised during the period	45 325	4 479	5 298	0	55 102
New financial assets originated or purchased	204 715	2 066	0	380	207 161
Modifications of contractual cash flows of financial assets	0	0	0	0	0

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Changes in interest accrual	367	20	0	0	387
Write-offs	0	0	115	0	115
FX and other movements	0	0	0	0	0
Gross carrying amount as at 31 December 2018	**607 468**	**28 378**	**12 045**	**380**	**648 271**

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

The Group evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the carrying value of the receivable and expected cash flows discounted at the effective interest rate. In 2018, the Group provisioned corporate loans in the total amount of EUR 4 303 thousand (2017: EUR 2 267 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 188 841 thousand euros at 31.12.2018 (31.12.2017: 179 572 thousand euros).

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2018 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 41 430 thousand (31.12.2017: EUR 48 899 thousand). All uncommissioned loans available to individuals have at least investment grade scoring as at the end of each reporting period.

Credit quality of off-balance sheet liabilities (unused loan commitments for corporate loans and financial guarantees) *(EUR thousand)*	**31.12.2018**	**31.12.2017**
5 low credit risk	5 302	5 632
6 low credit risk	17 202	13 135
7 medium credit risk	25 997	25 582
8 medium credit risk	71 244	57 446
9 heightened credit risk	25 142	28 932
10 high credit risk	10 534	4 176
11 high credit risk	17	342
12 payments are delayed	604	0
13 payments are delayed	0	760
Non-rated (retail clients)	737	719
Total	**156 780**	**136 724**

The total amount of undiscounted expected credit losses at initial recognition for purchased or originated credit-impaired financial assets recognised during the period was EUR 186 thousand.

3.2.6. Write-off policy

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

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

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

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

Credit cards and hire purchase

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

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

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

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

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

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

Leasing, private and business loans

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

3.2.7. Modifications of financial assets

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

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

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

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

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

3.3 Market risk

Market risk arises from the Group's 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.

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 *(EUR thousand)*	**2018**	**2017**
USD exchange rate +/- 10%	+/-13	+/-16
SEK exchange rate +/- 10%	+/-0	+/-4
GBP exchange rate +/- 10%	+/-10	+/-1
CHF exchange rate +/- 10%	+/-2	+/-1

Open currency exposures

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

31.12.2018

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

Open gross position derivative assets at contractual value	610	0	9 166	3 973	2 186	3 234	19 169
Open gross position derivative liabilities at contractual value	18 559	0	0	0	610	0	19 169
Open foreign currency position	**125 225**	**-20**	**-98**	**-2**	**-130**	**-232**	**124 743**

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

3.3.2 Price risk

Financial instruments bearing price risk at Group are securities held in the trading portfolio and investment portfolio (Note 9a, 9b, 10). At the Group, limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for debt securities in the investment portfolio. The risk management unit monitors the compliance with limits.

Bank does not hold significant amounts of equity securities in its position (see Note 10), due to which the sensitivity to change in the market 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% (2017: 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 *(EUR thousand)*	**2018**	**2017**
Equity securities and fund units +/-10%	+/-51	+/-43
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-387	+/-491
Impact on other comprehensive income *(EUR thousand)*	**2018**	**2017**
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-0	+/-6
Equity securities (FVOCI/AFS) +/-10%	+/- 30	+/- 22

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 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 statement of financial position and margins on assets and deposits are assumed to be constant over time. The deposits interest rates did not change in 2018 remaining at the level of up to 1.0% (up to 1.0% in 2017).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2018, the interest rate on loans received for specific purposes was around 1.0% (2017: 1.0%). 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 and in 2016 was 6.5%, the effective interest rate of subordinated debts entered into in 2018 was 6.0%. The information about subordinated debt contractual interest rates is provided in Note 18.

As at 31.12.2018, an increase of 1 percentage point in interest rates would affect the Group's annual net interest income and profit by EUR +10 263 thousand (2017: EUR +5 584 thousand). In the same time, a decrease of 1 percentage point in interest rates would affect the Group's annual net interest income (profit) by EUR -1 657 thousand (2017: EUR -1 567 thousand). A 1 percentage point increase in market interest rates would raise the Group's economic value, i.e. equity, by EUR +11 437 thousand (2017: EUR +7 520 thousand). A 1 percentage point decrease in market interest rates would decrease the Group's economical value (equity) by EUR +25 265 thousand (2017: EUR +16 639 thousand). Effect on the Group's economic value in both scenarios 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 Group grouped by the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.

31.12.2018 *(EUR thousand)*	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Subtotal**	**Accrued interest**	**Impair-ments**	**Total**
Financial assets								
Due from banks and investment companies (Note 8)	681 846	0	0	0	**681 846**	0	0	**681 846**

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Financial assets at fair value (debt securities) (Note 9, 10)	20 546	0	15 031	2 000	**37 577**	1 120	0	**38 697**
Loans and advances to customers (Note 11)	382 251	465 063	62 286	16 770	**926 370**	2 667	-10 276	**918 761**
Total	**1 084 643**	**465 063**	**77 317**	**18 770**	**1 645 793**	**3 787**	**-10 276**	**1 639 304**
Financial liabilities								
Deposits from customers and loans received (Note 15)	136 498	111 503	1 221 205	18	**1 469 224**	337	0	**1 469 561**
Subordinated debt* (Note 18)	0	0	0	30 000	**30 000**	150	0	**30 150**
Total	**136 498**	**111 503**	**1 221 205**	**30 018**	**1 499 224**	**487**	**0**	**1 499 711**
Net interest sensitivity gap	**948 145**	**353 560**	**-1 143 888**	**-11 248**	**146 569**			

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

* The contractual term of subordinated debts received in 2015, 2016 and in 2018 is 10 years and the interest rate is fixed at 6.0%.

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

3.4 Liquidity risk

Liquidity risk relates to the solvency of LHV Pank to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. LHV Pank's liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, LHV Pank's liquidity management reflects a conservative approach towards liquidity risk. The liquidity risk management includes stress testing and business continuity plan for liquidity management. Stress testing framework includes a survival period metrics, which represents a combined liquidity risk scenario, including both idiosyncratic and market-wide stress. Internal metrics are complemented by the Basel III metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), which LHV Pank is fully compliant with as at 31.12.2018 and 31.12.2017. The aim of the liquidity coverage ratio (LCR) standard is to ensure that the bank has an adequate amount of unencumbered assets of high quality and liquidity that could be monetized without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The bank's liquidity coverage ratio level as at 31.12.2018 was 144% (31.12.2017: 121%).

The objective of the net stable funding ratio (NSFR) is to ensure that the bank has adequate stable funding sources to finance longer-term assets. According to the proposals published in the banking regulation and the Banking Committee of Basel in October 2014, the bank's NSFR level as at 31.12.2018 was

153% (31.12.2017: 142%). The net stable funding ratio will be imposed as 100% minimum requirement from the year 2018.

The Treasury of LHV Pank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period, also the concentration of bank's liabilities by maturities is monitored. To enable covering unexpected monetary outflows, LHV Pank holds a liquidity buffer. The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Treasury, which can be readily sold or used as a collateral in funding operations with the central bank. LHV Pank has a sufficient supply of liquid resources to enable issuing standby loans. As at 31.12.2018 and 31.12.2017, 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.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows andin a separate column the statement of financial position balance is disclosed. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows). Explanation of the fair value of these financial assets and liabilities is presented in Note 3.5.

31.12.2018 *(EUR thousand)*	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**	**Carrying amount**
Liabilities by contractual maturity dates							
Deposits from customers and loans received (Note 15)	1 330 018	24 949	94 113	16 780	4 390	**1 470 250**	**1 469 561**
Subordinated debt (Note 18)	0	504	1 510	8 055	35 333	**45 402**	**30 000**
Accounts payable and other financial liabilities (Note 16)	0	20 948	0	0	0	**20 948**	**20 948**
Unused loan commitments (Note 21)	32 259	156 582	0	0	0	**188 841**	**0**
Financial guarantees by contractual amounts (Note 21)	0	9 314	0	0	0	**9 314**	**0**
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	**19 169**	**0**
Financial liabilities at fair value (Note 10)	0	11	0	0	0	**11**	**11**
Total liabilities	**1 362 277**	**230 867**	**95 623**	**25 445**	**39 723**	**1 753 935**	**1 520 520**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	681 846	0	0	0	0	**681 846**	**681 846**
Financial assets at fair value (debt securities) (Note 9,10)	0	20 690	0	15 845	2 161	**38 696**	**38 697**
Loans and advances to customers (Note 11)	0	63 584	198 293	634 077	154 853	**1 050 807**	**918 761**
Receivables from customers (Note 12)	0	2 509	0	0	0	**2 509**	**2 509**
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	**19 169**	**0**
Other financial assets (Note 13)	2 936	0	0	0	0	**2 936**	**2 936**
Total assets held for managing liquidity risk	**684 782**	**105 342**	**198 293**	**650 532**	**157 014**	**1 795 963**	**1 644 749**
Maturity gap from assets and liabilities	**-677 495**	**-125 525**	**102 670**	**625 087**	**117 291**	**42 028**	**124 229**

31.12.2017 *(EUR thousand)*	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**	**Carrying amount**
Liabilities by contractual maturity dates							
Deposits from customers and loans received (Note 15)	1 423 306	37 104	90 332	3 335	2 864	**1 556 941**	**1 556 573**
Subordinated debt (Note 18)	0	341	1 022	5 455	23 466	**30 284**	**20 000**
Accounts payable and other financial liabilities (Note 16)	0	60 126	0	0	0	**60 126**	**60 126**
Unused loan commitments (Note 21)	29 815	141 713	0	0	0	**171 528**	**0**

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Financial guarantees by contractual amounts (Note 21)	0	5 999	0	0	0	**5 999**	**0**
Foreign exchange derivatives (gross settled)	0	11 825	0	661	0	**12 486**	**0**
Financial liabilities at fair value (Note 10)	0	2	0	0	0	**2**	**2**
Total liabilities	**1 453 121**	**257 110**	**91 354**	**9 451**	**26 330**	**1 837 366**	**1 636 701**
Assets held for managing liquidity risk by contractual maturity dates							
Due from banks and investment companies (Note 8)	955 891	0	0	0	0	**955 891**	**955 891**
Financial assets at fair value (debt securities) (Note 9,10)	0	180	30 952	17 005	2 084	**50 221**	**50 014**
Loans and advances to customers (Note 11)	0	45 720	149 634	505 058	95 517	**795 929**	**719 390**
Receivables from customers (Note 12)	0	7 357	0	0	0	**7 357**	**7 357**
Other financial assets (Note 13)	2 289	0	0	0	0	**2 289**	**2 289**
Foreign exchange derivatives (gross settled)	0	11 825	0	661	0	**12 486**	**0**
Total assets held for managing liquidity risk	**958 180**	**65 082**	**180 586**	**522 724**	**97 601**	**1 824 173**	**1 734 941**
Maturity gap from assets and liabilities	**-494 941**	**-192 028**	**89 232**	**513 273**	**71 271**	**-13 244**	**98 240**

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

(EUR thousand)	**31.12.2018**	**31.12.2017**
Current assets		
Due from with central banks (Note 8)	639 862	920 714
Due from credit institutions (Note 8)	24 979	20 991
Due from investment companies (Note 8)	17 005	14 186
Available-for-sale financial assets (Note 9a)	0	555
Financial assets at fair value through profit or loss (Note 10)	20 392	30 427
Loans and advances to customers (Note 11)	225 036	209 216
Receivables from customers (Note 12)	2 509	7 357
Other assets (Note 13)	1 341	836
Total current assets	**931 124**	**1 204 282**
Non-current assets		
Available-for-sale financial assets (Note 9a)	0	220
Equity instruments at FVOCI (Note 9b)	298	0
Financial assets at fair value through profit or loss (Note 10)	18 521	18 812
Other financial assets (Note 13)	2 936	2 289
Loans and advances to customers (Note 11)	693 725	510 174
Tangible assets (Note 14)	1 122	1 225
Intangible assets (Note 14)	1 286	952
Total non-current assets	**717 888**	**533 672**
Total assets	**1 649 012**	**1 737 954**

Liabilities		
Current liabilities		
Deposits from customers and loans received (Note 15)	1 448 767	1 550 527
Financial liabilities at fair value through profit or loss (Note 10)	11	2
Accounts payable and other liabilities (Note 16)	23 861	61 858
Total current liabilities	**1 472 639**	**1 612 387**
Non-current liabilities		
Deposits from customers and loans received (Note 15)	20 794	6 046
Subordinated debt (Note 18)	30 000	20 000
Total non-current liabilities	**50 794**	**26 046**
Total liabilities	**1 523 433**	**1 638 433**

3.5 Fair value of financial assets and financial liabilities

(EUR thousand)	Note	Level 1	Level 2	Level 3	Valuation explanation	Total fair value 31.12.2018	Carrying value 31.12.2018	Diffe-rence
Financial assets at fair value through profit or loss								
Shares	10	157	0	0	Level 1 – quotes from active market	**157**	**157**	**0**
Equity instruments at fair value through other comprehensive income	9b	0	0	298	The shares of Visa are not traded on an active market, therefore their value is based on market information on similar transactions and management estimates.	**298**	**298**	**0**
Debt securities at fair value through profit or loss	10	38 697	0	0	Quotes from active market	**38 697**	**38 697**	**0**
Interest rate swaps and foreign exchange forwards	10	0	59	0	Mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. Markets supply observable inputs to the valuation model, which is used for establishing the fair value. The fair value for such over-the-counter derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.	**59**	**59**	**0**
Total financial assets at fair value throught profit or loss		**38 854**	**59**	**298**		**39 211**	**39 211**	**0**

Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards	10	0	11	0		**11**	**11**	**0**
Total financial liabilities at fair value throught profit or loss		**0**	**11**	0		**11**	**11**	**0**
Financial assets at amortised cost								
Due from other banks	8	639 862	0	0	Very liquid and short-term	**639 862**	**639 862**	**0**
Due from credit institutions	8	24 979	0	0	Very liquid and short-term	**24 979**	**24 979**	**0**
Due from investment companies	8	17 005	0	0	Very liquid and short-term	**17 005**	**17 005**	**0**
Loans and advances to customers	11	0	0	924 825	Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest rate of past 6 months prior to balance sheet date.	**924 825**	**918 761**	**6 064**
Receivables from customers	12	2 509	0	0	Short-term receivables	2 509	2 509	**0**
Other financial assets	13	2 936	0	0	Short-term deposits	**2 936**	**2 936**	**0**
Total financial assets at amortised cost		**687 291**	**0**	**924 825**		**1 612 116**	**1 606 052**	**6 064**
Financial liabilities at amortised cost								
Deposits from customers and loans received	15	0	0	1 469 708	Customer deposits and loans received with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount.	**1 469 708**	**1 469 561**	**147**
Subordinated debt	18	0	0	30 491	Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade.	**30 491**	**30 150**	**341**
Accounts payable and other liabilities	16	20 977	0	0	Short-term payables	**20 977**	**20 977**	**0**
Total financial liabilities at amortised cost		**20 977**	**0**	**1 500 199**		**1 521 176**	**1 520 688**	**488**

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

(EUR thousand)	Note	Level 1	Level 2	Level 3	Valuation explanation	Total fair value 31.12.2017	Carrying value 31.12.2017	Diffe-rence
Financial assets at fair value through profit or loss								
Shares	10	71	0	0	Level 1 – quotes from active market	**71**	**71**	**0**
Available-for-sale debt securities	9a	555	0	220	Level 1- quotes from active market Level 3 - 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.	**775**	**775**	**0**
Debt securities at fair value through profit or loss	10	49 138	0	0	Quotes from active market	**49 138**	**49 138**	**0**
Interest rate swaps and foreign exchange forwards	10	0	30	0	Mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. Markets supply observable inputs to the valuation model, which is used for establishing the fair value. The fair value for such over-the-counter derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.	**30**	**30**	**0**
Total financial assets at fair value through profit or loss		**49 764**	**30**	**220**		**50 014**	**50 014**	**0**
Financial liabilities at fair value through profit or loss								
Interest rate swaps and foreign exchange forwards	10	0	2	0		**2**	**2**	**0**
Total financial liabilities at fair value through profit or loss		**0**	**2**	0		**2**	**2**	**0**
Financial assets at amortised cost								
Due from other banks	8	0	920 714	0	Very liquid and short-term	**920 714**	**920 714**	**0**
Due from credit institutions	8	0	20 991	0	Very liquid and short-term	**20 991**	**20 991**	**0**
Due from investment companies	8	0	14 186	0	Very liquid and short-term	**14 186**	**14 186**	**0**
Loans and advances to customers	11	0	0	728 526	Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest rate of	**728 526**	**719 390**	**9 136**

					past 6 months prior to balance sheet date.			
Receivables from customers	12	7 357	0	0	Short-term receivables	**7 357**	**7 357**	**0**
Other financial assets	13	2 289	0	0	Short-term deposits	**2 289**	**2 289**	**0**
Total financial assets at amortised cost		**9 646**	**955 891**	**728 526**		**1 694 063**	**1 684 927**	**9 136**
Financial liabilities at amortised cost								
Deposits from customers and loans received	15	0	0	1 556 729	Customer deposits and loans received with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount.	**1 556 729**	**1 556 573**	**156**
Subordinated debt	18	0	0	20 863	Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade.	**20 863**	**20 150**	**713**
Accounts payable and other liabilities	16	60 126	0	0	Short-term payables	**60 126**	**60 126**	**0**
Total financial liabilities at amortised cost		**60 126**	**0**	**1 577 592**		**1 637 718**	**1 636 849**	**869**

The management board of the Group has assessed the fair value of assets and liabilities carried at amortized cost in the statement of financial position. For estimating fair value, the future cash flows are discounted based on the market interest yield curve.

Levels used in hierarchy:

1. Level 1 – quoted prices in active market
2. Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)
3. Level 3 – other valuation techniques (a)Quantitative information about the significant unobservable inputs used in fair value measurement (if developed and available for the entity); b)a narrative description of the sensitivity of FV measurement to changes in unobservable inputs (if the change might result in a significant change in FV measurement); c)effect of reasonable possible changes to unobservable inputs

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

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

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of AS LHV Pank and to evaluate capital requirements. The analysis of cases collected into the database enables AS LHV Pank to identify the flaws in business processes, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of Group is responsible for collecting information.

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

3.8. Compliance risk

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

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

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

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

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

The biggest challenges that faced LHV in 2018 from regulatory perspective were implementation of MiFID II, IFRS 9, GDPR and changes to reporting requirements (AnaCredit), PSD 2, PRIIP regulation, 4MLD and guidelines issued for its implementation.

Considering recent events, incl. the cases of Danske and Versobank, LHV continues to pay particular attention to AML related measures.

3.9. Anti-money laundering

Structure of money laundering and terrorist financing risks

- Money laundering and terrorist financing risk. The risk that bank products or services will be used for money laundering or terrorist financing, which may be expressed through realization of compliance and/or reputational risk.
- Compliance risk. The risk that the Group will not be able to comply with obligations imposed by the regulations on money laundering and terrorist financing (especially the implementation of due diligence measures), which may lead to a fine or a revocation of a license.
- Reputational risk. The risk that the reputation of the Group is damaged by the actual or suspected involvement of money laundering or terrorist financing, as well as the realization of the compliance risk, and which may have a significant negative financial impact (loss of profit, decrease of value, etc.).
- Concentration risk. The risk that the structure of customers and their assets are significantly related to the criminal activities, which may express in realization of compliance and reputational risk.
- Group can be affected also by liquidity risk through realization and escalation of above-mentioned risks.

AML/CTF Governance

LHV has established internal AML/CTF governance system, which is based on three lines of defence principle where all defence lines are committed to actively mitigate ML/TF risk guided by risk-based approach. Risk based approach is based on risk assessment of products, services and clients and on risk-based monitoring. It is supported by high awareness and commitment from all employees and management built on awareness rising, information sharing and training and supported by appropriate reporting.

Management and Supervisory Board of LHV Group and LHV Bank have strong commitment towards implementing, maintaining and developing AML/KYC regime all over Group entities. There have been at least yearly updates in AML/CTF Policy and Customer Acceptance Principles. In addition, all internal AML/CTF procedures are constantly updated.

Beside updating internal regulations also strong focus is set on technical capabilities to prevent and detect money laundering, terrorist financing, financial fraud and international financial sanctions. One highlight in 2018 was starting the implementation of two dedicated software solutions for screening and monitoring. Both tools are well-known trademarks in their area and will be fully implemented in first half of 2019. LHV uses Accuity`s Compliance Link for screening and FICO Tonbeller`s Siron for monitoring and risk segmentation. Additionally Bank has established cooperation with external experts with aim to continuously develop its analytical capabilities.

Not only there have been investments in to IT, but also to human resources. As regulations and expectations towards depth of KYC measures are constantly growing, then Group has significantly increased resources in that area. Comparing to 2017 Group has more than doubled number of employees directly involved with AML measures. Number of employees dealing directly with AML and KYC is planned to be increase in coming years.

AML/KYC measures

LHV main principles:

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

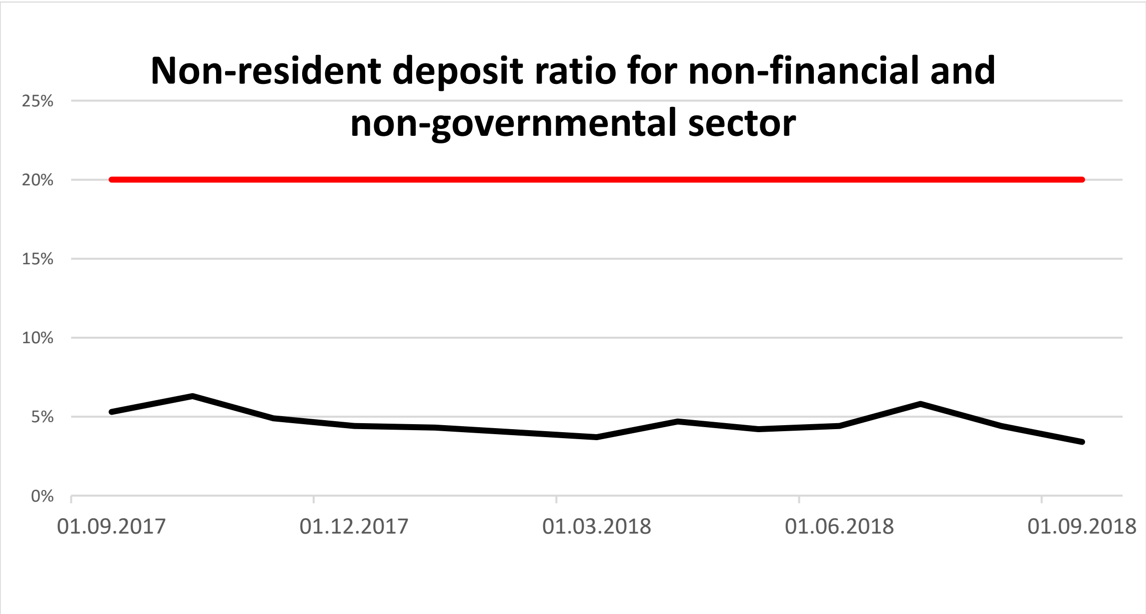
LHV has implemented four levels of customer acceptance in on-boarding stage:

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

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

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

LHV has set risk tolerance towards non-resident legal customers' deposits outside of non-financial and non-governmental sectors to 20%. In reality, those numbers are significantly lower:



One of first risk indicators is country and jurisdiction risk. LHV has four risk categories for countries which are based on money laundering and terrorist financing risks. Even EU member countries are not categorized in same way, but have different risk categories depending on their risks.

LHV welcomes country`s e-resident program, but all e-residents are still non-residents and require similar KYC measures as set to all other non-residents.

Financial intermediaries

LHV is accepting as customers modern financial intermediaries or so called fin.tech companies who provide financial services to their customers. As such service providers are potentially presenting higher money laundering and terrorist financing risk, then Group has dedicated special attention and measures to service such customers. There are dedicated customer managers having area related competence. AML team is always keeping eye on new trends and threats coming from that sector and KYC measures are constantly updated. Group has taken approach that all customers from fin.tech sector have to have same AML/KYC measures in place as does banking sector. During on-boarding and continuous KYC, Group assesses customers business model, team, AML/KYC measures, technical capabilities for screening and monitoring, customer focus, customer risk segmentation, limit policy, source of funds and etc. LHV carries out on-site visits to ensure that declared activities are really implemented and working. Special and continuous attention is set on financial activities of those customers.

Country

Through geographical location and historic connections there has been strong pressure from CIS countries to use neighbouring countries financial system as route for their finances to Western Europe. Recent public information demonstrates that there have been lack of strong KYC measures at least in two banks. Related to poor KYC measures that have led to the potential money laundering has FSA withdrawed a license from one bank in Estonia. Same reasons are behind of closure of non-resident business in one Scandinavian bank`s branch and limiting services in retail business.

Estonia adopted new AML/CTF law in the end of 2017. New law is based on fourth EU AML directive, but covers partially also requirements from fifth EU AML directive as well. FSA has adopted new AML guideline for financial sector based on new legislation. New FSA`s guideline is more detailed than previous ones and includes sample list of high risk situations financial industry should focus on. In general Estonian AML/CTF regulation is aligned with EU and FATF principles and is covering all new requirements (f.e. domestic PEP`s, register of beneficial owners, national and industry level risk assessment and etc.).

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 LHV Pank'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 preparing to start a business in the United Kingdom.

3.11. Offsetting assets and liabilities

The group has offset the following assets and liabilities

				Related arrangements not set off in the statement of financial position		
31.12.2018	**Gross amounts before offsetting in the statement of financial position**	**Offsetting**	**Net amount of exposure presented in the statement of financial position**	**Financial instruments**	**Cash collateral received**	**Net amounts**
Assets						
Derivatives	59	0	59	0	0	0
Liabilities						
Derivatives	11	0	11	0	0	0

31.12.2017						
Assets						
Derivatives	30	0	30	0	0	0
Due from investment companies	20 628	-20 625	3	0	0	3
Liabilities						
Derivatives	2	0	2	0	0	0
Payables to investment companies	20 628	-20 628	0	0	0	0

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the balance sheet date, and the reported amounts of income and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates. Management's estimates have been applied to valuation of loans, receivables and investments (Notes 3.2, 8, 9, 10 and 11).

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

NOTE 5 Net interest income

Interest income	**2018**	**2017**
Loans to companies (including retail loans)	27 048	20 784
incl. loans to related parties (Note 22)	31	27
*incl. stage 3 interests**	*340*	*421*
Hire-purchase	4 055	4 182
Consumer loans	5 313	4 018
Leasing	2 439	1 845
incl. loans to related parties (Note 22)	*4*	*6*
Loans to other Group companies	0	919
Leveraged loans and lending of securities	456	147
From debt securities	136	206
incl. debt securities available-for-sale (Note 9a)	0	24
incl. debt securities at FVOCI (Note 9b)	13	0
incl. debt securities at fair value through profit or loss (Note 10)	123	182
Credit card loans	770	694
From balances with credit institutions and investment companies	141	39
Other loans	5 264	2 658
incl. loans to related parties (Note 22)	*32*	*30*
Total	**45 622**	**35 492**
Interest expense		
Deposits from customers and loans received	-1 881	-1 218
From balances with central bank	-3 360	-1 773
Subordinated debt (Note 18, 22)	-1 360	-1 367

Total	**-6 601**	**-4 358**

Net interest income	**39 021**	**31 134**

Interest income of loans by customer location (interests from bank balances and debt securities not included):	**2018**	**2017**
Estonia	44 822	34 307
Lithuania	523	940
Total	**45 345**	**35 247**

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

NOTE 6 Net fee and commission income

Fee and commission income	**2018**	**2017**
Security brokerage and commission fees	3 687	3 072
Asset management and related fees	2 429	1 690
Currency exchange fees	1 639	977
Fees from cards and settlements	8 766	5 875
Other fee and commission income	2 381	1 482
Total	**18 902**	**13 096**
Fee and commission expense		
Security brokerage and commission fees paid	-544	-55
Fees related to bank cards paid	-2 765	-2 026
Fees related to acquiring paid	-2 834	-1 982
Fees related to consumer loans and hire-purchase paid	-518	-485
Other fee and commission expense	-1 138	-853
Total	**-7 799**	**-5 401**

Net fee and commission income	**11 103**	**7 695**

Fee and commission income by customer location:	**2018**	**2017**
Estonia	18 902	13 019
Lithuania	0	77
Total	**18 902**	**13 096**

NOTE 7 Operating expenses

	2018	**2017**
Wages, salaries and bonuses	10 687	8 715
Social security and other taxes*	3 191	2 572
Total staff costs	**13 878**	**11 287**
IT expenses	2 011	1 458
Information services and bank services	573	513
Marketing expenses	1 609	1 368
Office expenses	634	414

Transportation and communication costs	204	185
Training and travelling expenses of employees	585	437
Other outsourced services	1 988	1 481
Other administrative expenses	1 715	1 251
Depreciation	1 164	874
Operating lease payments	1 074	949
Other operating expenses	308	198
Total other operating expenses	**11 865**	**9 128**
Total operating expenses	**25 743**	**20 415**

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

The average number of employees working for the Group in 2018 was 342 (2017: 294).

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

	31.12.2018	**31.12.2017**
Demand and term deposits with maturity less than 3 months*	41 984	35 177
Statutory reserve capital at central bank	14 280	15 375
Demand deposit from central bank*	625 582	905 339
Total	**681 846**	**955 891**
* cash and cash equivalents in the statement of cash flows	667 566	940 516

Distribution of receivables by countries is presented in Note 3.5.

Mandatory banking reserve as at 31.12.2018 was 1% (2017: 1%) of all financial resources taken in (Deposits from customers and loans received). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 9a Available-for-sale financial assets

As of 31.12.2017 the Group had VISA shares in the amount of EUR 220 thousand. As of 31.12.2017 the Group had also available-for-sale debt securities portfolio consisting of bonds in the amount of EUR 555 thousand. The balance of other reserves in equity as at 31.12.2017 is EUR 36 thousand, see also Note 19. In 2017, no gains or losses arose from the sale of debt securities.

Available-for-sale financial assets 31.12.2016	**799**
Proceeds from disposal and maturities of assets available-for-sale	-124
Interest income (Note 5)	24
Revaluation of available-for-sale assets	76
Available-for-sale financial assets 31.12.2017	**775**

NOTE 9b Equity and debt instruments at fair value through other comprehensive income

Equity instruments 31.12.2017	**0**
Reclassification on 1 January 2018	**220**
Revaluation of equity instruments	78
Equity instruments 31.12.2018	**298**

On 1 January 2018, the VISA shares were recorded as fair value throught other comprehensive income, which is irrevocable election by management as these shares are not held for trading.

As of 31.12.2018 the Group has VISA shares in the amount of EUR 298 thousand. The balance of other reserves in equity as at 31.12.2018 is EUR 78 thousand, see also Note 19.

On 1 January 2018, debt securities classified as FVOCI was based on the management assessment of the instrument's business model. Therefore, fair value through other comprehensive income measurement basis was applied at the application of IFRS 9.

Debt instruments 31.12.2017	**0**
Reclassification on 1 January 2018	**555**
Proceeds from disposal and maturities of assets available-for-sale	556
Interest income (Note 5)	17
Revaluation of debt instruments	-16
Debt instruments 31.12.2018	**0**

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

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

Securities held for trading:	**31.12.2017**
Shares and fund units	71
Debt securities	49 138
Foreign Exchange forwards	30
Total financial assets	**49 239**
Interest rate swaps and foreign exchange forwards	2
Total financial liabilities	**2**

Financial assets at fair value through profit or loss 31.12.2016	**64 197**
Net changes of investment securities at fair value through profit or loss	-15 099
Interest income (Note 5)	182
Revaluation	-41
Financial assets at fair value through profit or loss 31.12.2017	**49 239**
Net changes of investment securities at fair value through profit or loss	-11 710
Interest income (Note 5)	123
Revaluation	1 261
Financial assets at fair value through profit or loss 31.12.2018	**38 913**

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.5). In 2018, a gain of EUR 407 thousand (2017: EUR 440 thousand) was recognized on the revaluation of bonds. No gain or loss was obtained from the revaluation of interest rate swaps in 2018 and in 2017. Interest income from bonds is recognized in interest income.

NOTE 11 Loans and advances to customers

	31.12.2018	31.12.2017
Loans to legal entities	**714 335**	**585 091**
incl. loans to other subsidiaries of the parent company	0	36 775
incl. corporate loans	624 425	456 748
incl. retail loans	16 200	13 656
incl. overdraft	23 846	39 192
incl. hire-purchase	249	269
incl. leveraged loans	1 997	4 547
incl. leasing	44 277	33 732
incl. credit card loans	274	172
incl. credit letters	3 067	0
Loans to individuals	**214 702**	**141 199**
incl. consumer loans	33 989	24 677
incl. private loans	37 884	0
incl. hire-purchase	17 501	19 022
incl. leveraged loans	1 733	2 621
incl. leasing	15 888	11 320
incl. credit card loans	6 579	5 838
incl. mortgage loans	101 009	77 640
incl. overdraft	43	81
incl. study loan	76	0
Total	**929 037**	**726 290**
Impairment provisions	-10 276	-6 900
Total	**918 761**	**719 390**

As at 31.12.2017, leveraged loans included repo loans to customers in total amount of EUR 778 thousand. As at 31.12.2017, the fair value of collateral of the repo loans amounted to EUR 1 832 thousand. As at 31.12.2018, there were no repo loans. As at 31.12.2017, loans had been issued to related parties in total amount of EUR 39 321 thousand; the loans were issued on market terms. As at 31.12.2018, there were no related party loans. See also Note 22.

In 2018, the average effective interest rate of new consumer loans issued to individuals was 18-20%.The average effective interest rate for hire-purchase was around 20%, credit cards 13% and leasing 3%. The contractual interest rate of leveraged loans issued to individuals is generally equal to their effective interest rate, because no other significant fees have been received upon their issue.

Changes in impairments in 2018	**Corporate loans, incl. overdraft**	**Retail loans**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consumer loans**	**Leasing**	**Leveraged loans**	**Credit letters**	**Total**
Balance as at January 1	**-4 594**	**-155**	**-243**	**-84**	**-235**	**-819**	**-770**	**0**	**0**	**-6 900**
Impairment provisions set up during the year	-4 272	-54	207	47	91	226	183	-3	-100	-3 675
Incl Changes in initial application of IFRS 9	-403	-46	0	-2	-50	-53	-158	0	0	-712

Written off during the year	115	25	0	10	4	25	120	0	0	299
Balance as at December 31	**-8 751**	**-184**	**-36**	**-27**	**-140**	**-568**	**-467**	**-3**	**-100**	**-10 276**

Changes in impairments in 2017	**Corporate loans, incl. overdraft**	**Retail loans**	**Mortgage loans**	**Credit cards**	**Hire-purchase**	**Consumer loans**	**Leasing**	**Total**
Balance as at January 1	**-2 338**	**-101**	**-143**	**-118**	**-195**	**-623**	**-217**	**-3 735**
Impairment provisions set up during the year	-2 257	-54	-100	-1	-480	-196	-562	**-3 650**
Written off during the year	1	0	0	35	440	0	9	**485**
Balance as at December 31	**-4 594**	**-155**	**-243**	**-84**	**-235**	**-819**	**-770**	**-6 900**

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

Net and gross investments on leasing's according to remaining maturity	**Gross investment**	**Unearned future interest income**	**Impairment loss provision**	**Present value of lease payments receivable**
up to 1 year	19 135	-1710	-134	17 291
1-5 years	43 901	-2 535	-319	41 047
over 5 years	1 880	-39	-14	1 827
Total as at 31.12.2018	**64 916**	**-4 284**	**-467**	**60 165**
up to 1 year	15 493	-1 274	-625	13 594
1-5 years	32 555	-1 756	-142	30 657
over 5 years	824	-20	-4	800
Total as at 31.12.2017	**48 872**	**-3 050**	**-770**	**45 052**

For credit risk exposures and loan collateral, see Note 3.2.
Distribution of loans granted by currencies is disclosed in Note 3.3.
Distribution of loans granted by due dates is disclosed in Note 3.4.

The regional distribution of loans granted is disclosed in Note 3.2.2.
For interest income on loans granted, see Note 5.

NOTE 12 Receivables from customers

	31.12.2018	31.12.2017
Asset management fees from customers	185	23
Other fees for providing services to customers	2 324	7 328
Payments in transit	0	6
Total	**2 509**	**7 357**

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

NOTE 13 Other assets

	31.12.2018	31.12.2017
Financial assets		
Guarantee deposits of Baltic stock exchanges	11	9
Guarantee deposit of MasterCard and VISA	2 925	2 280
Subtotal	**2 936**	**2 289**
Non-financial assets		
Prepayments to Financial Supervision Authority	359	223
Other prepayments *	982	613
Subtotal	**1 341**	**836**
Total	**4 277**	**3 125**

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

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

NOTE 14 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
Balance as at 31.12.2016			
Cost	3 112	2 783	5 895
Accumulated depreciation and amortization	-2 110	-2 012	-4 122
Carrying amount	**1 002**	**771**	**1 773**
Changes in 2017:			
Purchase of non-current assets	564	713	1 277
Depreciation/amortization charge	-341	-532	-873
Balance as at 31.12.2017			
Cost	3 676	3 496	7 172
Accumulated depreciation and amortization	-2 451	-2 544	-4 995
Carrying amount	**1 225**	**952**	**2 177**
Changes in 2018:			
Purchase of non-current assets	396	999	1 395
Depreciation/amortization charge	-499	-665	-1 164
Balance as at 31.12.2018			
Cost	4 072	4 495	8 567

Accumulated depreciation and amortization	-2 950	-3 209	-6 159
Carrying amount	**1 122**	**1 286**	**2 408**

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

In 2018 and 2017, there was no indication of impairment of tangible and intangible assets.

NOTE 15 Deposits from customers and loans received

	Individuals	Financial intermediates	Legal entities	Public sector	**31.12.2018 Total**	Individuals	Financial intermediates	Legal entities	Public sector	**31.12.2017 Total**
Demand deposits	374 491	193 893	753 582	7 935	1 329 901	278 430	606 600	531 990	6 203	1 423 223
Term deposits	57 605	0	54 456	5 734	117 795	51 075	0	70 221	5 816	127 112
Loans received	0	0	21 528	0	21 528	0	0	6 000	0	6 000
Accrued interest liability	197	0	131	9	337	144	0	87	7	238
Total	**432 293**	**193 893**	**829 697**	**13 678**	**1 469 561**	**329 649**	**606 600**	**608 898**	**12 026**	**1 556 573**
incl. related parties (Note 22)	*1 091*	*0*	*32 417*	*0*	*33 508*	*2 022*	*0*	*20 973*	*0*	*22 995*

In 2017, a loan received from Maaelu Edendamise Sihtasutus (Rural Development Foundation) was returned in total amount of EUR 778 thousand. AS LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) for EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2018, the loan amount taken into use by the Bank amounted to EUR 12.25 million.

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

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

Distribution of deposits from customers and loans received by maturity is presented in Note 3.4.
Distribution of deposits from customers and loans received by geography is presented in Note 3.2.2.

NOTE 16 Accounts payable and other liabilities

Financial liabilities	**31.12.2018**	**31.12.2017**
Trade payables	1 866	2 300
Other short-term financial liabilities	1 925	1 878
Accrued interest on subordinated loans (Note 18)	150	150
Payments in transit	16 800	55 661
Financial guarantee contracts issued	207	137
Subtotal	**20 948**	**60 126**
Non-financial liabilities		
Prepaid expenses	276	258
Performance guarantee contracts issued	263	159
Tax liabilities	1 100	401

Payables to employees	1 274	914
Subtotal	**2 913**	**1 732**
Total	**23 861**	**61 858**

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

NOTE 17 Operating lease

The Group leases office premises under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The future unilaterally non-cancellable lease payables in the next period are disclosed in the table below. In 2018, the operating lease payments for office premises in the amount of EUR 1 074 thousand (2017: EUR 870 thousand).

	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as at **31.12.2017**	911	1 460	**2 371**
Non-cancellable lease payables as at **31.12.2018**	919	3 211	**4 130**

NOTE 18 Subordinated debts

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

In June 2014, subordinated bonds were issued totaling EUR 8 000 thousand carrying a rate of interest at 7.25%. The due date of the bonds is 20.06.2024.

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

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

In June 2015 the issuer used the right to prematurely redeem the bonds issued in 2012 in the amount of EUR 4 000 thousand. These subordinated bonds were issued in 2012, and the due date of these bonds were 20.12.2020 and the interest rate was 7% during the first three-year period.

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

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

In 2017, no subordinated bonds were issued or redeemed.

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

Subordinated debt

(EUR thousand)

Subordinated debt as at 31.12.2016	**20 000**
Subordinated debt as at 31.12.2017	**20 000**
Subordinated bonds issued	10 000
Subordinated debt as at 31.12.2018	**30 000**

Accrued interest on subordinated debts

(EUR thousand)

Accrued interest on subordinated debts as at 31.12.2016	**150**
Interest calculated for 2017 (Note 5)	1 360
Paid out during 2017	-1 360
Accrued interest on subordinated debts as at 31.12.2017	**150**
Interest calculated for 2018 (Note 5)	1 360

Paid out during 2018	-1 360
Accrued interest on subordinated debts as at 31.12.2018	**150**

NOTE 19 Shareholders' equity in the public limited company

The sole shareholder of the Group is a company registered in Estonia, AS LHV Group. Rain Lõhmus who owns 24.9% of the voting rights and Andres Viisemann who owns 9.8% of the voting rights in AS LHV Group have significant influence over the company (31.12.2017: 25.1% and 9.9%, respectively). According to the Company's articles of association, the minimum share capital is EUR 25 million and the maximum share capital is EUR 100 million (at 31.12.2017: EUR 25 million and EUR 100 million, respectively). The share capital is paid in full through cash contributions. In 2018, the share capital of AS LHV Pank was increased by EUR 10 million and in 2017 by EUR 3 million through a cash contribution by the sole shareholder AS LHV Group. The bank's share capital increased to EUR 69.5 million by the year-end 2018.

As at 31.12.2018, the adjusted unconsolidated retained earnings of the Group amounted to EUR 49 679 thousand (31.12.2017: EUR 34 956 thousand). Thus, as at 31.12.2018 it is possible to pay out dividends in amount EUR 39 743 thousand (2017: EUR 27 965 thousand) and the related income tax charge would be EUR 9 936 thousand (2017: EUR 6 991 thousand). If the dividends were to be paid, the Group's capital adequacy would remain compliant.

	31.12.2018	**31.12.2017**
Share capital (EUR thousand)	69 500	59 500
Number of shares (pcs)	69 500 000	59 500 000
Par value of a share	1 EUR	1 EUR

In 2014, the General meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the Management Board members and equivalent employees and department managers and equivalent employees of group companies that are part of AS LHV Group. The aim of issuing share options is to align the interests of Management Board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labor market that is equal to competitors and comprehensive. The share options were issued in 2017 and in 2018.

In 2018, share options were granted to seven members of the Management Board of AS LHV Pank and fifty-six employees in the total amount of EUR 1 166 thousand. In 2017, share options were granted to six members of the Management Board of AS LHV Pank and fifty-four employees in the total amount of EUR 1 204 thousand. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options. Share options can be exercised after the expiry of a three-year period.

Share options issued in 2014 were exercised in 2017, when shares with nominal value of EUR 1 could be acquired for EUR 2 per share. In total, the former and current employees of the Group noted 278 033 shares. Share options issued in 2015 were exercised in 2018, when shares with nominal value of EUR 1 could be acquired for EUR 2.4 per share. In total, the former and current employees of the Group noted 278 594 shares. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of EUR 1 can be acquired for EUR 3.0 per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of EUR 1 can be acquired for EUR 4.65 per share. Share options issued in 2018 can be exercised between the period of 01.05.2021-31.07.2021 and shares with nominal value of EUR 1 can be acquired for EUR 5.33 per share.

Statutory reserve capital in equity is composed of:

(EUR thousand)	
Statutory reserve capital as at 31.12.2016	**888**
Transferred from 2016 net profit	604
Statutory reserve capital as at 31.12.2017	**1 492**
Transferred from 2017 net profit	699
Statutory reserve capital as at 31.12.2018	**2 191**

NOTE 20 Assets under management

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

	31.12.2018	31.12.2017
Cash balance of customers	9 773	10 266
Securities of customers	**1 476 258**	**1 277 535**
incl. parent company (Note 22)	*93 100*	*84 300*
incl. shareholders of the parent company and related entities (Note 22)	*156 961*	*168 637*
Total	**1 486 031**	**1 287 801**

Asset management fees for the management of these assets have been in the range of 0,015 – 0,025 % (for, respective income, see Note 6).

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

NOTE 21 Contingent assets and liabilities

Irrevocable transactions	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2018	11 927	9 314	55	188 841	**210 137**
Liability in contractual amount 31.12.2017	10 129	5 999	51	171 528	**187 707**

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 2017 - 2018. The Group's management estimates that there are no such circumstances, which may lead the tax authorities to impose significant additional taxes on the Group.

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

According to sectors	31.12.2018	31.12.2017
Construction	6 594	7 083
Water supplies	2 600	1 237
Manufacturing	623	212
Professional, scientific and technical activities	1 157	708
Other areas at activities	953	889
Total	**11 927**	**10 129**

According to internal ratings	31.12.2018	31.12.2017
5 low credit risk	257	346
6 low credit risk	1 799	3 722
7 medium credit risk	6 055	3 938
8 medium credit risk	1 622	374
9 heightened credit risk	625	621
10 high credit risk	187	84
11 high credit risk	0	0
12 non-satisfactory rating	21	16
13 non-satisfactory rating	405	605
Non-rated*	956	423
Total	**11 927**	**10 129**

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

Performance guarantees are over-collateralized as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2018 nor in previous period.

NOTE 22 Transactions with related parties

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

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

Transactions	Note	2018	2017
Interest income	**5**	**27**	**982**
incl. management		27	27
incl. entities in the consolidation group of the parent		0	955
Interest expenses	**5**	**1 402**	**1 401**
incl. management		*2*	*1*
incl. parent company		*1 360*	*1 360*
incl. shareholders, related entities and close relatives that have significant influence		*40*	*40*
Fee and commission income	**6**	**11**	**8**
incl. management		*2*	*2*
incl. shareholders, related entities and close relatives that have significant influence		*9*	*6*
Other income		**0**	**17**
incl. shareholders, related entities and close relatives that have significant influence		*0*	*17*
Other expenses		***0***	***16***

incl. shareholders, related entities and close relatives that have significant influence		*0*	*16*

Balances	**Note**	**31.12.2018**	**31.12.2017**
Loans and receivables as at the year-end	**11**	**3 328**	**39 594**
incl. management		*1 811*	*1 463*
incl. shareholders, related entities and close relatives that have significant influence		*1 517*	*38 131*
Deposits and loans received as at the year-end		**33 509**	**22 995**
incl. management	*15*	*222*	*283*
incl. parent company	*18*	*21 565*	*11 018*
incl. shareholders, related entities and close relatives that have significant influence	*15*	*11 722*	*11 694*

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

As at 31.12.2018 and 31.12.2017, the management did not have term deposits and the interest rate on demand deposits corresponds to the overall price list applicable to customers.

The subordinated loan received in June 2014 has the interest rate of 7.25%. The subordinated debt received in June and in August 2015, in May 2016 and in Decmeber 2018 have the interest rate of 6.5%.

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

In 2018, salaries and other compensations paid to the management of LHV totaled EUR 861 thousand (2017: EUR 797 thousand), including all taxes. The Management Board of the Bank had six members in 2018 and 2017. As at 31.12.2018, the remuneration for December and accrued holiday pay in the amount of EUR 59 thousand (as at 31.12.2017: EUR 46 thousand) is reported as a payable to management (Note 16). The Group did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2018 and 31.12.2017 (pension liabilities, termination benefits, etc.). In 2018 and 2017, no remuneration was paid to the members of the Supervisory Board.

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

Information on assets of related parties held as an account manager is presented in Note 20.

NOTE 23 Subsidiary

As at 31.12.2018, the Bank has one subsidiary that has been consolidated in these financial statements:

- AS LHV Finance (ownership interest 65%)

AS LHV Pank paid EUR 325 thousand of monetary contribution for 65% of ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand of monetary contribution for 35% of ownership.

The contribution of the non-controlling interest has been reflected in the consolidated statement of financial position on the line „Non-controlling interest".

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

AS LHV Finance

Summarized statement of financial position	31.12.2018	31.12.2017
Loans and advances to customers and other current assets	51 338	43 209
Non-current assets	45	46
Current liabilities	1 996	2 192
Non-current liabilities	37 581	30 957
Total net assets	**11 806**	**10 106**

	AS LHV Finance	
Summarized statement of profit or loss and other comprehensive income	**2018**	**2017**
Net interest and fee & commission income	8 110	6 902
Profit before income tax	5 881	4 604
Income tax expense	-838	0
Net profit	**5 043**	**4 604**
Total comprehensive income	5 043	4 604
Profit and other comprehensive income allocated to non-controlling interests	1 765	1 612

	AS LHV Finance	
Summarized statement of cash flows	**2018**	**2017**
Cash flows from operating activities	-1 188	-1 788
Interest paid	-1 215	-1 103
Income tax paid	-838	0
Net cash from/(used in) operating activities	**-3 241**	**-2 891**
Net cash from/(used in) investing activities	-28	-26
Net cash from/(used in) financing activities	3 274	2 917
Net increase/(decrease) in cash and cash equivalents	**5**	**0**
Cash and cash equivalents at the beginning of the year	0	0
Cash and cash equivalents at the end of the year	**5**	**0**

NOTE 24 Separate financial statements of parent company

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

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

(EUR thousand)	2018	2017
Interest income	37 476	28 386
Interest expense	-6 601	-4 358
Net interest income	**30 875**	**24 028**
Fee and commission income	18 385	12 623
Fee and commission expense	-7 246	-4 724
Net fee and commission income	**11 139**	**7 899**
Net gains from financial assets measured at fair value	2 582	420
Foreign exchange rate gains/losses	64	265
Net gains from financial assets	**2 646**	**685**
Other income	951	7
Administrative and other operating expenses	-23 685	-18 749
Profit before credit losses	**21 926**	**13 870**
Impairment losses on loans and advances	-4 708	-2 953
Profit before income tax	**17 218**	**10 917**
Income tax expense	**-1 676**	**0**
Profit for the year	**15 542**	**10 917**
Other comprehensive income/loss:		
Items that may be reclassified subsequently to profit or loss:		
Changes in the fair value of available-for-sale financial assets	0	76
Changes in the fair value of debt instruments measured at FVOCI	-36	0
Items that will not be reclassified to profit or loss:	78	0
Net profit and other comprehensive income for the year	**15 584**	**10 993**

Statement of financial position of the parent

(EUR thousand)	**31.12.2018**	**31.12.2017**
Assets		
Due from central bank	639 862	920 714
Due from credit institutions	24 974	20 991
Due from investment companies	17 005	14 186
Available-for-sale financial assets	0	775
Equity instruments at fair value through other comprehensive income	298	0
Financial assets at fair value through profit or loss	38 913	49 239
Loans and advances to customers	905 422	707 528
Receivables from customers	5 223	7 095
Other assets	1 317	3 120
Subsidiaries	325	325
Tangible assets	1 120	1 218
Intangible assets	1 243	913
Total assets	**1 635 702**	**1 726 104**
Liabilities		
Deposits from customers and loans received	1 469 561	1 556 573
Financial liabilities at fair value through profit or loss	11	2
Accounts payable and other liabilities	22 031	59 789
Subordinated debt	30 000	20 000
Total liabilities	**1 521 603**	**1 636 364**
Equity		
Share capital	69 500	59 500
Statutory reserve capital	2 191	1 492
Other reserves	78	36
Retained earnings	42 330	28 712
Total equity	**114 099**	**89 740**
Total liabilities and equity	**1 635 702**	**1 726 104**

Statement of cash flows of the parent

(EUR thousand)	**2018**	**2017**
Cash flows from operating activities		
Interest received	37 341	28 080
Interest paid	-6 501	-4 634
Fees and commissions received	18 385	12 623
Fees and commissions paid	-7 246	-4 724
Other income received	951	7
Staff costs paid	-12 076	-9 599
Administrative and other operating expenses paid	-9 696	-7 470
Income tax paid	-1 132	0
Cash flows from operating activities before change in operating assets and liabilities	**20 026**	**14 283**
Net increase/(decrease) in operating assets:		
Net acquisition/disposal of trading portfolio	-115	278
Loans and advances to customers	-197 658	-191 100
Mandatory reserve at central bank	1 094	- 7 639
Security deposits	-647	-1 348
Other assets	-485	-119
Net increase/(decrease) in operating liabilities:		
Demand deposits of customers	-93 323	791 270
Term deposits of customers	-9 316	-25 052
Net loans received (including loan repayments)	15 528	5 221
Financial liabilities held for trading at fair value through profit or loss	8	-207
Other liabilities	-38 129	45 081
Net cash from/(used in) operating activities	**-303 017**	**630 668**
Cash flows from investing activities		
Purchase of tangible and intangible assets	-1 367	-1 251
Proceeds from disposal and redemption of investment securities	520	124
Net changes of investment securities at fair value through profit or loss	13 023	15 075
Net cash from/(used in) investing activities	**12 176**	**13 948**
Cash flows from financing activities		
Paid in share capital	10 000	3 000
Proceeds from subordinated debt	10 000	0
Paid dividends	-2 178	0
Net cash from financing activities	**17 822**	**3 000**
Effect of exchange rate changes on cash and cash equivalents	**64**	**265**
Net increase/(decrease) in cash and cash equivalents	**-272 955**	**647 881**
Cash and cash equivalents at the beginning of the year	940 516	292 635
Cash and cash equivalents at the end of the year	**667 561**	**940 516**

Statement of changes in shareholders' equity

(EUR thousand)	Share capital	Statutory reserve capital	Other reserves	Retained earnings	Total
Balance as at 01.01.2017	**56 500**	**888**	**-40**	**17 647**	**74 995**
Paid in statutory reserve capital	0	604	0	-604	**0**
Paid in share capital	3 000	0	0	0	**3 000**
Share options	0	0	0	752	**752**
Net profit for the year	*0*	*0*	*0*	*10 917*	***10 917***
Other comprehensive income	*0*	*0*	*76*	*0*	***76***
Net profit and other comprehensive income for 2017	0	0	76	10 917	**10 993**
Balance as at 31.12.2017	**59 500**	**1 492**	**36**	**28 712**	**89 740**
Carrying amount of holdings under control and significant influence	0	0	0	-325	-325
Value of holdings under control and significant influence under equity method	0	0	0	6 569	6 569
Adjusted unconsolidated equity as at 31.12.2017	**59 500**	**1 492**	**36**	**34 956**	**95 984**
Balance as at 01.01.2018	**59 500**	**1 492**	**36**	**28 712**	**89 740**
Paid in statutory reserve capital	0	699	0	-699	**0**
Paid in share capital	10 000	0	0	0	**10 000**
Dividends paid	0	0	0	-2 178	**-2 178**
Share options	0	0	0	953	**953**
Net profit for the year	*0*	*0*	*0*	*15 542*	***15 542***
Other comprehensive income	*0*	*0*	*42*	*0*	***42***
Net profit and other comprehensive income for 2018	0	0	42	15 542	**15 584**
Balance as at 31.12.2018	**69 500**	**2 191**	**78**	**42 330**	**114 099**
Carrying amount of holdings under control and significant influence	0	0	0	-325	-325
Value of holdings under control and significant influence under equity method	0	0	0	7 674	7 674
Adjusted unconsolidated equity as at 31.12.2018	**69 500**	**2 191**	**78**	**49 679**	**121 448**

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

Signatures of the Management Board to the consolidated annual report

The Management Board has prepared the management report and the consolidated financial statements of AS LHV Pank for the financial year ended on 31 December 2018. The consolidated financial statements present a true and fair view of the Bank's financial position, the results of operations and its cash flows.

13.03.2019

Erki Kilu____________________
Chairman of the Management Board

Andres Kitter____________________
Member of the Management Board

Indrek Nuume____________________
Member of the Management Board

Jüri Heero ____________________
Member of the Management Board

Meelis Paakspuu____________________
Member of the Management Board

Martti Singi____________________
Member of the Management Board

Kadri Kiisel____________________
Member of the Management Board

Independent auditor's report

To the Shareholder of AS LHV Pank

(Translation of the Estonian original)*

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS LHV Pank and its subsidiary (together the Group) as at 31 December 2018, 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 profit or loss and other comprehensive income for the year ended 31 December 2018;
- the consolidated statement of financial position as at 31 December 2018;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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

Independence

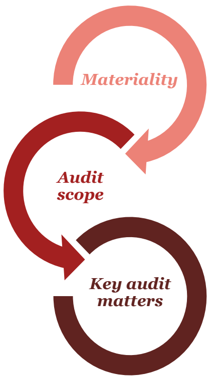
We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities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

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

The non-audit services that we have provided to the Group, in the period from 1 January 2018 to 31 December 2018, are disclosed in the management report.

Our audit approach

Overview



Materiality

Overall group audit materiality is EUR 1,150 thousand, which represents 5% of profit before income tax.

Audit scope

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

Key audit matter

Impairment of loans and advances to customers

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

Materiality

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

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

Overall group audit materiality	EUR 1,150 thousand
How we determined it	5% of profit before income tax
Rationale for the materiality benchmark applied	We have applied this benchmark, as profit before tax is the key measure used both internally by management and, we believe, externally by shareholder in evaluating the performance of the Group.

Key audit matters

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

Key audit matter	*How our audit addressed the key audit matter*
Impairment of loans and advances to customers (refer to Note 2 "Summary of significant accounting policies", Note 3.2 "Credit risk" and Note 11 "Loans and advances to customers" for further details) As at 31 December 2018 loans and advances to customers amounted to EUR 918.8 million and related impairment loss for 2018 amounted to EUR 4.9 million. We focused on this area because management makes complex and subjective judgments over both timing of recognition of impairment and the estimation of the size of any such impairment, using complex models with subjective inputs. Furthermore, due to implementation of IFRS 9 from 1 January 2018, the accounting policies and methods applied on impairment calculation have changed as compared to prior years. IFRS 9 has introduced a 3-stage Expected Credit Loss (ECL) model. ECL calculations are forward-looking and probability-weighted, based on complex modelling and subjective inputs determined by the management. Key areas requiring significant management judgements and modelling in calculating ECL include: • the criteria for assessment of significant increase in credit risk for corporate and retail products (Note 3.2.3.1) for determining loan exposures in stage 1 and stage 2; • the modelling and calculation of key	We assessed whether the Group's accounting policies and methodology applied for the calculation of impairment of loans and advances to customers are in compliance with IFRS 9. We assessed the design and operating effectiveness of key controls over ECL data and respective calculations. This included controls over the allocation of assets into stages, data accuracy and completeness, credit monitoring and overdue loans monitoring. We have also assessed the IT general controls over relevant systems. In addition, we tested the design and operating effectiveness of the credit file periodic review and rating assessment, and monitoring of collateral controls for corporate loans. We determined that we could rely on these controls for the purposes of our audit. We performed detailed testing over: • the completeness and accuracy of data used in the ECL calculation system; • the compliance of key inputs used in the ECL calculation system with IFRS 9 methodology; • the accuracy and compliance of 12-month and lifetime ECL calculations with IFRS 9 methodology; • the accuracy of discounting in the ECL system; • the accuracy and completeness of data used for staging of loans;

parameters of the ECL model, including probability of default (PD), loss given default (LGD) and exposure at default (EAD) (Note 3.2.3.3);

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

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

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

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

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

We have audited the results of back-testing performed by management and agree with their assessment that the impairment provisions have been adequate, in all material respects, in the prior period.

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

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

How we tailored our audit scope

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

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

Other information

The Management Board is responsible for the other information 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 appointment has been renewed by tenders and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for AS LHV Group, as a public interest entity, of 10 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of AS LHV Group can be extended for up to the financial year ending 31 December 2028.

AS PricewaterhouseCoopers

Ago Vilu
Certified auditor in charge, auditor's certificate no.325

Verner Uibo
Auditor's certificate no.568

13 March 2019

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

Proposal for profit distribution

The Management Board of AS LHV Pank proposes to the General meeting of shareholders to distribute the profit of the financial year 2018 as follows:

- transfer EUR 834 thousand to statutory reserve capital
- pay dividends in total amount of EUR 2 665 thousand
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 13 143 thousand to the retained earnings.

Signatures of the Supervisory Board to the annual report

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

13.03.2019

Madis Toomsalu__________________
Chariman of the Supervisory Board

Rain Lõhmus__________________
Member of the Supervisory Board

Andres Viisemann__________________
Member of the Supervisory Board

Tiina Mõis__________________
Member of the Supervisory Board

Raivo Hein_______________
Member of the Supervisory Board

Heldur Meerits ______________
Member of the Supervisory Board

Allocation of income according to EMTA classificators

EMTAK	Activity	2018	2017
66121	Security and commodity contracts brokerage	6 116	4 762
64191	Credit institutions (banks) (granting loans)	55 969	41 981
64911	Finance lease	2 439	1 845
	Total income	**64 524**	**48 588**