

**Privredna banka Zagreb dd**

Annual report

31 December 2016

## Table of contents

Introduction .....	3
Who we are and what we do.....	4
Five year summary and financial highlights.....	5
Report from the President of the Supervisory Board.....	6
Management Board report for the Bank .....	8
Management Board report for the Group .....	10
Macroeconomic developments in Croatia in 2016 .....	14
Organisational chart.....	19
Business description of the Bank.....	20
Business description of the Group.....	32
The statement on the implementation of corporate governance code .....	36
Separate and consolidated financial statements and Independent Auditor's report	
Responsibilities of the Management and Supervisory Boards for the preparation and approval of the separate and consolidated financial statements and other information.....	52
Independent auditors' report to the shareholders of Privredna banka Zagreb dd .....	53
Income statement .....	59
Statement of comprehensive income .....	60
Statement of financial position .....	61
Statement of cash flows .....	63
Statement of changes in equity .....	65
Notes to the financial statements .....	67
Appendix 1 - Supplementary forms required by local regulation .....	199
Appendix 2 - Supplementary financial statements in EUR (unaudited).....	224

## Introduction

The Management Board of Privredna banka Zagreb dd has the pleasure of presenting its Annual report to the shareholders of the Bank. This comprises a summary of financial information, Management Board reports for the Bank and the Group, the audited financial statements and the accompanying audit report, supplementary forms required by local regulation and unaudited supplementary statements in EUR and other information. Audited financial statements are presented for the Group and the Bank.

### Croatian and English version

This document comprises the Annual Report which also includes separate and consolidated financial statements of Privredna banka Zagreb dd for the year ended 31 December 2016 in the English language. This report is also published in the Croatian language for presentation to shareholders at the Annual General Meeting.

### Legal status

The separate and consolidated financial statements are prepared in accordance with International Financial Reporting Standards as adopted by European Union (hereinafter: EU) and audited in accordance with International Standards on Auditing.

The Annual Report is prepared in accordance with the provisions of the Companies Act and the Accounting Law, which require the Management Board to report to shareholders of the company at the Annual General Meeting.

### Abbreviations

In this Annual Report, Privredna banka Zagreb dd is referred to as “the Bank” or “PBZ” or as “Privredna banka Zagreb”, and Privredna banka Zagreb dd, together with its subsidiaries and associates undertakings are referred to collectively as “the Group” or “the Privredna banka Zagreb Group”.

The central bank, the Croatian National Bank, is referred to as “the CNB”. The European Bank for Reconstruction and Development is referred to as “EBRD”.

In this report, the abbreviations “HRK thousand”, “HRK million”, “USD thousand”, “USD million”, “CHF thousand”, “CHF million”, “EUR thousand”, “EUR million” and “BAM thousand” or “BAM million” represent thousands and millions of Croatian kunas, US dollars, Swiss francs, Euros and Bosnian convertible marks respectively.

### Exchange rates

The following mid exchange rates set by the CNB ruling on 31 December 2016 have been used to translate balances in foreign currency on that date:

CHF 1	=	7.036 HRK
USD 1	=	7.169 HRK
EUR 1	=	7.558 HRK
BAM 1	=	3.857 HRK

## Who we are and what we do

We are a leading Croatian financial services group engaged in retail and corporate banking, credit card operations, investment banking, private banking, leasing, investment management services and real estate activities. We operate in the entire area of Croatia and in Bosnia and Herzegovina and employ over four thousand people.

Our mission is to permanently and effectively utilize all of the resources at our disposal to continuously improve all aspects of our business activities, including human resources, technology and business processes.

Our vision is to be a model company and centre of excellence in creating new value, as well as provision of high-quality service in all of our activities for the benefit of our clients, the community, our stakeholders and our employees.

<b>1,812 thousand</b> TOTAL CUSTOMERS	<b>HRK 84.8 billion</b> TOTAL CUSTOMERS' FUNDS*	<b>531,337</b> INTERNET BANKING USERS
<b>925 thousand</b> CURRENT ACCOUNTS	<b>HRK 11 billion</b> ASSETS UNDER CUSTODY	<b>248</b> TOTAL BRANCHES
<b>811</b> ATM MACHINES	<b>HRK 56 billion</b> TOTAL GROSS LOANS	<b>2,558 thousand</b> TOTAL CARDS ISSUED
<b>120</b> DAY AND NIGHT VAULTS	<b>HRK 9.7 billion</b> TOTAL HOUSING LOANS	<b>33,464</b> EFT POS

*\*Comprises customers deposits, assets under management and assets under custody*

## Five year summary and financial highlights

	(in HRK million)				
	2016	2015	2014*	2013*	2012*
<b>Group</b>					
<b>Income statement and statement of financial position</b>					
Total gross revenue	5,439	5,198	5,355	5,234	5,468
Net interest income	2,624	2,515	2,454	2,257	2,406
Net operating income	4,518	3,975	3,938	3,726	3,761
Net profit for the year	1,587	370	989	821	1,014
Total assets	82,128	78,423	78,328	70,117	72,554
Loans and advances to customers	52,885	50,985	51,187	48,557	49,960
Due to customers	60,378	58,180	55,346	47,729	48,143
Shareholders' equity	14,509	13,179	13,983	12,772	12,788
<b>Other data (as per management accounts)</b>					
Return on average equity	11.39%	2.66%	7.19%	6.44%	8.14%
Return on average assets	1.85%	0.43%	1.17%	1.07%	1.29%
Assets per employee	19.4	19.7	18.9	17.2	17.4
Cost income ratio	41.35%	45.93%	46.72%	45.41%	43.63%

\* Presented information does not include Intesa Sanpaolo Banka dd Bosnia and Herzegovina, a subsidiary acquired in 2015 in a common control transaction.

	(in HRK million)				
	2016	2015	2014	2013	2012
<b>Bank</b>					
<b>Income statement and statement of financial position</b>					
Total gross revenue	4,532	4,087	4,052	4,351	4,489
Net interest income	2,335	2,193	2,132	2,145	2,213
Net operating income	3,839	3,161	2,944	3,039	3,035
Net profit for the year	1,605	193	643	615	846
Total assets	72,050	69,214	68,876	65,617	68,411
Loans and advances to customers	45,667	44,186	44,543	45,106	46,918
Due to customers	54,108	52,815	50,387	46,427	46,973
Shareholders' equity	12,769	11,424	11,660	11,499	11,726
<b>Other data (as per management accounts)</b>					
Return on average equity	13.44%	1.67%	5.57%	5.30%	7.49%
Return on average assets	2.13%	0.26%	0.88%	0.86%	1.19%
Assets per employee	21.3	21.7	20.4	17.7	18.1
Cost income ratio	38.36%	43.73%	48.01%	46.95%	41.93%

## Report from the President of the Supervisory Board

On behalf of the Supervisory Board of Privredna banka Zagreb dd, I am honored to present you the business results of the Bank and Group for the year 2016.

2016 will be remembered as a year that pursued a very strenuous 2015 characterized by an adverse situation related to the forced conversion of Swiss franc pegged loans. Additionally, 2016 was marked by modest yet still existing recovery of Croatian macroeconomic environment. Once again, we in Privredna banka Zagreb and its Group managed to cope exceptionally well with these imposed external elements and by doing so to outperform our peers. This achievement is a direct result stemming from our thoughtfully planned strategy and its comprehensive execution along with momentous aide by our long-term strategic accomplice: the parent bank Intesa Sanpaolo.

Although 2016 lacked political stability required for needed structural reforms, Croatian economy backed by an increase of a foreign demand and simultaneous revival of domestic consumption and investment activities, grew by 2.6%. In addition, Croatia managed to reduce its general government and public debt level.

Foreign economic environment was encouraging due to the expansionary monetary policy of the European Central Bank. Locally, monetary policy continued to be loose through generating further decrease in interest rates thus gently increasing demand for loans, primarily in kuna. As clients still tend to display currency risk aversion related to deposits, banks' liabilities are still dominantly funded by foreign currency deposits, although kuna deposits are on a rise.

Despite positive trends, it is clear that without structural reforms a long-term potential growth rates will remain absent. Although more than before, Croatian fiscal position is still vulnerable, thus lacking investment grade rating. 2017 may bring new uncertainties to the table, i.e. impact of Brexit, the direction of the new US economic policy, as well as the expectations that 2018 will bring a change in the direction of the European Central Bank monetary policy.

In an environment where macroeconomic trends are positive, but lacking firm foundations, PBZ Group managed to stabilize its business and to control risks arising from its transactions far better than our peers. We coped more than adequate, thus fully protected our capital base, deposits and liquidity and earned notable profits for our shareholders. This good result was achieved by application of our long-term strategy built around conservatism in identification and measurement of all risks arising from our daily operations and full dedication to client-oriented approach in all stages of our activities. On top of all this, the PBZ Group maintains a comfortable structural liquidity position, given its stable customer deposit base, appropriate sources of long-term funding and its shareholders' equity. Mix of all those elements enabled us to be truly proud of the strength and resiliency that have been proven in such circumstances. We have succeeded in meeting our goals and were able to retain the value of our Group. Total gross revenue for the PBZ Group amounted to HRK 5.4 billion. Consolidated net operating income equaled HRK 4.5 billion, whereas net profit recorded HRK 1,587 million. Our cost/income ratio, an efficiency key measure, closed once again significantly below 50 (41.4) percent, while the return on average equity reached 11.39 percent. These are all very satisfactory figures consistently representing strong performance throughout the years.

In 2016, the PBZ Group further reinforced its position as one of Croatia's foremost banks in terms of productivity, returns and value creation for its shareholders. We are the second largest group in the country with a strong customer base. Looking ahead, the present economic climate suggests that the respective environment in 2017 will nevertheless remain challenging. Therefore, a continued focus by management on overseeing asset quality, maintaining optimal product mix as well as an active monitoring of operating costs will be crucial. We have the ability to overcome the near-term challenges. Furthermore, we are well positioned to earn benefits from the present and future trends in growing integration of the Croatian market into the global financial markets. Given our business model, these trends present a significant growth opportunity for us.

On behalf of the Supervisory Board, I would like to express my gratitude and appreciation to all the employees of the Group for their commitment and valued contribution. I would also like to thank the Management Board for its strong leadership and outstanding performance. Finally, I would like to express my great appreciation for the work to my former and new colleagues on the Supervisory Board, as well as to the Audit Committee members for their wise counsel and contribution.

## Report from the President of the Supervisory Board (continued)

### Report on the performed supervision in the year 2016

In 2016 the Supervisory Board of the Bank performed duties in conformity with the law, the Bank's Articles of Association, and Rules of Procedure of the Supervisory Board of the Bank. During 2016 the Supervisory Board held three regular meetings and fifteen meetings by letter in order to make decisions on the issues that had to be resolved without delay. In order to prepare the decisions that fall within its competence and supervise the implementation of the previously adopted decisions, the Supervisory Board of the Bank was provided with the assistance of Audit Committee, which regularly reported on their work at the meetings of the Supervisory Board. In 2016, the Audit Committee held five meetings where it discussed the processes within its competence. In accordance with its legal responsibility, the Supervisory Board of the Bank has examined the Annual Financial Statements and consolidated Annual financial statements of the Bank for 2016, Report on the Operation of the Bank and its Subsidiaries and Draft Decision on the Allocation of the Bank's Profit Earned in 2016, that were all submitted by the Management Board of the Bank. The Supervisory Board made no remarks on the submitted reports. In that respect, the Supervisory Board established that the Annual Financial Statements and Consolidated Annual Financial Statements were prepared in accordance with the balances recorded in the business books and that they impartially disclosed the assets and financial status of the Bank and the PBZ Group, which was also confirmed by the external auditor KPMG d.o.o., Zagreb, the company that had audited the financial statements for 2016. Since the Supervisory Board has given its consent regarding the Annual Financial Statements and Consolidated Annual Financial Statements of the Bank for 2016, the respective financial statements are considered to have been confirmed by the Management Board and by the Supervisory Board of Privredna banka Zagreb pursuant to the provisions of Art. 300.d of the Companies Act. The Supervisory Board of the Bank accepted the report of the Management Board on the operation of Privredna banka Zagreb and its subsidiaries and it agreed that HRK 481,525,731.68 of the Bank's net profit totaling HRK 1,605,188,350.76, earned in the year that ended on 31 December 2016, should be distributed by pay-out of dividends (or HRK 25.33 per share) whereas the remaining amount should be allocated to retained earnings.

Yours faithfully

Giovanni ~~Gitti~~



14 February 2017

## Management Board report for the Bank

Distinguished shareholders,

I am honoured to present you the Annual Report and Financial Statements of Privredna banka Zagreb dd and PBZ Group for the year ended on 31 December 2016.

After significantly prolonged period of gloomy economic conditions, 2016 turned out to be a year that finally displayed positive signals to entrepreneurs. As we have consistently been proving our operations to be resilient and sound, we remained strong and agile and readily welcomed these positive tendencies. Therefore, Privredna banka Zagreb dd and its subsidiaries, supported by our strategic partner Intesa Sanpaolo, managed to substantially outperform our peers in most relevant business aspects. We continued executing our predetermined business strategy built around customer relations and well-diversified source of income, thus keeping a steady course and reflecting the ability to strengthen our earnings power. All our business segments managed to increase the size of its loan portfolio, especially SME and Corporate segments of our portfolio, thus proving our commitment to be one of the elements required to be put forward in the efforts to revitalize our economy. Supplementary to this, we have been investing significant effort into shaping ourselves into well-capacitated, experienced and agile entity able to conduct exceptional management of non-performing loans. Our proactive credit risk management and execution of well-defined collection strategies are showing continuous downward trends in non-performing loans stock and share.

### *Outlook*

Although the political environment in 2016 was not particularly encouraging from the aspect of political stability (expiration of the terms of offices of the previous government, a long-time coming formation of a new coalition government) the economy, driven by a continuation of a solid foreign demand, but also a revival of domestic consumption and investment activities, recorded a real growth of 2.6 percent. A considerable progress was also made in the area of fiscal policy, where the general government deficit was reduced by 2 percent, with a simultaneous decrease in the public debt level below 85 percent of the gross domestic product.

The international environment was particularly favourable given the expansionary monetary policy of the European Central Bank. Similarly, domestic financial market witnessed further monetary policy relaxation, which contributed to a further fall in interest rates. Although the cleaning-up of balance sheets through sales and write-off of non-performing loans, reduced the exposure to the private sector, placements to this sector slightly increased. It is particularly important to emphasise that in 2016 there was a significant increase in the demand for kuna loans, due to which their share in total loans to the private sector rose to 40 percent. Currency risk aversion of clients remained disproportionate to kuna savings, given the dominant share of foreign currency deposits in total deposits of the private sector.

Regardless of the growth of the gross domestic product of almost 3 percent in 2016, and despite that fact that a similar trend is expected to continue in 2017, it is clear that the current phase of our economic development is not sufficient to guarantee a long-term growth rates aiming at faster convergence to EU average and a more considerable improvement in the wellbeing of citizens. Although more stable than over the previous years, the government fiscal position is still relatively vulnerable, as seen in the credit rating which has remained below investment grade. As already in 2017 we may expect a new series of uncertainties in international economic environment, a sustainable economic growth has to be ensured by enhancing and strengthening the domestic economy competitiveness through undelayed structural reforms.

### *Unconsolidated financial results of the Bank*

The Bank's net result in 2016 was HRK 1,605 million, representing a significant upsurge compared to the preceding year. Again, this upsurge was achieved by gains from extraordinary events as well as careful planning and enduring execution of our business strategy. Defying the fact that the economy is still in the process of the recovery (although in its upward phase), net interest income rose by vast 6.5 percent. It is noticeable that interest income slightly declined, caused exclusively by the presence of excessive liquidity pushing downwards reference market rates. On the other hand, although volume of deposits rose, interest expense contracted considerably proving that we are widely recognized as steady and low-risk partner to all our clients further affirming us to continue practicing our dedication to fulfilment of overall client requirements. This strategy was accompanied by efficient and omnipresent cost management enterprise carried within all organizational units enabling us to successfully control the expense side of our business. Hence, we were able to maintain our cost to income ratio at 38.4 percent.



## Management Board report for the Bank (continued)

### *Unconsolidated financial results of the Bank (continued)*

The overall Bank's balance sheet eminently increased by 4.1 percent, reaching a level of HRK 72.1 billion. Although it is difficult to recognize a notable increase in demand for loans on the market, loans and advances to customers rose by hefty 3.4 percent, amounting to HRK 45.7 billion. Current accounts and deposits from customers increased for notable 2.4 percent, reaching the level of HRK 54.1 billion. Considering the total structure of the balance sheet, the relative portion of customer deposits was increased and now amounts to 75.1 percent. The total loan to deposit ratio of the Bank equals 84.4 percent emphasizing the stability and conservative nature of our ventures.

### *Extraordinary business events*

During the year, the parent company Intesa Sanpaolo decided to alter its business model by disinvesting from all card processing companies. Thus, it was decided to sell Setefi Services S.p.A, a card processing company established in Italy and to sell ISP card, a card processing company established in Croatia. Based on this strategic decision, Privredna banka Zagreb decided to sell all shares of our associate ISP Card. This transaction generated a gain in the gross of tax amount of 241 million HRK on the Bank's level and HRK 162 million on PBZ Group's level.

On international level, Visa Inc. decided to make a buyout of Visa Europe Ltd. shares. Based on this decision, Privredna banka Zagreb amounted a gain in the gross of tax amount of HRK 150 million, both on Bank's and PBZ Group's level.

### *Future development and the Bank's subsidiaries*

In 2016, the PBZ Group members coped well with the overall economic conditions that resulted in positive financial outcomes. Therefore, PBZ Card achieved a net profit of HRK 133.5 million, PBZ Leasing HRK 17.8 million, PBZ Stambena štedionica HRK 3.2 million, whereas PBZ Croatia osiguranje, our jointly owned pension fund management company, earned a profit of HRK 24 million.

Intesa Sanpaolo Banka dd Bosna i Hercegovina, our subsidiary established in Bosnia and Herzegovina, earned HRK 98.9 million attributable to PBZ Group. Their strategic objectives are jointly planned on PBZ Group level - progressing with multi-year plan of investments for the infrastructural and technological modernization, organizational changes in terms of increase of the competitiveness and faster reaction to market changes and continuous assessment of risk profile. Implementation of these objectives are already bearing fruits in current business result but also represent a solid foundation for the future events.

As a part of a regional ownership restructuring project within Intesa Sanpaolo Group aimed at improving the synergies within the ISP Group, Privredna banka Zagreb has announced its intention to purchase 51 percent of the share capital of Banka Koper d.d. (member of the ISP Group), from the majority owner Intesa Sanpaolo S.p.A.

Risks to which the Bank is or might be exposed are explained in details within Corporate Governance section.

### *Conclusion*

The PBZ Group is well-fitted not only to face up to challenges, but also to seize opportunities. We have a strong capital base, liquidity and funding positions, preparing us for potential market uncertainties and for tighter regulation. We are continuously transiting to a better balanced, more diversified and lower-risk business model.

In the end, I would like to take this opportunity to express gratefulness to all my colleagues and all employees of the PBZ Group for their dedication and true professionalism that enabled us safely to sail through these troubled times. Furthermore, I would like to thank all our acclaimed clients and business partners for putting their trust in our hands. Also, I would like to express my most sincere gratitude to all the members of the Supervisory Board for their encouragement in conducting our business affairs.

Božo Prka, M.S.  
President of the Management Board

14 February 2017

## Management Board report for the Group

### Financial Highlights of the Group

The consolidated net profits for 2016 amounted to HRK 1,587 million, representing a momentous increase compared to 2015. This exceptional result came from carefully planned and perennially executed business strategy that encompasses execution of conservative and systematic approach towards all risks arising from the business transactions, dedication to client orientation and diversification of income sources. Additionally, the Group experienced notable gains from extraordinary events, i.e. sell of ISP Card and Visa Europe Ltd. shares.

Backed by the present positive macroeconomic signals, that eventually do reflect to the banking industry, we managed to control risks arising from our operations in a far better way than our peers. This achievement is stemming from our commitment to manage non-performing part of our portfolio in flexible, prudent and swift manner allowing us to sell noticeable parts of non-performing portfolio, increase collection and improve restructuring process. This resulted in a decrease of non-performing loans ratio from 11.9 to 9.6 percent, compared to the previous year. Additionally, we managed to substantially control cost of risk while simultaneously increasing the coverage of non-performing portfolio, thus making us well-fitted to meet all future challenges.

It is also important to stress that in recent periods the validity of our approach towards the measurement of the risk has been tested and proven sound by detailed Asset Quality Review exercise performed by joint home-host supervisory team under the ECB's Comprehensive Assessment and Stress Test which encompassed most significant European banking groups.

The Group's capital management policies and practices, among other tools, are based on an internal capital adequacy assessment process (ICAAP). In this process, the Group regularly identifies its risks and determines the amount of free available capital in stress scenarios. I am pleased to report that the PBZ Group is one of the leading, well-capitalized banking groups in the country, with more than sufficient capital shield compared to internal capital requirement in a stress scenario. Our Capital Adequacy Ratio sits comfortably above 20 percent, which is significantly higher than required by the regulation.

Additionally, the Group's earnings per share amounted HRK 83.2. Based on the methodology used for management reporting, the Group's return on average equity in 2016 was 11.4 percent, while return on average assets stood at 1.9 percent. Assets per employee equalled 19.4 million, whereas the cost to income ratio, according to the consolidated financial statements, was maintained at 41.4 percent.

As a reflection of these events, the positive effect of our in-built-long-lasting client orientation, aided by the existence of the positive economic signals, had profound influence on net interest income and net fee and commission income. Equally important, despite still unstable surroundings we have found ourselves in, our previously taken strategic decisions enabled us to additionally strengthen our capital base and secure stable liquidity sources thus reducing our costs of funding and allowing us to adopt customer driven practices that resulted in an improvement of our products and services.

Aligned with the above and in more details, our net interest income rose by 4.3 percent compared to 2015, though affected by a decrease in interest income it was overly-compensated by a stronger decrease in interest expense. These effects were caused by high liquidity on the market and by still restrictive and defensive nature of the economic community towards consumption and investments. Net fee and commission income increased by 1.5 percent. Level of provisions and impairment, although increased compared to the previous year, are direct evidence of the quality of our non-performing loans management.

The balance sheet of the PBZ Group increased notably by 4.7 percent, amounting to HRK 82.1 billion. The most significant portion of our assets are loans and advances to customers which experienced an increase in the outstanding amount by 3.7 percent in spite of still prevailing lack of demand for loans caused by the unstable economic situation that affected our clients, both corporate and retail. We continue practicing a well-diversified loan portfolio policy, having remotely higher volume of placements to retail customers on one side than placements to public and corporate clients on the other. Given our firm commitment to apply a prudent approach in risk identification and measurement and by conducting sale actions, non-performing loans fell below 10 percent threshold, additionally indicating the quality of our non-performing loans management. As we are well aware that the excellence in customer orientation can only be accomplished if one stands by its customers during troubled times, we have embedded such approach in all our business processes. Therefore, we continue developing comprehensive initiatives aimed at helping our customers during crises. From the liabilities perspective, customer deposits mainly fund our balance sheet, where the retail segment plays the most significant role. In 2016, we experienced an upsurge in customer deposits by 3.8 percent caused by both high liquidity observable on the market and our reputation of being one of the most stable and client oriented financial group on the market. Capital adequacy ratio remained stable and it is by far exceeding the prescribed threshold.

Below we provide an overview of business results of the Bank's subsidiaries and associate. Presented business results are on a stand-alone basis, before intercompany and consolidation adjustments.

## **Management Board report for the Group (continued)**

### **Financial Highlights of the Group (continued)**

#### **PBZ Card**

In 2016, PBZ Card's business results indicate the continuation of stable business and confirm its leading position in the domestic card market.

The Company's profit before tax amounted to HRK 179.8 million and HRK 133.6 million after taxation. The financial results for the year 2016 were influenced by the impairment of the goodwill in the amount of HRK 40 million. Company's goodwill was recognized during the purchase and takeover of the company for credit card transactions Atlas American Express by Privredna banka Zagreb in 1998. Impairment of goodwill was the result of prudence caused by the fact that American Express Ltd reached the business decision about changing the current business model in the countries of the European Union.

Total net operating income of the Company in 2016 amounted to HRK 584.8 million, which is 0.9 percent more than the result achieved in 2015. Net fee and commission income amounted to HRK 534.1 million, that is 5.2 percent more than last year. This increase is mostly caused by the changes in the regulation on the European level that reduced interchange fees.

Net interest income amounted to HRK 25 million, which is 46.6 percent less than previous year. This was caused by the measures taken in the area of collection of receivables during 2015, including the sale of part of the claims. The decline in interest income on overdue payments was further influenced by the decrease of the maximum statutory penalty interest rates prescribed by the regulation.

The total operating expenses for 2016 amounted to HRK 354.1 million, which represents a decrease of 7.8 percent compared to the year 2015. This decrease is mainly the result of the reduction in other operating expenses in the part of the legal costs due to changes in the non performing portfolio after the settlement and sale of the part of the portfolio. Another significant factor related to the lower operating expenses in 2016 is the reduction of the costs of advertising.

Total assets of PBZ Card as of 31 December 2016 amounted to HRK 2,555 million, which represents an increase of 4 percent compared to the end of the 2015.

These results make PBZ Card the second most profitable segment of the PBZ Group. PBZ Card will continue with business transactions aimed at creating income by further boosting cards consumption, both physical and virtual, launching new products, focusing on innovative, modern digital technology and investing in value-added services for cardholders and merchants. By doing so, PBZ Card shall maintain a leading position in the market, which will further strengthen the position of the PBZ Group in the field of card business.

#### **Intesa Sanpaolo banka Bosna i Hercegovina**

The 2016's net profit of HRK 103 million shows a 5.5 percent increase compared to the previous year. Despite the continuous decrease of lending rates, which more than offset the growth of total loan portfolio, the net interest margin recorded a 2.7 percent year-on-year improvement thanks to savings in interest expense achieved through further compression of cost of funding from customers, banks and international financial organizations. The total operating income was also sustained by continuously increasing contribution of commission income.

Total operating costs recorded a yearly increase by 2.0 percent mostly due to the significant infrastructural, technological and organizational investments strategically implemented to support the Bank in facing the stricter and more demanding domestic and international regulatory framework and in sustaining the expansion of the business activities.

Double digit lower net impairment costs on portfolio exposed to credit risk is the result of effective processes for collection of non performing positions, appropriately high level of coverage of defaulted exposures already achieved in previous years and advanced processes for monitoring the risk profile of the debtors, which enables anticipating and minimizing the risk of new defaults. The above allowed further decrease of the non-performing to total loans ratio, reaching a level of 8.35 percent, significantly lower than the industry's average, while maintaining a prudent coverage ratio for defaulted exposures (72 percent).

Total assets increased by 14.1 percent at HRK 6,836 million with net loans in the amount of HRK 4,610 million and customer deposits in the amount of HRK 4,894 million. Loan portfolio growth was sustained by Retail and Corporate segment, where lending to private customers increased by 6.5 percent and lending to legal entities increased by 4.9 percent. Positive performance was confirmed also by improvement in collection of retail deposits (7.4 percent) and corporate deposits (35.2 percent). The Bank's position in terms of available liquidity remains comfortable and safe, even if we were to assume worsening macro-economic scenarios, thus ready to sustain expected further expansion of credit.

The Bank's capital adequacy ratio further improved to 14.1 percent (excluding the net profit for the year).

## **Management Board report for the Group (continued)**

### **Financial Highlights of the Group (continued)**

#### **Intesa Sanpaolo banka Bosna i Hercegovina (continued)**

Strategic objectives of the Bank for 2017 are planned in coordination with Privredna banka Zagreb - progressing with multi-year plan of investments for the infrastructural and technological modernization of the Bank, organizational changes in terms of increase of the competitiveness of Bank's commercial offers to clients, improving support in decision-taking for faster reaction to market changes and continuous assessment of risk profile of Bank's assets.

#### **PBZ Leasing**

PBZ Leasing had a successful business year, earning net profit of HRK 18.1 million. In 2016, the Company signed new lease contracts in the total value of HRK 284 million, thus retaining one of the leading positions in the Croatian leasing industry in terms of the number of realized placements.

At the end of 2016, the Company's total portfolio included net fixed assets under operating leases in the amount of HRK 374 million and net receivables under finance leases in the amount of HRK 586 million.

In 2017 the business activities of PBZ Leasing will be focused on maintaining a stable balance sheet, retaining the Company's market share and achieving product diversification through introduction of new distribution channels.

#### **PBZ Stambena Štedionica**

In 2016 profit before tax of PBZ Stambena Štedionica amounted to HRK 4.1 million and net profit to HRK 3.2 million. During the year, the Company was faced with significant fall in interest rates on the market that had more pronounced effect on the assets side. In 2016 PBZ Stambena Štedionica introduced HRK deposits and loans and significantly improved lending activities. Using the large network of PBZ branches, as well as its own sales channels, PBZ Stambena Štedionica increased its deposits by HRK 107 million and the balance of housing loans by HRK 180 million, having more than 100,000 thousand customers. As at 31 December 2016, total assets of PBZ Stambena Štedionica amounted to HRK 1,766 million.

In 2017 business operations of PBZ stambena štedionica will be focused on increase in lending activities and on retaining the existing customers as well as attracting the new ones.

#### **PBZ Nekretnine**

In 2016 PBZ Nekretnine continued to be affected by the economic developments in Croatia, especially in the real estate market. Nevertheless, PBZ Nekretnine maintained its presence on the real estate market by realizing more than 6 thousand appraisals.

During 2017 PBZ Nekretnine will continue to promote its activities with the aim of becoming the centre of excellence for real estate operations not only within the PBZ Group but in the whole country.

#### **PBZ Croatia osiguranje**

PBZ Croatia osiguranje continues to achieve positive financial results. In 2016 the Company reached net profit of HRK 24.9 million. At the same time, the cost income ratio stands at 50.9 percent. Total assets as of 31 December 2016 was HRK 142.7 million.

Net profit was influenced by the statutory change of management fee from 0.45 percent in 2015 to 0.419 percent in 2016.

PBZ Croatia osiguranje is a well-recognised and highly respectable pension fund management company in Croatia. Development strategy for 2017 will be oriented at maintaining its status within the general public in the country as well as successfully managing the funds' assets.

## Management Board report for the Group (continued)

### Financial Highlights of the Group (continued)

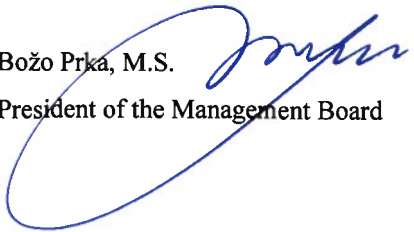
#### Intesa Sanpaolo Card

In December 2016, PBZ sold its 31.2 percent stake in the company Intesa Sanpaolo Card Ltd. to a wholly-owned subsidiary of Mercury UK Holdco Limited. For details on the transaction, please refer to Note 23 Investment in subsidiaries and associates.

Risks to which the Group is or might be exposed are explained in details within Corporate Governance section.

Božo Prka, M.S.

President of the Management Board



14 February 2017

## Macroeconomic developments in Croatia in 2016

### Economic growth in 2016 – year of three prime ministers

Although the political environment in 2016 was not particularly encouraging from the aspect of political stability (expiration of the terms of offices of the previous government, a long-time coming formation of a new coalition government and its brief duration and, eventually, early elections and a formation of a new government again), the economy, driven by a continuation of a solid foreign demand but also a revival of domestic consumption and investment activities, recorded a real growth of 2.6%. A considerable progress was also made in the area of fiscal policy, where the general government deficit was reduced to approximately 2.0%, with a simultaneous decrease in the public debt level below 85% of the gross domestic product. The international environment was particularly favourable given the expansionary monetary policy of the European Central Bank, and also mostly calm with the exception of slightly more turbulent movements following the UK referendum in June and the US presidential elections in November. At the same time, the domestic financial market saw a continuation and further monetary policy relaxation through structural repo operations conducted by the Croatian National Bank, which contributed to a further fall in interest rates and a gradual strengthening of the credit activity, especially one denominated in kuna. Although the conversion of housing loans in Swiss francs (conducted in early 2016) and the cleaning-up of balance sheets through sales and write-off of non-performing loans (throughout the year), reduced the exposure to the private sector by around 5% (November 2016), transaction data indicates that placements to the private sector over the first eleven months cumulatively increased by 1.7%, with a stronger increase in placements to corporations (3.0%) compared to retail loans (0.8%). It is particularly important to emphasise that in 2016 there has been a significant increase in the demand for kuna loans, due to which their share in total loans to the private sector rose to 40% compared with 32% recorded at the end of 2015. Currency risk aversion of clients has remained disproportionate to kuna savings, given the dominant share of FX deposits in total deposits of the private sector (around 67%), although a stronger fall in deposit interest rates on FX deposits from those on kuna slowly increases the inclination to kuna savings.

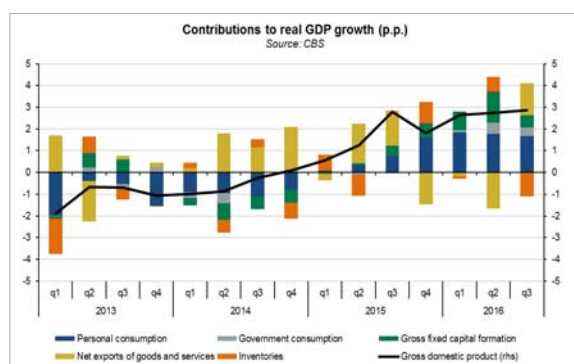
Regardless of the growth of the gross domestic product of almost 3% in 2016, and we expect a similar trend to continue in 2017, it is clear that without structural reforms a long-term potential growth rates will remain insufficient for a faster convergence to EU average and a more considerable improvement in the wellbeing of citizens. Although more stable than over the previous years, the government fiscal position is still relatively vulnerable, as seen in the credit rating which has remained below investment grade. As already in 2017 we may expect a new series of uncertainties over the impact of Brexit, the direction of the new US President economic policy, but also the expectations that 2018 will bring a change in the direction of the European Central Bank monetary policy, after the US FED has already strengthened its policy at the end of 2016, a sustainable economic growth has to be ensured by enhancing and strengthening the domestic economy competitiveness through undelayed structural reforms.

## Macroeconomic developments in Croatia in 2016 (continued)

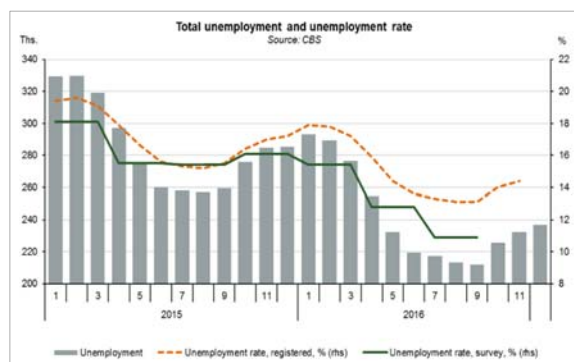
### 2016 in review

After a growth of 1.6% in 2015, a real growth rate of the gross domestic product in 2016 accelerated, according to our estimate, to 2.6%, where the largest contribution came from a recovery of domestic demand with a stable growth of the exports of goods and, particularly, services.

According to the available data for the first three quarters of 2016, the largest contribution to GDP growth came from the exports of goods and services which rose at the rate of 5.8%, mainly as a result of the exports of services, i.e. excellent tourism results (9% more arrivals, 8.3% higher income), while the exports of goods grew at a slower pace compared with the previous two years (when two-digit growth rates were recorded on average), which is mainly a consequence of the diminishing positive effect of the entry into EU. Over the same period, the imports of goods and services rose by 6.5%, driven by a recovery of domestic demand. According to the foreign trade statistics, a faster growth in the imports of goods led to a deterioration of 3% in the foreign trade deficit over the ten months of 2016 versus the same period of 2015. As a result of a stable foreign demand and a recovery of domestic demand, the industrial production, after its growth of 1.2% in 2014 and 2.7% in 2015, rose by 4.1% yoy over the first eleven months of 2016, due to which positive movements in this sector have continued for the third consecutive year. Thereby, manufacturing, with a share of almost 80% in total industrial production, recorded an increase of 4.5% yoy, i.e. up by 1 percentage point versus the same period of 2015.



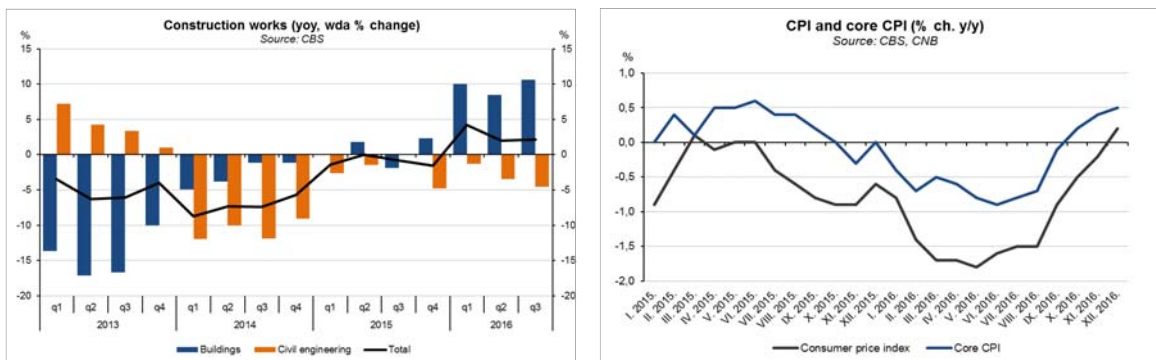
Personal consumption, in the first three quarters of 2016, rose by 3.2% yoy, supported by a growth in real net earnings (+2.8%), a more dynamic labour market and a growth in consumer crediting. The recovery of personal consumption may also be seen in the accelerated growth of retail trade which recorded a nominal and a real-term growth of 2% and 3.9%, respectively, over the first eleven months of 2016. Labour market was marked by a further reduction in the registered unemployment rate to 15% from 17% in 2015, owing to better economic movements and further unfavourable migration movements. Although a total number of persons in employment in 2016 declined by an average of 1.2% yoy (to 1.37 million), the data on the growth of job openings in 2016 by around 15% are encouraging. A decrease in employment along with the considerable emigration (particularly young labour force with higher education) and a higher number of retired persons, led to a reduction in the working-age population by around 60 thousand persons, which will have a restrictive effect on the future GDP growth rates.



## Macroeconomic developments in Croatia in 2016 (continued)

### 2016 in review (continued)

Gross investments in the fixed capital in the first three quarters of 2016 increased by 4.5% yoy, a significantly higher growth compared with the previous year when a 1.6% growth of the investments was recorded, which is partly a result of almost two times higher withdrawal from the EU funds versus 2015, but also significant investments in the private sector, particularly tourism sector. According to the ten-month data, an increase in the volume of construction works in 2016 amounted to 2.6% (the first year of growth following seven consecutive years of decline in the activity), where the volume of works on buildings, due to a better utilisation of the EU funds, fostering of energy renewal and the construction of tourism-related buildings, recorded an impressive increase of 9.4% yoy, while civil engineering works continued to fall (-3.3%), mainly as a result of political turbulences during 2016 and, consequently, a decrease in public investments.



Consumer prices in 2016 dropped by 1.1% yoy, recording a stronger fall compared with the previous two years (-0.2% in 2014 and -0.5% in 2015), as a result of lower prices of crude oil and food products in the global markets and the administratively reduced price of gas for households in April of 2016. After a gradual weakening of deflationary pressures in the second half of 2016, due to higher prices of food and transport, an increase in the consumer prices of 0.2% yoy was recorded in December, thus signalling a trend reversal in 2017.

Owing to noticeably favourable economic movements over 2016, the fiscal position has significantly improved and, according to the European Commission estimate, the general government deficit decreased to approximately 2.0% of GDP (from 3.3% in 2015). Although the reduction in the fiscal deficit was mainly a consequence of a substantial increase on the revenue side (6% compared with 2015), operational non-functioning of the caretaker government during most part of the year and a stricter control limited the growth on the expenditure side of the budget to approximately 2.5%. The reduction in the deficit favourably affected the movements of the public debt, the level of which declined to 289 billion kuna, or 84.4% of GDP at the end of September of 2016.

The domestic financial market in 2016 was characterised by a continuation of the expansionary monetary policy by which the central bank has maintained ample liquidity at low interest rates, thus supporting the recovery of crediting, mainly a higher demand of the private sector for kuna loans.

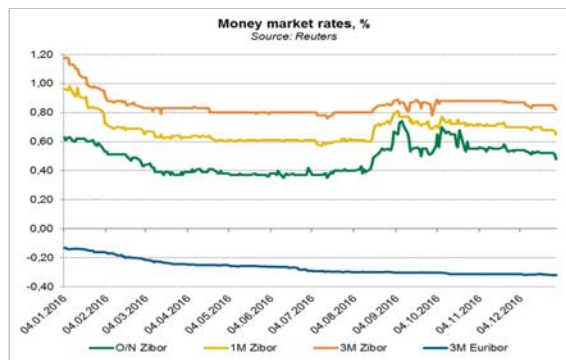
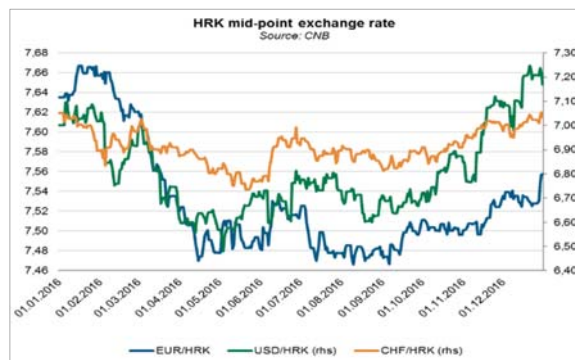
In 2016, CNB held regular reverse repo operations, and also introduced structural repo operations, where a total of 993 million kuna were injected in the system for a four-year period at the fixed repo rate of 1.8% at the first two, or 1.4% at the last two auctions. Along with generous liquidity, the average interest rate in the interbank market in 2016 was reduced, amounting to 0.5% on overnight loans (-20 b.p. compared with the previous year), 0.7% on 1M (-40 b.p.) and 0.9% on 3M (-40 b.p.), while 3M Euribor fell to -0.3% (-20 b.p.).

Along with repo operations, CNB held also four FX interventions, where for the first time since 2012 foreign exchange was purchased from banks, totalling 869 million euro, thus maintaining the stability of the exchange rate and creating additional kuna liquidity. Due to the growing FX inflows from the exports of goods and a record tourism season, positive net foreign position of banks and reduced fiscal risks, the kuna to the euro exchange rate dropped to the average of 7.53 kuna to the euro (2015: 7.61), down by 1.0% versus the previous year. The kuna strengthened against both the dollar and the Swiss franc by even 0.8, or 3.2% on average, so the exchange rate decreased to 6.81 kuna to the dollar and 6.91 kuna to the franc (2015: 6.86 and 7.13).

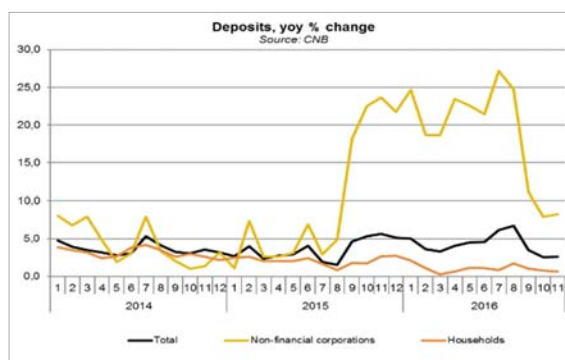
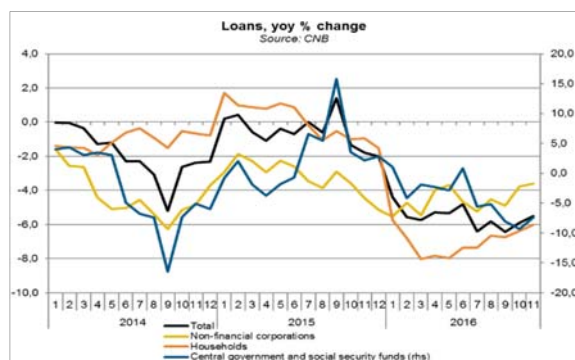


## Macroeconomic developments in Croatia in 2016 (continued)

### 2016 in review (continued)



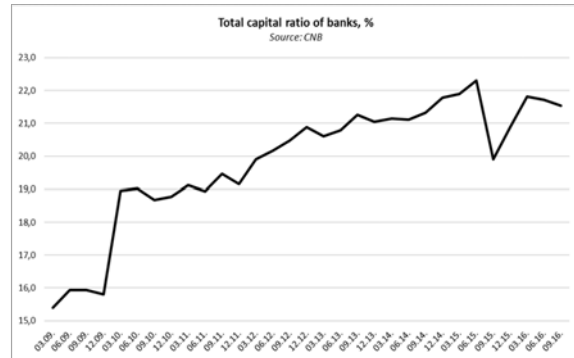
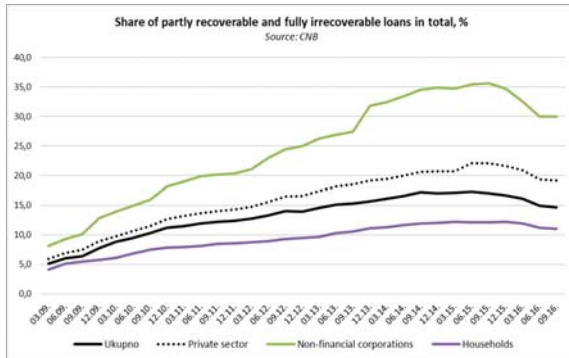
The movements in the banking sector were influenced by the effect of the conversion of housing loans indexed to the Swiss franc and the sale and write-off of the loans that significantly reduced the credit portfolio volume and thus the assets of monetary financial institutions, which were down by 2.6% yoy at the end of November. Total loans declined by 5.5% yoy, where the fall in the loans to households reached 6.0% (write-off of loans due to the conversion was around 5 billion kuna), to non-financial corporations 3.6% and to the central government and the social security funds 7.4%. However, kuna loans climbed by 17.3% yoy due to an increase in the aversion to the currency risk and the fall in the kuna active interest rates, therefore, a higher demand for kuna loans was recorded in both households (+25.1%), where a significant part of demand accounts for the refinancing of housing loans with a currency clause, and the corporate sector (+7.8%). The yoy growth of total deposits substantially slowed down in 2016 versus the year before (+2.6% in November), since the effect of the sale of TDR ceased to exist, which increased corporate deposits in 2015 and raised the yoy growth rate of total deposits above five per cents. A more dynamic economic activity supported the growth of deposits to non-financial corporations which were higher by even 8.2% yoy at the end of November, while for households, the growth slowed down to the low 0.7%, which is a result of the tax on interest income and lower interest rates on term deposits which encouraged citizens to transfer their funds from bank accounts to more profitable forms of investment.



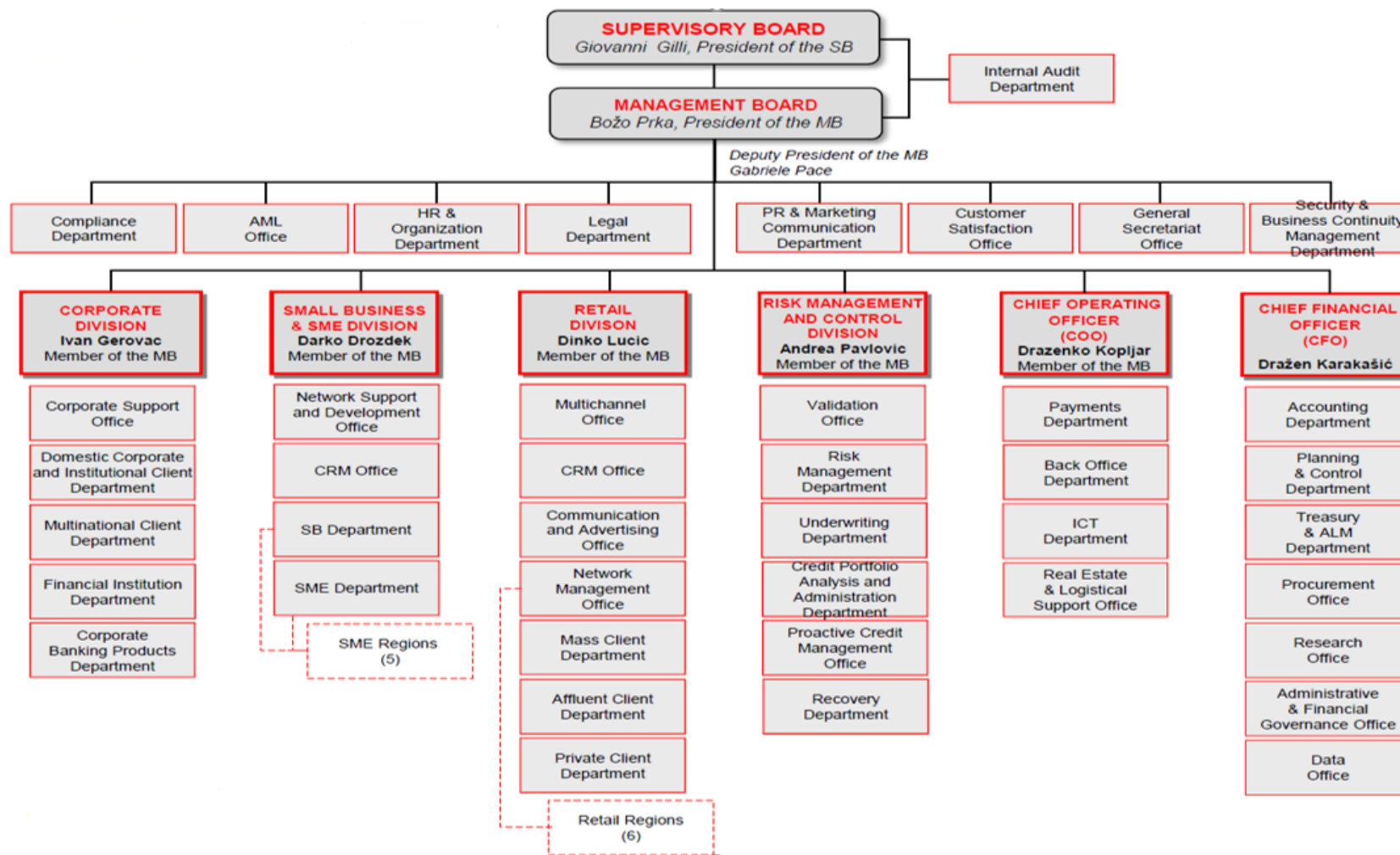
The increased activity of the sale and write-off of the receivables and the conversion of housing loans in 2016 resulted in the more significant improvement in asset quality due to a sharp fall in the share of partly recoverable and fully irrecoverable loans in total loans. At the end of the third quarter, the share at the level of total credit portfolio amounted to 14.7% (end of 2015: 16.7%), where the said level for the private sector declined to 19.2% (end of 2015: 21.6%), of which for the household sector to 11.1% (end of 2015: 12.2%), and for non-financial corporations to 30.0% (end of 2015: 34.7%). The capitalisation of banks has remained strong and the total capital ratio was 21.5% at the end of September of 2016.

## Macroeconomic developments in Croatia in 2016 (continued)

### 2016 in review (continued)



## Organisational chart



## **Business description of the Bank**

Privredna banka Zagreb dd was founded in 1966 and has consistently been a leading financial institution in the Croatian market, with an established business base and a highly recognized national brand name.

During all periods of its history, PBZ supported the largest investment programs in tourism, agriculture, industrialisation, shipbuilding, electrification and road construction. PBZ has become a synonym for economic vitality, continuity and the Croatian identity.

Privredna banka Zagreb dd today is a modern and dynamic financial institution, which has actively sought and won the role of market leader on the financial markets in Croatia. It is a fully licensed bank with nationwide branch network. With its nationwide network of branches and outlets, as well as a broad group of banking and non-banking subsidiaries, PBZ is one of the universal banks that cover the whole territory of Croatia.

### **Organisational Structure and Business Activities**

According to data from the end of 2015, PBZ is the second bank in terms of total assets in Croatia and the fifth bank in terms of subscribed share capital. It has consistently been a leading financial institution on the Croatian market with an established business base and recognised national brand name.

Upon successful privatisation in December 1999, PBZ became a member of Gruppo Intesa Sanpaolo – the largest Italian banking group and one of the most significant financial institutions in Europe. With this partnership, PBZ has retained its business strategy aimed at modern forms of banking and new products, confirming its image of a dynamic and modern European bank, which meets the demands of the market and its clients. The benefits of strategic partnership are clearly visible in the continuously improving financial results of the Bank, as well as of the PBZ Group.

Along with the adoption of the business and corporate governance standards set by its parent bank, Privredna banka Zagreb dd has maintained the strategic development orientation of a modern, client oriented, technically innovative universal financial institution. PBZ is focused on the continued advancement of its economic performance well into the future, as well as strengthening its position as a product leader in offering the most progressive banking products, through the optimal mix of traditional and modern distribution channels. This ensures that PBZ will continue to be able to set standards of the highest quality for product innovations and services offered to both its domestic and international clients.

This commitment to quality and advanced banking practices is clearly seen by the fact that Privredna banka Zagreb dd received the Best Bank in Croatia award from Euromoney in 2001, 2002, 2004, 2005, 2007, 2008, 2009, 2013, 2014 and 2015. During 2006 PBZ received The Best Debt House in Croatia award by Euromoney. In 2012 PBZ won award for the Best Private Banking Service in Croatia. PBZ also received The Banker's Award for the Croatian Bank of the Year in 2005 and 2011. Additionally, PBZ's quality was confirmed by Global Finance's magazine in 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010 and 2011 when it received the Award for the Best Bank in Croatia, while in 2012, 2013 and 2014 it was recognised as the Best Internet Bank in Croatia in the category Best Internet Banks in Croatia and Eastern Europe.

Also, in 2013, 2015 and 2016 Global Finance magazine announced that PBZ is the Best Bank in Croatia in the category Best Emerging Markets Banks in Central and Eastern Europe. In 2003, 2004, 2005 and 2006 PBZ received the domestic prestige awards – the Golden Share Award for the Best Banking Share in the country, and the Golden Kuna Award in 2004, 2005 and 2010 for the previous year. Bank also received acknowledgement from Central European, Finance Central Europe, Adria Zeitung and others.

In addition, Privredna banka was listed among the world's top 500 financial brands for 2007 by Global 500 Financial Brands Index. This report, initially published in 2006, was the first publicly available table analysing the financial value of the world's leading banking brands.

Privredna banka Zagreb dd currently employs some 3,635 employees and provides a full range of specialized services in the areas of retail, corporate and investment banking services. The business activities of the Bank are organized into three principal client-oriented business groups.

## **Business description of the Bank (continued)**

### **Retail Division**

In the retail banking segment, PBZ has a comparative advantage over its competitors due to the fact that it has the most extensive branch network in Croatia, consisting of 195 organizational units in 6 regions and 19 sales centres, which cover the entire territory of Croatia. Our customer orientation is confirmed by “inovacija”, a rewarding scheme for clients who use several product groups (up to 8) and who are given discounts on fees charged or awarded incentive interest rates.

In addition to restructuring and repositioning the traditional distribution channels of the business network, PBZ also continues to develop and improve its direct banking distribution channels. It has extended the network of ATMs that accept Maestro, MasterCard, Visa and Visa Electron as well as American Express cards (a total of 722 ATMs have been installed). The number of EFT POS's (point of sale) has reached 31,099.

As a leader in modern technologies, PBZ has also expanded its distribution channels and products by applying the most advanced technology in order to implement its PBZ 365 services. With Internet banking - PBZ365@NET and mobile banking - mPBZ services – clients can access their accounts 24 hours a day, seven days a week, from any location in the world with Internet access. Several years ago PBZ introduced mPBZ, a full range of banking services over the mobile phone, such as paying bills (including 2D barcode scanning - „scan & pay“), checking account balances, trading with securities etc. These achievements have firmly established PBZ as the Croatian market leader in electronic banking, as well as the technological leader on Croatia's financial market. PBZ was one of the leading bank in Croatia to implement secure e-commerce based on 3D Secure technology (Verified by Visa and MasterCard SecureCode) and CAP/DPA technology for user authentication. Most recently, PBZ introduced a new innovative service – an Internet channel for distribution of investment banking services, now brokerage services on the domestic stock exchange and as well as custody accounts. In the area of retail product development, PBZ is constantly monitoring market demands and improving its wide range of products and services accordingly.

Based on identified needs, PBZ recognized its role in the environmental protection and social responsibility, and therefore amended and extended its product offer with loans such as Energo loans, tuition fee loans and student cost of living loans, loans for retired persons, socially stimulated housing loans, state subsidy housing loans, etc. In addition to responding to market requirements, PBZ is monitoring regulatory and legislative requirements and timely adjusting its products and services to them. Thus it has introduced several types of credit scoring loans.

Overall in the period from 2000, PBZ established itself as the market leader in retail loans with over 20 percent share in the loan market on the Group level. In the area of savings, the PBZ Group has significantly increased its deposits, keeping over 20 percent of all retail deposits in Croatia.

PBZ's retail operations comprise the following departments: Multichannel Office, CRM Office, Communication & Advertising Office, Network Management Office, Mass Client Department, Affluent Client Department and Private Client Department.

### **Multichannel Office**

Direct distribution channels department is responsible for the development and maintenance of Internet and mobile distribution channels, contact centers, ATMs and other self-service terminals. Development activities include participation in research and development of innovative multichannel solutions with aim of improving customer experience and achieving the strategic goals of the bank, supporting the integration of CRM solutions in direct distribution channels, development of own and partner network of ATMs, cooperation on marketing and promotional projects, customer training and education and improving sales of direct channel PBZ branch network.

### **CRM Office**

This Office deals in analysis and development of models of client relationships as well as supervision and implementation of measurements of key indicators related to the effectiveness of the distribution network, production and services aimed at retail customers for the Bank and other members of the PBZ Group. The key tasks of the sector are CRM activities, conducting analyses (of clients, products, services and distribution network) and direct marketing, the development of support for better relationship management with clients and calculation of key indicators of success in managing relations between the client and the Bank. The Retail Division also includes the ISBD CRM Business Competence Centre for supporting ISBD banks in implementing CRM Business practice.

## **Business description of the Bank (continued)**

### **Retail Division (continued)**

#### **Communication and Advertising Office**

The activities of this Office encompass the selection and coordination of suitable communication and marketing campaigns and the development of ideas for promotion and supporting the sales for the Bank's retail and SME products and services. In cooperation with the marketing agency, the Office defines, organises and implements marketing campaigns (direct marketing, promotion and advertising). The Office's tasks also include choosing the most efficient communication channels for particular market segments and creating advertising plans in cooperation with the marketing agency

The Office takes part in drafting marketing budgets and marketing plans and monitors their implementation all year round. It regularly keeps track of the Bank's new and existing products and services and those of its competitors. It also monitors the competitors' communication channels and marketing campaigns.

#### **Network Management Office**

The Network Management Office is responsible for organization, development, coordination, support and monitoring of the Retail Business Network, the fundamental distribution channel with Bank's retail clients, contact channels with retail clients and subcontractor sales network. The most important responsibilities of the Office include managing retail regions and contact channels for retail clients, managing subcontractor sales, capital investments and investments into business network, HR management of business network, participating in specifying and dividing budget amounts and remodeling the setting of targets, measuring effects and awards in the business network and conducting development and education of HR, defining and continuously advancing modality, process, procedures and rules, and prescribing instructions for advancing modalities, processes, procedures and rules for prescribing instructions regarding regular planning, as well as planning and introducing new technologies in business, and development and supporting.

#### **Mass Client Department**

"Mass" Clients' task is to define and implement business strategies and policies, products and services as well as value propositions and pricing for the "Mass" segment. It designs and updates the "customer journey" for the relevant segment and products and services. It develops, manages and updates products and services related to Current Accounts, Transaction, Mortgages, Personal Loans and Non-life insurances for Retail clients of all segments. In co-operation with ISP Card it manages and updates products and services related to Cards. In co-operation with the Network Management it supports and provides commercial coordination to the segment-related sales force in the Branch Network.

#### **Affluent Client Department**

The "Affluent" Client Department is responsible for defining and implementing business and commercial strategies, products and services as well as value propositions and pricing for Affluent segment. Its task is also designing and updating the "customer journey" for the Affluent segment, supporting and providing commercial coordination to the Affluent-related sales force in the Branch Network and providing sales coordination for Affluent segment, supporting the Branch Network and the sales channels in adopting the defined strategies in order to reach the sales target of the Affluent segment. Very important responsibilities are also developing, managing and updating products and services related to term deposits for Retail clients of all segments, managing and updating products and services related to investments and life bankassurance in cooperation with Eurizon Capital, Banca IMI ISP Insurance Division and local Partners.

#### **Private Client Department**

The "Private" Client Department is responsible for defining and implementing business and commercial strategies products and services as well as value propositions and pricing for Private segment. Its task is also designing and updating the "customer journey" and managing commercial coordination of the Private segment.

### **Corporate Division**

Privredna banka Zagreb dd is one of the leading Croatian banks in the field of corporate banking. Taking into account a wide range of products and services offered to its corporate clients both locally and internationally, it is difficult to find a major company in Croatia today that does not bank with Privredna banka Zagreb dd. Supported by powerful electronic distribution channels, our network of well-organized branches is the key driving force in serving our clients efficiently. We strive to create additional value by providing integrated financial solutions designed to satisfy the individual requirements of our clients.

Privredna banka Zagreb dd has developed a modern platform for supporting classic cash as well as other transactions of corporate clients within the Bank's network. A wide network of correspondent banks, and its SEPA reachability, make it possible for the Bank to offer its clients fast and affordable services in the area of international payments.

## **Business description of the Bank (continued)**

### **Corporate Division (continued)**

Also, Privredna banka Zagreb dd has significantly improved the process of handling domestic payments. The Bank directly participates in the Croatian RTGS system (HSVP) and in the national clearing system (NKS) and thus has the ability to process any payment through the most appropriate channel. The Internet banking service for corporate clients – PBZ COM@NET, after being upgraded, is available for both domestic and international payments. In terms of investment banking, Privredna banka Zagreb dd is a dominant participant in the Croatian market. It has originated many contemporary products and has initiated and largely contributed to the development of the financial market in the country. Because of its active role in the primary and secondary capital market, PBZ has been recognized as a market leader. We are determined to keep the position of the best financial institution in the region. Such recognition has been given by our clients because of our ability to deliver the best service in everything we do.

The **Corporate Division** consists of the following organizational units: the Domestic Corporate and Institutional Client Department, Multinational Client Department, Financial Institutions Department, Corporate Banking Products Department and the Corporate Support Office.

### **Domestic Corporate and Institutional Client Department**

The Domestic Corporate and Institutional Client Department is responsible for business relationships with the largest domestic corporate clients, central government, public institutions, public utility companies and related companies and institutions. The Department is also responsible for handling and monitoring the entire business relationship with major private enterprises, whose relationship with the Bank is exceptionally complex and structured, which implies the multiple interweaving of the products and services they use.

Business activities of this Department include presentation and sales of Bank products to existing and potential clients, preparing and organizing specific presentations for the sale of products and services of the Bank, advising clients on all forms of financing and creation of the best possible solution for the respective entity, submitting offers to clients, providing incentives for product development and coordination between all organizational units of the Bank and the relevant client. In cooperation with other organizational units, the Department offers all types of banking products and services such as opening of business accounts, contracting Internet banking, granting all types of loans and credit facilities, purchase of receivables, B/E discounting, factoring, letters of guarantees, letters of credit, cash handling services (organization, collection and transportation of cash, cash pooling), card operations, leasing, multi-purpose facilities, providing financial support to export-oriented businesses and other innovative solutions adjusted to the requirements of each single client. In coordination with other units of the Bank, we participate in cross-selling of all the PBZ Group products.

The Domestic Corporate and Institutional Client Department also provides agency services to clients, by performing transactions on behalf and for the account of the particular principal, as well as by carrying out activities in its own name and for the account of the principal – all in accordance with the mandate of an agent, as agreed in a specific case. In every segment of its business activities, operations and services, the Department seeks to promote the highest banking standards, first and foremost by fostering a highly professional as well as flexible approach both to its present and potential clients.

### **Multinational Client Department**

The Multinational Client Department is responsible for establishing and managing business relationships with large Croatian companies, companies in foreign ownership, as well as foreign legal entities – non-residents.

The Department offers a complete range of banking products and services tailored to specific customer needs, in cooperation with other organisational units of the Bank and of the PBZ Group. Clients receive an individual approach, which takes into account their requirements, and are provided with different banking and advisory services as well as support in all aspects of their business activities. Clients have at their disposal the following banking products and services: opening of transaction accounts, centralised account management, contracting of the Internet banking services, approval of loan facilities, purchase of receivables, B/E discounting, advisory services related to all aspects of financing, issuing of guarantees and letters of credit, cash handling services (organisation, collection and transportation of cash, cash pooling, global cash management), card operations, leasing, retail products designed for employees of our corporate clients, and many other.

The leading clients of the Department are companies engaged in tourism, IT, energy industry, retail trade, construction business, food manufacturing, and pharmaceutical industry. The Department is in charge of coordinating activities of Privredna banka Zagreb d.d. and its parent bank – Intesa Sanpaolo. The Department provides all banking and advisory services to Intesa Sanpaolo Group clients present in the Croatian market, as well as to other companies. Given the well-developed business network of Privredna banka Zagreb d.d., we have successfully organised the entire process of execution and management of cash transactions for some of our clients who are among the largest chain stores, and also for companies in the tourist industry

## **Business description of the Bank (continued)**

### **Corporate Division (continued)**

#### **Multinational Client Department (continued)**

To companies that engage in the construction of residential and business premises intended for sale we can offer a complete project implementation service – from the control of project documentation and building supervision to the financing of construction and the sale of real estate to final buyers. Apart from managing business relations, this unit also assists foreign investors in the process of starting up a new company in Croatia, provides advisory services and general information on business terms and conditions in Croatia, contacts clients and puts them in touch with institutions that are crucial for the performance of regular business activities.

The Department is responsible for establishing and developing co-operation with foreign entities (foreign companies and private individuals that engage in business activities, foreign diplomatic and consular missions and representative offices of foreign legal entities, foreign associations, foundations and other non-profit organisations, international missions). Such co-operation includes the opening and managing of accounts, depositing funds, providing the clients with all the necessary information required for conducting business in Croatia, which demands continuous monitoring of all local currency regulations (close cooperation with the Croatian National Bank and the Ministry of Finance, particularly in the area of anti-money laundering & terrorism financing prevention).

The Department will take care to ensure that all client-related initiatives and interactions are in compliance with local standards and requirements (both internal and external) as well as with the local Bank Board decisions and agreements / authorizations.

#### **Financial Institutions Department**

The Financial Institutions Department has overall responsibility for establishing, promoting and managing the complete business relationship between the Bank and more than 1800 domestic and international banks and other financial institutions (including investment and pension funds) in both emerging and mature markets. We are also responsible for cross-selling of all Bank and PBZ Group products, as well as for providing professional advice and offering individual, single-source solutions, tailored to suit our clients' specific requirements.

We believe that trust, continuity in relationships and personal commitment create a solid foundation for consistent and successful business opportunities and, therefore, in each Relationship Manager in our Department, our clients will find a reliable partner for the entire product range of the PBZ Group. The Department offers to all the Bank's clients tailor-made financing solutions including trade finance, loans and specialised arrangements with financial institutions (both domestic and international), buyer's credits and forfaiting for the promotion of Croatian export, etc. PBZ has profiled itself as the leading commercial bank in Croatia in providing export financing through Buyer's Credits. In order to support payments and the documentary business of the Bank's clients, as well as explore other possibilities for mutual cooperation with reputable international financial institutions, PBZ has put in place various agreements, such as: Low Value Payments Agreements, MT101 Bilateral Agreements, Rebate Agreements, Cash Letter Services Agreements, Risk Sharing Agreements etc. It should be emphasized that PBZ is the first Croatian bank that has fully implemented Global Cash Management and one of the first offering SEPA payments to its clients. By continuously investing in new channels and methods of effecting international payments, we are able to provide our clients with most efficient, time saving and cost beneficial execution of their payments around the world. In close cooperation with its foreign bank partners, PBZ has achieved a Straight Through Processing (STP) rate of 99.9%, thus continuously, year after year, receiving STP excellence awards given by eminent foreign banks (Deutsche Bank AG, Citibank NA, JP Morgan Chase and Bank of New York). Through our well-developed correspondent network, our clients have direct access to all world markets, which is crucial for their export and import activities. In order to deliver the best possible professional service to customers, our Documentary Business i.e. Documentary Payments and International Guarantees teams work in synergy with the Financial Institution Relationship Management team. Thanks to the commitment of an experienced team of trade finance specialists, the Bank is able to provide strong professional support and facilitate financing of export oriented customers, as well as imports of equipment, construction works, and other specific projects. In response to the needs of the market, the Bank has started to effect inland documentary payments, being the first bank in Croatia that offers such service to its clients.

Through the EU Desk, the Bank provides clients with information and advisory services regarding EU programmes and EU Tenders. The Bank also concluded several credit lines with supnationals, thus obtaining funds for on-lending to its clients, i.e. for financing of projects aimed at improvement of environmental, health and safety standards, improvement of product quality and energy efficiency in line with EU requirements, and similar projects.

Most of those credit lines are supported by the European Commission grants, i.e. the Commission provides Croatian companies with comprehensive technical assistance, which is intended to help them structure and prepare investments projects in order to be able to meet EU requirements.



## **Business description of the Bank (continued)**

### **Corporate Division (continued)**

#### **Financial Institutions Department (continued)**

The awards that PBZ has recently won, primarily the EBRD award for the most active trade finance bank in Croatia, as well as the EBRD award for excellence in the implementation of the programme for financing energy efficiency refurbishment of residential buildings, prove our dedication to the highest professional standards in dealings with supranational institutions. Further, acting in close cooperation with the Croatian Bank for Reconstruction and Development (HBOR), the Bank provides various credit programmes for the entire PBZ's corporate client network. The Department is also responsible for the long term funding of the entire PBZ Group, i.e. the Bank and its subsidiaries, as well as coordination and monitoring the overall business cooperation of the PBZ Group subsidiaries with financial institutions, international banks for development and EU.

#### **Corporate Banking Products Department**

Privredna banka Zagreb has always been focused on the clients and the client needs, and for that purpose, at the beginning of 2016, we carried out a reorganisation with the aim of making it possible for large and medium-size companies to be offered products and services from one central spot, where we can provide a comprehensive review of business operations and the needs of a particular client in today's dynamic and demanding business environment.

The Corporate Banking Products Department comprises the following functions: activities of the former Investment Banking Division – i.e. (under the current organisational structure) activities of the Capital Market Office, Custody Office and the Depository Office, Brokerage Office, M&A Advisory Office, Structured Finance Office (which includes Syndicated Finance and Project Finance), Investment Analysis Office, as well as the Factoring Office, Transaction Banking Office and PBZ Leasing.

##### ***Factoring***

PBZ factoring, as one of the corporate banking products, refers to the purchase of short-term receivables of good quality, that have arisen as a result of the delivery of goods and the provision of services that took place between suppliers and buyers, on the basis of documents that prove the existence of receivables. By selling the receivables, the user of the factoring service can reduce the time needed for collection of its short-term receivables, originally subject to deferred payment, and in this way the client can significantly improve its liquidity, without having to take a loan.

PBZ Factoring Office engages in purchases of receivables created in the course of domestic and international trade of goods and services, and is able to offer the following factoring services: domestic factoring, bills of exchange discounting, export factoring (involving two factors) and import factoring.

##### ***Transaction banking***

PBZ has recently paid a lot of attention to developing a range of transaction banking products intended for corporate clients, thus satisfying the demands of all client segments - from the smallest business entities to big multinational companies, which now have at their disposal a large variety of products, from those simplest ones, related to opening and maintaining transaction accounts, to more complex products, which enable large clients centralised management and the optimum use of funds.

The transaction banking products and services, as well as all other groups of products, are available to PBZ clients via a number of different electronic channels that range from a sophisticated system of Internet banking to the solutions for direct communication with the client systems. At the same time, PBZ devotes utmost attention to the development of the security systems in order to ensure maximum and full protection of business operations of its clients. Through cooperation with other banks of the Intesa Sanpaolo Group, PBZ has become a major player in the international market precisely because of the sophisticated and highly automated services it is able to offer to the most demanding groups of clients.

##### ***Investment analysis***

Investment analysis serves as an indispensable source of information for the performance of investment banking operations and is equally valuable to other internal users, because - through preparation of industry research reports and corporate profiles/analyses - the relevant information is supplied regarding the trends in a specific industry or about the performance of a specific company. The tasks of investment analysis are carried out by the Investment Analysis Office within the Department, which is unique in terms of the scope of analytical activities and the type of analyses it can conduct/offer, and it should be mentioned that other banks, our competitors, have not developed investment analysis as a product i.e. a (highly sophisticated) service in this way, as is the case at PBZ. Apart from establishing and maintaining contact with relevant agencies and experts from specific industries and companies, the task of the Investment Analysis Office is also to set up and develop relevant databases.

## **Business description of the Bank (continued)**

### **Corporate Banking Products Department (continued)**

#### ***Capital markets***

PBZ has earned a reputation in the domestic capital market as a leader in providing innovative financing solutions, which our capital market team has successfully designed and delivered to the state, to local government units, and also to a large number of corporate clients.

We are number one in terms of the number of recently completed public offerings of shares (IPOs, SPOs) that have been successfully arranged for our clients for the purpose of raising capital. PBZ is also a major player in the domestic debt market; as such, it has participated in the majority of domestic bond issues and commercial paper issues, thus handling the major portion of the total amount of debt issued in the domestic capital market.

#### ***Brokerage services***

In addition to carrying out purchases and sales of securities on domestic and foreign stock exchanges, the Bank's brokerage services consist of providing detailed information on trading activities, as well as supply and demand, readily available through electronic trading systems, and prompt reporting of securities transactions. Due to the quality of its brokerage service, the Bank has been recognised in the domestic market as one of the leaders in this area, especially in electronic trading. The key driver of our brokerage business is the internet platform, PBZ Investor, completely developed in-house, primarily for retail and institutional investors.

#### ***M&A Advisory Office***

Our M&A Advisory Office provides advisory services related to mergers and acquisitions, corporate and financial restructuring and divestments, employee stock ownership programs, MBOs, LBOs and other transaction-based projects. We can provide support and assistance to companies that wish to enhance their shareholder value. We have a strong network base and strong presence in various industries, an in-depth understanding of the dynamics of the markets in which our clients operate, and are quite familiar with intricacies of deal structuring and negotiations.

We have represented clients in a number of different industries, including tourism, food processing, confectionery industry, transport and logistics, IT, retail trade, pharmaceutical industry, construction, oil and gas industry, and others.

#### ***Structured finance***

As the ultimate leader in the domestic financial market, the Structured Finance Office provides syndicated finance solutions, club and project finance solutions to corporate investors/clients, commercial banks, local government units and public entities. Our team of experienced specialists with broad market knowledge and an extensive network of partners (both local and international), stands ready to structure even the most complex transactions that will suit the clients' specific financing requirements. Over the past five years, PBZ has arranged large syndicated deals in the field of project finance for clients from various industries, including infrastructure, healthcare, oil and gas industry, tourism, renewable energy, property development (shopping centres), shipping, and others. In addition to engaging in primary syndication, PBZ is also active in the secondary market (domestic as well as international).

#### ***Custody services and depositary services***

The Bank takes great pride in providing top quality custody services to private and institutional clients from all over the world, and has established itself as a highly reliable partner that delivers efficient local custody services, due to its in-depth knowledge of local legislation and market practices. At the same time, by establishing and continuously developing its own custodian network, the Bank is able to offer its domestic institutional and private clients easy access to local and foreign markets.

Also, by being entrusted with the role of a depositary for top Croatian investment funds, we take all necessary steps to ensure that investors' assets are protected, managed and valued in accordance with applicable regulatory requirements and recognized accounting standards.

Our know-how and experience, combined with the ability to access local and regional markets, provide our clients with the assurance that they will receive top-notch support required for the successful accomplishment of their business goals.

#### ***Business support***

The responsibility of this business department is to provide support to the sales organizational units within the business with corporate and investment banking and transaction services related to banking, implementation and monitoring of agreed syndicated loans, preparation of internal and external reports arising from all business activities with corporate and investment banking, as well as participation in drafting budget and monitoring its implementation.

## **Business description of the Bank (continued)**

### **Small Business & SME Division**

Privredna banka Zagreb d.d., as one of the leading corporate banks, established the SME business area in 2006, with a clear focus on small and medium-sized enterprises. The Small Business & SME Division is made up of three functions within the Bank's head office (SB Department, SME Department, Network Support and Development Office and CRM Office) and the network.

With the aim of building a strong business relationship with customers, the Small Business & SME Division has a wide-spread network organised into 5 regions, 17 SME business banking centres and 50 Sinergo desks with around 250 employees.

The Division is committed to developing new and improving the existing products, introducing state-of-the-art business applications, optimising processes and organisation in order to provide a more efficient service to more than 60,000 customers - companies, crafts and enterprises.

Customers can use the largest network of branches, ATMs (Cash-In/Cash-Out), night safes, and EFT POS terminals.

PBZ is a technological leader and has a pioneering role in terms of introducing the Internet and mobile banking services to the domestic market, currently available under labels PBZCOM@NET, mPBZ, e-salaries and PBZ365@NET. An increasing number of users as well as a more frequent use of direct distribution channels are the best indicators of the quality of our services. VISA Electron debit cards linked to transaction accounts, American Express business cards, and the largest network of EFT POS terminals are available with the support of PBZ CARD, a company of the PBZ Group.

In cooperation with local and EU partners (HAMAG, EIF) we provide easier access to financing based on the developed business models (guarantee schemes). Furthermore, in cooperation with the national development bank – Croatian Bank for Reconstruction and Development, the Small Business & SME Division offers to local self-government units and small and medium-sized enterprises an extensive range of (long-term) development loans intended to finance production, export and other development projects.

In order to expedite and optimise the process of loan approval to MICRO enterprises and crafts, the Small Business & SME Division uses an automated credit scoring system, which is a significant step forward in terms of lending to this segment of customers in the Croatian market. The range of products approved through the automated system is continuously expanded.

The Small Business & SME Division consists of four business functions: SB Department, SME Department, Network Support and Development Office, CRM Office and 5 SME Regions.

### **SB Department and SME Department**

These Departments are primarily responsible for the organisation, portfolio management and sales monitoring, coordination and sales support, enhancing of the service model, processes and products.

### **Network Support and Development Office**

The Network Support and Development Office is a function responsible for providing support to the SME network, developing and maintaining business applications and processes, providing support in the development of new products and services, developed jointly with other business functions and IT, and assisting SME customers in using products and services of the Bank. In order to ensure quality performance, there is the Customers Contact Service (sub-function) within the Network Support and Development Office.

### **CRM Office**

The CRM Office is a function responsible for establishment, development and monitoring of the business relationship with the customers of the Small Business & SME Division. The Office is responsible for defining products and distribution channels, monitoring of revenue, expenses and profitability of the client and business centres, planning and calculation of key performance indicators and remuneration system. Also, its role is to define business segments and to manage all types of marketing campaign activities by using the Customer Relationship Management and DWH tool through available media and communication channels of the Bank.

### **SME Regions**

The Small Business & SME Division is organised into 5 regions (regional centres): Zagreb, Central Croatia, Dalmatia, Istria-Rijeka-Lika and Slavonia within which there are 17 business banking centres and 50 Sinergo Desks. Activities and responsibilities of the centres and desks are the sale of products and services to the SME clients (services of lending, issuing of guarantees, letters of credit, factoring, collection of deposits, payment transactions and other services), advisory services to the clients on financing, and coordination with other organisational units of the Bank and PBZ Group members.

## Business description of the Bank (continued)

### Logistics areas

Business areas focusing on client requirements can only fully exploit their potential if they are provided with a reliable and efficient infrastructure.

The Accounting Department, Planning & Control Department, Treasury & ALM Department, Administrative & Financial Governance Office, Procurement Office, Research Office and Data Office led by the Chief Financial Officer (CFO), provide skillful and in-depth support with regard to all financial monitoring and reporting matters, financial planning and budgeting as well as administrative assistance to the business areas.

Listed below are the basic roles the business functions (mission):

- mission of the **Accounting Department** is preparation the Bank's Financial Statements in accordance with the required standards, management, monitoring and taking into consideration all applicable tax laws and providing consultancy to the all Bank's Structures on these matters, management of all accounting activities as well as preparation and submission of Regulatory reporting to the National Bank and to the other Regulatory Authorities;
- mission of the **Planning & Control Department** is to assist the Top Management in assessing the overall and segment specific performance as well as the strategic and market position of the Bank and the Group. The Planning and Control Department provides the business divisions/departments with financial and business information (by segment, product, channel, geographical area and organizational structure) and to supports them in analyzing and monitoring the relevant trends. The Department manages the all budget process (preparation of the strategic plan, budget and forecast for Bank and the Group), ensures the cost controlling of the Bank and the Group and identifies the strategies for capital allocation for optimizing the capital usage and maximizing the value of the Bank;
- the **Treasury & ALM Department** manages the liquidity of the Bank/PBZ Group in all currencies, the interest rate risk and the FX risks of the Bank/PBZ Group and the Bank/Group's securities portfolios. Furthermore, the Treasury and ALM Department carries out all the necessary (cash and derivative) transactions in the monetary and financial markets and with the Central Bank, in order to manage the above mentioned activities within the limits assigned. The Treasury and ALM Department provides transaction execution services in the relevant financial markets for customers and sales functions;
- the **Administrative & Financial Governance Office** implements ISP Group procedures and guidelines for the management of administrative and financial processes, carries out the assessment of adequacy and effectiveness of the system of internal controls over the financial information process, provides support to internal attestation requested and attestation issued by the CEO and Manager responsible for preparing of the Bank's financial reports in accordance to legislation;
- main duty and responsibility of the **Procurement Office** is management of the procurement process of all necessary goods and services for the Bank and its subsidiaries according to the Group Procurement Rules ensuring the regularity of the entire procurement process. The Procurement Office provides support to all the organizational units of the Bank and PBZ Group members in all the phases of the procurement process;
- the **Research Office** creates and maintains a database of all the relevant macroeconomic and financial indicators and of all the major microeconomic variables for the countries in which PBZ Group operates, produces regular reports regarding major macroeconomic and financial market developments (current and expected), provides ad-hoc analyses and research in the microeconomic areas of industry, trade and banking, and provides the inputs and forecasts regarding the covered countries, necessary for the annual budget and long term planning of the local Bank, in coherence with the Group guidelines;
- main duties and responsibilities of the **Data Office** are to set up and maintain a proper Data Governance framework and the development of the data governance culture within the Bank. The Data Office oversees the content and the coherence of the data feeding for the Parent Company, ensures the effectiveness of the data quality controls and oversees the process of managerial reporting in the area of the corporate data management.

## Business description of the Bank (continued)

### Logistics areas (continued)

ICT Department, Back Office Department, Payments Department and Real Estate & Logistical Support Office represents a key business functions as part of the organization that serves the entire Bank by providing IT and communications assistance, supporting distribution channels and feeding the system with financial information.

- mission of the **ICT Department** is to identify the ICT needs of the Bank and to define strategies, solutions and initiatives regarding architectures, technologies, standards and rules. ICT Department designs, implements and manages the applications, the central and distributed technological infrastructures coherently with the defined budget and objectives. Furthermore, the ICT Department assures the implementation and management of the ICT security measures and oversees the related incidents management;
- the **Back Office Department** performs back office activities related to all banking products and services, continuously monitors their service level and performs book-keeping records for the Bank and PBZ Nekretnine. The Department is proposing and participating in development of the relevant ICT solutions;
- mission of the **Payments Department** is to perform all the back office activities related to the outgoing and incoming payments, national, cross border and international in HRK and other currencies, performs the cash administration and handling activities and monitors processes related to SWIFT, RTGS and ACH, SCT, SDD, CSM. The Payments Department supports development of new products and services and implementation of regulatory requirements related to payments and proposes the evolution of the relevant ICT solutions;
- mission of the **Real Estate and Logistical Support Office** is to define the strategies and to manage the real estate portfolio of both Head Office and network structures and assures the effective and efficient maintenance of all Bank's physical assets

Risk Management and Control Division is a crucial part of our commitment to providing consistent, high-quality returns for our shareholders. It is our belief that delivery of superior shareholder returns greatly depends on achieving the appropriate balance between risk and return. Role of the Risk Management and Control Division is to protect the Bank from the risk of severe loss as a result of unlikely events arising from any of the material risks that Bank face and to limit the scope of materially adverse implications to shareholder returns. Within this area are the following structures: Risk Management Department, Validation Office, Proactive Credit Management Office, Underwriting Department, Recovery Department and Credit Portfolio Analysis and Administration Department.

- **Risk Management Department** is responsible for developing and prescribing elements of overall risk management system for the Bank and PBZ Group i.e. for defining the framework for risk management which includes rules, procedures and resources for identifying risks, quantifying / assessment of risk, mastering of risk management and risk monitoring, including determining the risk appetite and risk profile and reporting on risks to which the PBZ Group is exposed to or could be exposed to through its activities;
- mission of the **Validation Office** is to ensure stability of the risk management system, its consistency and adequate coverage of all significant risks involved in Basel 3 (Pillar I and Pillar II) for the Bank and PBZ subsidiaries. Validation secures alignment of operations of Bank with regulatory framework in the part relating to risk management, including monitoring of efficacy and stability of the risk management system and control of the application of models and methodologies for risk assessment by comparing realized results with expected values;
- **Proactive Credit Management Office** contributes to the implementation of an early warning system based on borrower's monitoring so to early/timely identify signals of customer's financial/commercial difficulties, design and activate the necessary measures/action plan for identified clients;
- mission of the **Underwriting Department** is management and assessment of credit risk through the process of loan approval and process of placements monitoring and participation in process of assignment and management of internal credit rating of the clients, process of management of credit protection instruments and in the process of early detection of increased credit risk;
- the **Recovery Department** is responsible for entire collection at the level of the Bank and for coordination of the collection at the level of the PBZ Group;
- mission of the **Credit Portfolio Analysis and Administration Department** is control of loan/credit documentation before loan utilization in order to reduce the operational risk, utilization of loan, care about integrity and completeness of loan/credit files in accordance with internal rules, policies and regulatory provisions, operatively management of the loan/credit files and collaterals, ensuring a comprehensive view of the credit portfolios and coordinating all activities related to the 1st level credit controls.

## Business description of the Bank (continued)

### Logistics areas (continued)

The Internal Audit Department, General Secretariat Office, Human Resources and Organization Department, Legal Department, Compliance Department, AML Department, PR & Marketing Communication Department, Customer Satisfaction Office and Security & Business Continuity Management Department are integral elements of the overall logistics and support of the business groups and the management.

- main duties and responsibilities of the **Internal Audit Department** are to ensure a constant and independent monitoring on the regular way of conducting activities and on the Bank's processes in order to prevent or highlight anomalous or risky behaviors or situations, evaluating the functioning of the Internal Control System and its suitability to guarantee the efficiency and effectiveness of company's processes, the safeguard of assets and the prevention from losses, the reliability and integrity of accounting information, the compliance of the performed transactions with the policies established by the governance bodies as well as with the internal and external regulations. The Internal Audit Department provides advisory to the Bank's functions and units, also by means of participating to projects in order to create added value and to improve the effectiveness of control processes, risk management and governance activities, supports the company's governance and ensures the Top Management, the Internal Bodies as well as the Regulators (i.e. Central Banks) with a prompt and systematic information flow on the Internal Control System status and on the findings of the activities carried out. The Internal Audit Department ensures the monitoring on the Internal Control System of Subsidiaries through audits or by governance activities to be executed towards relevant internal auditing functions;
- the **General Secretariat Office** provides comprehensive support to facilitate the execution of Bank's Bodies meetings, as well as Internal Committees, and to manage the relationship with the Parent Group, the supervisory authorities and other regulators with reference to Bank corporate governance and legal status matters. Furthermore, the Office provides legal support to the relevant structures of the Bank in the field of corporate governance and legal status matters at the level of the Bank, which includes interpretation and application of the Companies Act, the Credit Institutions Act, and other regulations in the sphere of status law/corporate governance
- mission of the **HR & Organization Department** is to govern the planning, development and management of human resources by guaranteeing the recruitment, remuneration, staff mobility and training of the human resources as well as the assignment of responsibilities, and by paying attention to the enhancement of expertise, skills development, merit recognition and internal satisfaction levels. It manages the internal communication initiatives (except of Intranet) aiming at facilitating the development of the corporate values and culture and supports the development of the Bank by leveraging all organizational assets (such as models, sizing tools, processes and rules), as well as by providing support to the Bank in project management and by coordination of the demand management of IT services
- mission of the **Legal Department** is to provide legal assistance to all organizational units of the Bank aiming at assuring a proper interpretation and application of laws and regulations and to provide the representation and defense of the Bank's interest in legal disputes and other legal proceedings
- the **Compliance Department** guarantees effective and efficient governance of the compliance risks and associated controls according to the provisions of the local Authorities and the Parent Company Guidelines;
- mission of the **Anty Money Laundering Office** is to ensure the management of anti-money laundering, terrorism financing and embargoes in the Bank according to the indications of Parent Company Guidelines and local Authorities;
- mission of the **PR & Marketing Communication Department** is to manage and coordinate the communication activities addressed to the external audience with the purpose of providing them with economic, financial, institutional and regulatory information and developing and enhancing a positive corporate image and reputation of the Bank itself as well as to coordinate plans for implementing the promotion of the PBZ Group's products and services;

## **Business description of the Bank (continued)**

### **Logistics areas (continued)**

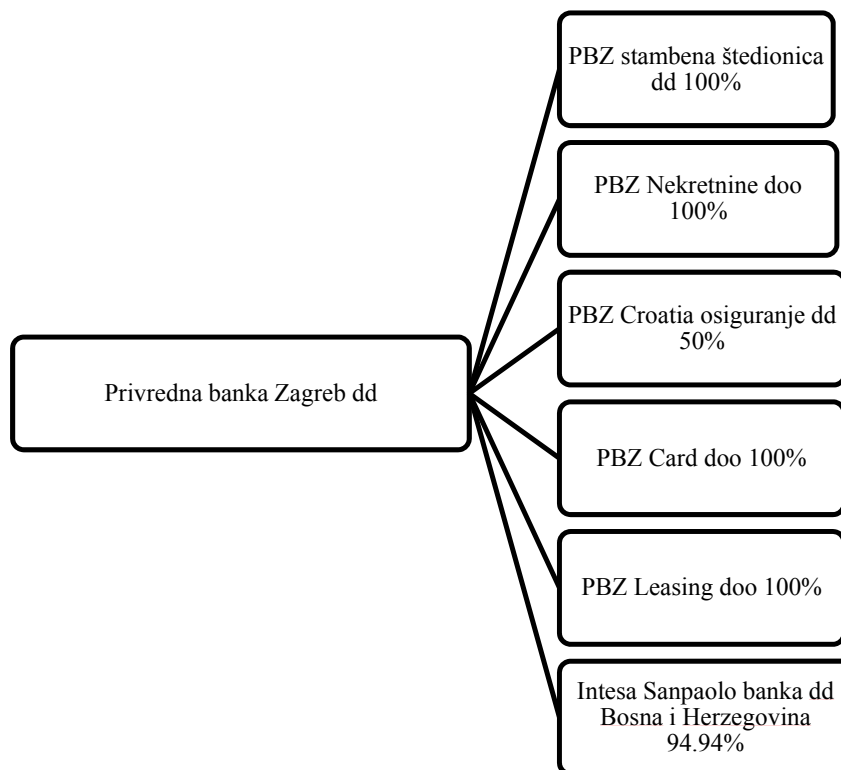
- the **Customer Satisfaction Office** is responsible for measuring and monitoring customer satisfaction, continuously proposing, implementing and managing action plans and initiatives aimed at strengthening satisfaction and loyalty of Bank's customers through improving existing and implementing new products and services of the Bank as well as continuously developing and improving relationship with clients in cooperation with other organizational units of the Bank. The Office supervises, adjusts and coordinates activities related to all aspects of receiving and solving complaints and inquiries in the Bank and Group and coordinates and participates (together with responsible organizational units) in activities related to the legal obligation of consumer protection;
- mission of the **Security & Business Continuity Management Department** is to define strategies and policies related to information security matter, physical security, business continuity and fraud prevention, to oversee their correct implementation, to manage the risks linked to specified areas as well as to manage the Business Continuity Plan of the Bank and to monitor activities in order to detect and handle any fraudulent actions. Role of the Department is to spread the culture of information security, physical security, fraud prevention and business continuity within the Bank by identifying the needs of awareness, communication and education of employees and by developing the contents and the educational trainings.

## Business description of the Group

Joining the Intesa Sanpaolo Bank dd Bosna and Hercegovina in July 2015 the Privredna banka Zagreb Group is a multinational based financial services group which provides a full range of retail and corporate banking services to customers in Croatia and Bosna and Hercegovina. At the end of 2016 the Group employs some 4,550 employees and serves over 1.8 million both private and corporate clients in both of the countries. PBZ Group is a well-organised institution whose market share in the overall banking system stands at 18.3 percent in Croatia (data from October 2016) and 10 percent in Bosna and Hercegovina.

On 31 December 2016 the Group consisted of Privredna banka Zagreb dd and 5 subsidiaries and 1 associates.

The composition of the Group and a brief description of each subsidiary are set out below.



### PBZ Card

PBZ Card is the leading company in business with charge and credit cards of citizens and entities, and includes business with the retailers which includes signing agreements on the cards acceptance with the retailers. The company also offers a full range of travel services. The company's portfolio contains about forty American Express, Visa, Visa Electron, MasterCard and Maestro products of Privredna banka Zagreb, including a rich selection of charge, debit, debit delayed, credit, pre-paid cards and other cards, intended for natural and legal persons. The success of PBZ Card is based on a large knowledge and experience built up over almost forty-five years of American Express presence on our market leading position brands American Express on the charge and revolving credit cards market in Croatia, on the values of the brands Visa and MasterCard and a solid position built by Privredna banka Zagreb as the leading bank in introducing new technologies and products in cards business.

Late last year, taking into account the number of cards, PBZ Group held 26.6 percent of the Croatian active cards market, including a leading position in the credit card market with a share of 33 percent. Total turnover generated by the user card products American Express, Visa and MasterCard of PBZ Group in 2016 accounted for 28.2 percent of total turnover of Croatian cardholders market made in the first three quarters of last year. That same year, PBZ Card has maintained its leading position also in regard to the total number of EFT POS devices, on which it holds about 30 percent of the market.



## **Business description of the Group (continued)**

### **PBZ Card (continued)**

The Company has maintained the leading position in the domestic card market and further strengthened the same during 2016, offering its customers and business partners the products and services of superior quality, which products and services have been further improved by a number of new benefits and special actions organized in cooperation with the retailers. Among the projects to improve the existing and introduce new services and products, it is to emphasize the new Croatia Airlines American Express charge card, which was presented to the market in May last year. This card combines the best offer of Croatia Airlines and card brand American Express, by offering to collect award miles in the most favourable ratio on the market, the best choice for users who travel a lot and use a number of financial benefits of American Express charge card. With new American Express product, last year was also marked by further improving innovative PBZ Wave2Pay - services contactless payment via mobile phone, which uses the latest technology of contactless mobile payment at home and abroad, based on the Host Card Emulation (HCE) technology for NFC (Near-Field Communication) mobile payment at POS devices of PBZ Group. PBZ Group was the first on the Croatian market introducing this technology for payment in 2015 when it offered this service to the users of American Express and Visa Inspire card.

The enhancement of these services during 2016 included the increase in the number of its users, planned marketing activities and improved user awareness about the benefits and importance of contactless, mobile payments including a simpler, faster and safer payment. Also during the same year, in cooperation with business partners, it has continuously increased a number of points of sale that allow contactless payments. At the end of the year, the contactless payment services were available at approximately 22,500 POS terminals, or approximately 17,500 retail points of sale in Croatia, which represents 72 percent of the POS network of PBZ Group, as the largest network of POS terminals in the country.

Last year was marked by the migration project from the existing CMS system (a system for back office support to the credit card transactions) to a new EXACT platform, whose goal is to standardize IT resources, unification of the existing infrastructure, technological improvement, standardization portfolio of card products and functionality, and the exercise of certain savings.

In 2016, PBZ Card enabled also the use of Dynamic Currency Conversion (DCC) services through a network of POS terminals. DCC service offers choice of payment currencies for Visa or MasterCard cards issued outside Croatia in their domestic currency, which has improved the quality of the use of cards at retail points of sale for card users issued abroad.

In 2016, the production included the first terminals through which the cardholders are allowed to independently pay for goods and services cards without control and the presence of sellers, so-called unattended terminals. These terminals enable contact and contactless payment cards with the highest safety standards, and the first such devices were installed to pay the self-service kiosks, parking payment, ticketing for public transport, payment of fuel at gas stations and the like in different parts of Croatia.

Among the new services for points of sale, it is to emphasize WSPayAPP, presented in partnership with Web Studio, which allows private owners online booking payment or advance booking in real time. In addition to charging a provision, WSPayAPP can be used for payment of other services provided by the lessor, while offering easy deployment and ensuring a high level of protection.

The year 2016 was also marked by further adapting to regulatory changes related to the entry into force of the Regulation of the European Parliament and the Council on the inter-bank charges for payment transactions under the card.

Also, during the year the Bank implemented a range of activities to strengthen the Company's reputation as a socially responsible company. In addition to the many sponsorship projects, which support important sport, artistic, cultural and other events in the country, the Group has continued on intensive work and promotion of the humanitarian project of PBZ and PBZ Card "Do Good Every Day" and American Express Heart card, which is supported by two important projects for the benefit of children and young people in Croatia, "Monitoring Children with Neurological Risks" of the Ministry of Health and "For a Better Life for Children in Social Welfare" of the Ministry of demography, family, youth and social policy, donating for each transaction made by this card one Croatian Kuna for these two projects, in 50:50 ratio. This long-term and continuous project of helping the community, which we launched in 2016, has achieved outstanding results. Thus, since 2008, when the project started, to the end of last year, we have collected a total of about 8.5 million Croatian Kuna, including more than 2 Croatian Kuna collected only during 2016. By the end of the last year a total of 27 grants have been realized, including 21 donations to the hospitals across Croatia, for the purchase of medical devices and six grants to social welfare institutions for the purchase of necessary equipment. During 2016, as part of this project five significant new grants have been realized, namely: grants to General Hospital Varaždin, Centre for Education Lug, County General Hospital Požega, Rehabilitation Centre Sv. Filip i Jakov and Children's Hospital Zagreb.

## **Business description of the Group (continued)**

### **PBZ Stambena Štedionica**

PBZ Stambena Štedionica is a member of the PBZ Group and in the 100% ownership of Privredna banka Zagreb. PBZ Stambena Štedionica was founded in 2003 and is doing its business according to the Law on housing savings and government incentives to housing savings. Housing savings include organized collection of cash deposits from natural entities aimed at meeting the housing needs of depositors by means of loan approval for house building purposes in the area of the Republic of Croatia with financial support of the Government. Depositors, besides the interest received on their deposits from Štedionica, are also entitled to government incentives, which are related to the amount of deposits made on their housing savings accounts up to a limited amount. The government incentives are determined by the special decision taken by the Government each year.

PBZ Stambena Štedionica offers its clients four types of savings: Prima, Basic, Golden and Golden Children's Savings. Prima savings are aimed at clients whose goal is to make use of a housing loan as soon as possible. The Basic savings are aimed at clients who want to dispose of a larger amount of deposits for investments through a longer loan repayment period. The Golden Savings are aimed at clients whose first interest is in saving money. In order to promote the savings products with young clients PBZ Stambena Štedionica offers the Golden Children's Savings intended for children under 13 years. Depending on their needs during the saving period, depositors can change the savings type, as well as gain the right to a housing loan by means of interfinancing programme even before the savings period has expired.

Housing savings contracts can be made in all branches of Privredna banka Zagreb, where clients can obtain all the necessary information on savings accounts and their existing housing savings accounts, make deposits into their savings accounts as well as the payment for their housing loans.

Currently PBZ Stambena Štedionica has over 100,000 active housing savings accounts and deposits amounting to HRK 1.45 billion.

### **PBZ Leasing**

PBZ Leasing is wholly owned by Privredna banka Zagreb dd. Company was founded in 1991 under the name of "PBZ Stan". In the beginning it dealt with property appraisals and restructuring of the public housing fund. From 1995 until 2004, the company commenced granting car purchase loans by placing funds of Privredna banka Zagreb dd.

From 2004, leasing has become core business activity of the company. Through finance and operating leases, the Company engaged in financing of real estates, personal and commercial vehicles, vessels, machinery and equipment. In the last year the Company made new leasing placement in amount of HRK 284 million.

By the end of 2016, PBZ Leasing made over 4.9 thousand active lease arrangements with customers, which in financial terms reached HRK 960 million.

### **PBZ Nekretnine**

PBZ Nekretnine is a wholly owned subsidiary of Privredna banka Zagreb dd which engages in property transaction services, real estate valuation, financial and technical supervision over the construction of real estate. Privredna banka Zagreb dd established PBZ Nekretnine with the goal of providing its clients with a complete range of services relating to property and investment in business projects. PBZ Nekretnine offers apartments, houses, business premises, construction sites and other properties for sale.

The activities of PBZ Nekretnine involve property transactions services (mediation in the sale, lease, property renting), appraisal of property value, construction, planning, construction supervision, construction evaluation, preparation of feasibility studies for investments, as well as legal supervision of works.

PBZ Nekretnine has a professional team capable of answering all its clients' complex requests. The company provides all kinds of services related to the activities mentioned, no matter how specific and complicated the clients' demands are. PBZ Nekretnine employs highly trained employees, (civil engineers, architects, economists, lawyer), five of which are court experts in the field of construction.

The company has been operating successfully within the Group since it was founded at the beginning of 1999. For the needs of its clients, PBZ Nekretnine has developed a network of associates and at the moment collaborates with over 60 external associates.

## **Business description of the Group (continued)**

### **Intesa Sanpaolo banka Bosna i Hercegovina**

Intesa Sanpaolo Banka dd Bosna i Hercegovina was established in Sarajevo on 2000 as UPI bank dd Sarajevo. In 2006 the main shareholder became Intesa Sanpaolo Holding S.A Luxembourg, with 94.92 percent of ownership. In July 2007, UPI banka finished merger process with LT Gospodarska banka dd Sarajevo. In 2008 the Bank change its name in Intesa Sanpaolo Banka dd Bosna i Hercegovina.

Part of Intesa Sanpaolo Group form Italy, the Bank's majority shareholding was purchased in July 2015 by former sister company Privredna Banka Zagreb dd, within the framework of an equity investments portfolio reorganization undertaken by the parent group.

As of September 2016, Intesa Sanpaolo Banka dd BiH is the 5th bank in Bosnia and Herzegovina by Total Assets, present in the country with 43 agencies in the Federation of BiH and 5 agencies in Republika Srpska. Its business operations are mainly concentrated (96 percent of Total Assets) in Federation of BiH, where the Bank ranks 3rd in total assets and total loans, with respective market shares of 10.0 percent in Total Assets and 10.3 percent in loans.

ISP Banka BiH performs general banking business with Retail and Corporate clients offering all ranges of products and commercial services commonly traded in the industry at BiH level.

The Bank's maintains its commercial presence on the territory BiH through its agencies and ATM network and further strengthens its cooperation with merchants and clients with the expansion of POS network. Support to private individuals and legal entities is shown by the development of product portfolio but most of all through available credit to the economy represented by almost HRK 5.3 billion gross disbursement of loans during 2016.

### **PBZ Croatia osiguranje**

PBZ Croatia osiguranje is a joint stock company for compulsory pension fund management. The company was incorporated on 26 July 2001 in accordance with changes in Croatian pension legislation and it is a mutual project of both Privredna banka Zagreb dd and Croatia osiguranje dd with ownership in the company of 50 percent belonging to each shareholder.

The principal activities of PBZ Croatia osiguranje include establishing and management of the compulsory pension funds category A, B and C. Following the initial stages of gathering members, PBZ Croatia osiguranje fund category B became one of the three largest compulsory funds in the country. The company's pension funds continued to operate successfully during 2016.

At this point, pension funds under management have nearly 326 thousand members and net assets in personal accounts exceeding HRK 13.8 billion, which represents a sound base for the long-term stable and profitable operation of the company.

### **Intesa Sanpaolo Card**

In December 2016 PBZ sold its 31.2% share in Intesa Sanpaolo Card doo to the company which is owned by Mercury UK Holdco Limited. For details on the transaction please refer to note 23 Investment in subsidiaries and associates.

## The statement on the implementation of corporate governance code

As a member of Intesa Sanpaolo group, Privredna Banka Zagreb adheres to the objectives and guidelines of the Corporate Governance Code and the principles contained therein in accordance with regulations and directives of Republic of Croatia, Croatian National Bank and national best practices. The aim of such corporate governance is to ensure effective and transparent distribution of the roles and responsibilities of its corporate Bodies, proper balance of strategic supervision, management and control functions with emphasis on risk management, protection of assets of the Bank and its reputation.

### Corporate governance structure

In accordance with the Companies Act, the Credit Institutions Act, and the Bank's Articles of Association, the bodies of the Bank are the General Meeting, the Supervisory Board, and the Management Board. The mentioned acts regulate also their duties and responsibilities.

#### General Meeting of the Bank

The General Meeting decides on issues stipulated by law and by the Articles of Association and, among other, it adopts the Articles of Association, decides on the allocation of profits, decides on an increase and a reduction of the share capital, appoints and relieves of duty members of the Supervisory Board, grants the approval of action to members of the Management Board and of the Supervisory Board of the Bank, appoints the external auditor of the Bank, and performs also other tasks in compliance with the law and the Bank's Articles of Association.

In 2016 a regular Annual General Meeting was held on 25 March 2016, while an Extraordinary General Meeting was held on 19 December 2016.

#### Supervisory Board

The Supervisory Board of the Bank supervises the conduct of business affairs in the Bank. With this end in view, it goes through and examines the Bank's business books and documentation. The Supervisory Board submits to the General Meeting of the Bank a written report on the supervision exercised with respect to the conduct of business affairs in the Bank. The Supervisory Board consists of seven members. As a rule, regular Supervisory Board meetings are called quarterly. The Supervisory Board may decide on important and urgent matters in meetings held by letter. The members of the Supervisory Board of the Bank are elected for a three-year term of office.

Members of the Supervisory Board are the following:

**Giovanni Gilli**, President of the Supervisory Board, Intesa Sanpaolo – term of office from 31 March 2014

**Draginja Đurić**, Deputy President of the Supervisory Board, Banka Intesa ad Beograd – term of office from 31 March 2014

**Paolo Sarcinelli**, Member of the Supervisory Board, Intesa Sanpaolo – new term of office from 30 March 2016

**Christophe Velle**, Member of the Supervisory Board, Intesa Sanpaolo – new term of office from 17 October 2016

**Fabrizio Centrone**, Member of the Supervisory Board, Intesa Sanpaolo – term of office from 3 December 2015

**Branko Jeren**, Member of the Supervisory Board, independent – new term of office from 21 April 2016

Membership that ended in 2016:

**Antonio Nucci**, Member of the Supervisory Board – until 17 October 2016 (resignation).

#### Audit Committee

Pursuant to the Articles of Association of Privredna banka Zagreb d.d., the Supervisory Board established the Audit Committee at its 15<sup>th</sup> meeting held at 10 December 2002. The work of the Audit Committee is governed by the Audit Committee Charter.

The Audit Committee, appointed in accordance with the law and the parent bank's rules, consisted of five members during the previous year, two of whom were also members of the Supervisory Board of the Bank. During 2016 five meetings of the Audit Committee were held, discussing the issues within the competence of the Supervisory Board. The Audit Committee helped the Supervisory Board in carrying out its duties related to the supervision of the financial reporting process, the audit process (including the recommendation of the General Meeting for the election of the external auditor), as well as compliance with laws, regulations, rules and the code of ethics.

## The statement on the implementation of corporate governance code (continued)

### Supervisory Board (continued)

#### *Audit Committee (continued)*

The Supervisory Board, with the help of the Audit Committee, monitored the adequacy of the internal control system, which is achieved through three independent control functions (internal audit, risk control, compliance), and in order to establish such a system of internal controls that will enable early detection and monitoring of all risks to which the Bank is exposed in its operations.

In 2016 the Audit Committee was composed of:

**Mauro Zanni**, President of the Audit Committee – new term of office from 26 March 2016

**Christophe Velle**, Member of the Audit Committee – new term of office from 17 October 2016

**Antonio Furesi**, Member of the Audit Committee – term of office from 26 March 2016

**Fabrizio Centrone**, Member of the Audit Committee – term of office from 3 December 2015

**Marco Velle**, Member of the Audit Committee – new term of office from 26 March 2016

Memberships that ended in 2016:

**Guido Gioncada**, Member of the Audit Committee – until 25 March 2016.

### Technical committees of the Supervisory Board

In 2014, in accordance with the provisions of the new Credit Institutions Act, as a significant credit institution the Bank established three technical committees of the Supervisory Board: Remuneration Committee, Nomination Committee, and Risk Committee, which are responsible for the Bank and its subsidiaries. Each committee has three members who are appointed from among the members of the Supervisory Board, of whom one is the committee president. All members of the Supervisory Board appointed to these committees have appropriate knowledge, skills, and expertise that Croatian regulations require for membership in committees, especially for membership in the Risk Committee. In 2016 all the three committees held meetings at which they discussed issues within their competence in accordance with the Credit Institutions Act, the Charter of the Committees of the Supervisory Board of the Bank, and relevant decisions of the Croatian National Bank.

#### *Remuneration Committee*

**Fabrizio Centrone**, President – term of office from 3 December 2015

**Giovanni Gilli**, Member – term of office from 30 June 2014

Memberships that ended:

**Antonio Nucci**, Member – term of office to 17 October 2016

#### *Nomination Committee*

**Giovanni Gilli**, President – term of office from 30 June 2014

**Draginja Đurić**, Member – term of office from 30 June 2014

**Branko Jeren**, Member – new term of office from 21 April 2016

#### *Risk Committee*

**Paolo Sarcinelli**, President – new term of office from 30 June 2016

**Christophe Velle**, Member – new term of office from 17 October 2016

**Fabrizio Centrone**, Member – term of office from 3 December 2015

## The statement on the implementation of corporate governance code (continued)

### Management Board of the Bank

The Management Board conducts business operations of the Bank. The Board consists of seven members who are appointed for a three-year term of office and entrusted with a specific area of responsibility. The Management Board regularly meets fortnightly to reach management decisions.

Members of the Management Board are the following:

**Božo Prka**, President of the Management Board, manages the activities of the Management Board and coordinates all business functions within the Bank and the PBZ Group, and he is also responsible for: Control and Staff functions: Internal Audit, Compliance and Anti-Money Laundering, HR and Organization, Legal Affairs, PR and Marketing Communication, General Secretariat, Customer Satisfaction, a new term of office from 10 February 2015.

**Gabriele Pace**, Deputy President of the Management Board, is responsible for Control and Staff functions: Security and Business Continuity Management, Project Management in terms of strategic projects; area under the authority of the Chief Financial Officer: Accounting, Planning and Control, Treasury and ALM, Administrative and Financial Governance, Procurement, Research, Data Management; coordination of the Risk Management and Control Division save for the Risk Management Department and coordination of the COO Area save for the Treasury Back Office, a new term of office from 19 July 2016.

**Darko Drozdek**, Member of the Management Board responsible for the Small Business and SME Division, a new term of office from 23 October 2016.

**Ivan Gerovac**, Member of the Management Board responsible for the Corporate Division, a new term of office from 10 February 2015.

**Draženko Kopljar**, Member of the Management Board responsible for the operations area (*Chief Operating Officer*): Payments, Back Office, ICT, Real Estate and Logistical Support, a new term of office from 10 February 2015.

**Dinko Lucić**, Member of the Management Board responsible for the Retail Division, a new term of office from 10 February 2015.

**Andrea Pavlović**, Member of the Management Board responsible for the Risk Management and Control Division, a new term of office from 14 May 2016.

### Committees of the Management Board of the Bank:

In performing its duties, the Management Board establishes committees and other bodies to assist it in its work and transfers some of its powers to such committees. The committees to which the Management Board has transferred some of its powers are:

- *Committees in the Credit Area:*
  - *Credit Committee of the Bank* – responsible for decision-making regarding performing counterparties. Its main responsibility consists in adopting credit decisions in line with the issued strategic guidelines and credit policies, while acting within the credit prerogatives of the Bank, and in compliance with the applicable laws of the Republic of Croatia, internal acts of the Bank, and ISP regulations/guidelines.
  - *Credit Risk Governance Committee* - ensures a qualified and coordinated management of credit risk within the exercise of credit prerogatives of the Bank and in compliance with the applicable laws, ISP Group regulations and Parent Company strategic decisions. The Committee's main responsibility is to define and update credit risk strategic guidelines and credit risk management policies based on the constant credit portfolio monitoring.
  - *Problem Assets Committee* – responsible for decision-making regarding risky and non-performing counterparties. Its main responsibility consists in taking the necessary measures in order to prevent and mitigate credit losses connected with risky and deteriorated assets.
- *Asset and Liability Committee (ALCO)* – responsible for planning, supervision, control, and management of key indicators of the Bank's performance, especially in the medium and long term, using instruments of asset/liability management, while at the same time maintaining the value of the Bank's capital.
- *Operational Risk Committee* – responsible for the management of operational risk at PBZ Group level.
- *Governance Board* – puts forward proposals of new projects or proposals to abandon project launch initiatives to the Management Board of the Bank, oversees the implementation of projects from the portfolio and the quality of project management, etc.

## **The statement on the implementation of corporate governance code (continued)**

### **Committees of the Management Board of the Bank (continued):**

- *Real Estate Committee* – responsible for reporting to the Management Board of the Bank on the implementation of the activities of sale of real properties of the Bank and PBZ Group companies, proposing strategies for the sale of real properties of the Bank and PBZ Group companies to the Management Board of the Bank.

### **Key elements of the systems of Internal controls and risk management relating to financial reporting for the Bank and the Group**

The Bank's and the Group's overall control systems include:

- appropriate organizational structure at all levels with segregation of duties and defined authority limits and reporting mechanisms to higher levels of management
- internal controls integrated into the business processes and activities
- accounting and administrative policies and procedures within the scope of the control functions relating to key risks
- dual corporate governance model consisting of a Supervisory Board and a Management Board which has confirmed its concrete operation and consistency with respect to the overall structure, demonstrating its capacity to meet the efficiency and effectiveness needs of governance of a structured and complex Group
- Management Committees with responsibility for core policy areas
- reconciliation of data, consolidated into the Group's financial statements, giving a true and fair view of the financial position of the Bank and Group. A review of the consolidated data is undertaken by Management Board to ensure that the financial statements have been prepared in accordance with required legislation and approved accounting policies
- a Code of Conduct establishing the basic standards of conduct of the members of the Management Board and supervisory bodies, as well as employees and external collaborators who are, within their roles, obliged to perform their duties in the interest of the Bank, the PBZ Group, and their shareholders in a diligent, proper, just and professional manner
- the Code of Ethics between the Bank and all its stakeholders describing the values in which the Bank believes and to which it is committed, outlining the principles of conduct which derive from the context of the relationship with each stakeholder and, consequently, raising the standards that each person within the Credit institution must maintain in order to merit the trust of all the stakeholders.

The basis of the Bank's and the Group's internal control system is internal policy that defines the basic principles, structure and activity holder functions of internal controls, which contributes to proper corporate governance and business transparency promotion ensuring safe and stable operations in accordance with the regulatory requirements. The main features are as follows:

- a comprehensive set of accounting policies and procedures relating to the preparation of the annual financial statements in line with, International Accounting Standards, International Financial Reporting Standards as adopted by the European Union, and the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of Banks, dated 30 May 2008 (Official Gazette 62/08)
- Bank's Internal Audit that oversees the overall operations of the Bank to assess the adequacy of the established system of internal controls
- independent specialized bearers of control functions responsible for the identification, assessment and risk management, including Risk control and Compliance function
- Department for Administrative and Financial Management ensuring the reliability of accounting and financial reporting, controlling and protecting system of internal controls for the preparation of financial information
- a compliance framework incorporating testing of specific controls over key financial processes to confirm that the Bank's key controls are appropriate to mitigate the financial reporting risks
- the Annual Report is subject to detailed review and approval through a structured governance process involving senior and executive finance personnel.

## The statement on the implementation of corporate governance code (continued)

### Risks to which the credit institution is or might be exposed

Bank directs particular attention to identification of risks to which is or might be exposed to. Identification is conducted through risk mapping – technique that is used to determine the existence of risks and assess risk significance for each of the defined units of observation. Units of observation can be:

- in a comprehensive risk identification: all legal entities in the PBZ Group, meaning that the existence and significance of all types of risks is determined for each member of the PBZ Group, or
- in a partial risk identification: individual members of the PBZ Group, organisational units, processes, products, outsourced activities, and the like.

Identification is comprehensively conducted in cooperation with senior management of the PBZ Group and relevant control functions as one of the key phases of ICAAP process. The comprehensive risk identification and mapping is performed on annual basis, the same procedure is used partially in case of outsourcing, introduction of new products or implementation of significant business changes.

The risk mapping is based also on Risk catalogue containing risk definition used by the PBZ Group, which are aligned to risk definitions defined within CNB Decision on risk management and mapped to corresponding ISP risk.

Risk map of PBZ Group:

High significance	Medium significance	Low significance
<ul style="list-style-type: none"> <li>▪ Credit risk</li> <li>▪ Liquidity risk</li> <li>▪ Operational risk</li> <li>▪ Interest rate risk</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strategic risk</li> <li>▪ Reputational risk</li> <li>▪ Outsourcing risk</li> </ul>	<ul style="list-style-type: none"> <li>▪ Market risk</li> <li>▪ Equity risk in banking book</li> <li>▪ Real estate risk</li> <li>▪ Risk of excessive financial leverage</li> </ul>

**Credit risk** - The Bank as a credit institution is primarily oriented to the providing traditional banking services (loans, deposits) which account for a major portion of total assets of the Bank. Capital requirement for credit risk represents a major part of total regulatory capital requirement. Bank puts continuous focus on credit risk management and particular attention is directed to maintenance of sound credit portfolio and appropriate credit risk measurement and monitoring. Therefore, as a key and most significant risk in Bank's portfolio, **credit risk is defined as a risk of high significance.**

**Liquidity risk** – During 2016, Bank continued period of high liquidity and ensured alignment to all internal and external requirements. Nevertheless, the liquidity management process in the Bank is continuously being improved – both in terms of liquidity governance principles and enhancement of technical support/ tools for liquidity measurement. During 2017, Bank will continue to treat liquidity risk as highly important, ensuring continuously sufficient level of liquidity and constantly working on alignment with regulatory requirements and other valid regulations. Moreover, adequate focus will be also directed to structural liquidity, ensuring sufficient equilibrium between long term assets and related required available sources of funding. Taking in consideration all above mentioned, liquidity risk is deemed as **highly significant.**



## The statement on the implementation of corporate governance code (continued)

### Risks to which the credit institution is or might be exposed (continued)

**Operational risk** – the Bank is continuously exposed to operational risk. However, due to the successful implementation of operational risk measurement and management system into business decision-making process and day-to-day management, in 2011 PBZ was allowed to use the most sophisticated approach for the calculation of operational risk capital requirement, i.e. AMA (Advanced Measurement Approach), on the individual level. Methodological changes, introduced during the 2013, including the creation of the specific insurance umbrella policy at the ISP Group level, have enabled significant operational risk capital savings.

Even though the comprehensive and rigorous operational risk management system is in place, due to its (fat tail) nature this risk is considered as **highly significant**.

**Interest rate risk** – Interest sensitive items account for a major portion of total assets and total liabilities making majority of PBZ Group balance sheet subjected to Interest rate risk. Although Bank implemented clear and strict rules for interest rate risk measurement, interest rate risk exposure required additionally careful monitoring and management. Namely, a change in customers risk preferences is recorded as well as taking increased demand for loans with fixed interest rates which impacts interest rate risk exposure of the Bank. The exposure is fully aligned with defined risk appetite, but under more focused attention and monitoring by relevant functions. Therefore, it is important to continue carefully managing interest rate risk and maintain its mark as **highly significant risk**.

**Strategic risk** – With a broader perspective of strategic risk impact on strategic objectives achievement, Bank anticipated requirement for establishment of strategic risk management framework and risk monitoring. Strategic risk management include both internal and external forces that may threaten the achievement of Banks strategic objectives. Therefore, the Bank analyses:

- the overall macroeconomic environment through political, economic, social, technological, legislative and banking sector risks and estimates their potential damage on the PBZ;
- monitors actual financial and business results, as well as the execution of the budgeted figures;
- market conditions, key competitors and the whole banking system performance.

The analysis of strategic risk is an integral part of Banks strategy definition process and general risk management framework. Therefore, strategic risk significance is deemed as medium.

**Reputational risk** – adequate reputational risk management is an important part of a general risk management framework. Bank recognised importance of reputational risk management and established reputational risk management system with clear definition of actions and responsibilities. Apart from definition of key functions of reputational risk management, additional effort is directed into definition of preventive actions for reputational risk control as defined by internal regulations, such as:

- Confidentiality of information (banking secret, business secret, classification of confidential data etc.);
- Clear lines of public communication;
- Codes regarding ethical behaviour of its employees;
- Anti-money laundering and prevention of terrorist financing;
- Exclusion of some activities from financing by the PBZ Group;
- Special scrutiny for financing political parties and politically exposed persons.

All reputational risk related internal regulation is clearly communicated and distributed among all Bank employees. Finally, through hereby explained reputational risk management principles, particular effort is directed to achievement of embedding preventive reputational risk actions into the core functions at all hierarchy levels. Therefore, **reputational risk significance is deemed as medium**.

## The statement on the implementation of corporate governance code (continued)

### Risks to which the credit institution is or might be exposed (continued)

**Outsourcing risk** – The Bank has implemented well defined and prudent rules and procedures in case of initiation of outsourcing activities assuming comprehensive risk analysis and identification, definition of outsourcing activity significance and regular control and monitoring of quality of outsourced service. Nevertheless, due to existence of significant outsourced activities on PBZ Group level, this risk is deemed as of **medium significance**.

**Market risk** - Trading book positions are insignificant. Most significant market risk exposure is currency risk arising from Banks open position management. Nevertheless, Bank has well defined framework for market risk management including definition of roles, responsibilities, measurement methodologies, monitoring and reporting principles and limit structure for market risk exposures. Therefore, **market risk significance is deemed as low**.

**Equity risk in Banking Book** - Bank has negligible amount of equity investments. Therefore, banking book equity risk significance is deemed as **low**.

**Real Estate risk** - Bank does not hold real-estates for speculative purposes, almost all property owned by PBZ is used as own long-term business premises. Therefore, real estate risk significance is deemed as **low**.

**Risk of excessive financial leverage** – leverage ratio is defined as one of Bank’s strategic limits that should be maintained above prescribed minimum. Limit compliance is monitored on quarterly basis. Taking in consideration that bank is well capitalised and that maintaining of adequate ratio of capital and overall assets<sup>1</sup> is of strategic importance of the Bank, significance of this risk is considered as **low**.

---

<sup>1</sup> For calculation of leverage ratio adjusted assets is used in line with defined ISP Group methodology and standards.

## **The statement on the implementation of corporate governance code (continued)**

### **Statement on the implementation of the Code of Corporate Governance of Privredna banka Zagreb dd**

According to the provisions of Article 272.p of the Companies Act and Article 22 of the Accounting Act, the Management Board of Privredna banka Zagreb d.d. declares that the Bank voluntarily applies the Corporate Governance Code that was prepared jointly by the Croatian Financial Services Supervisory Agency and the Zagreb Stock Exchange, on the websites of which it has been published.

The *Annual Questionnaire for the Business Year 2016* (also available on the Bank's website) makes an integral part of this Statement and discloses the status and the practice of corporate governance at the Bank in the light of the recommendations comprised in the Corporate Governance Code, providing explanations for specific departures. Specifically, corporate governance at the Bank does not imply only full satisfaction of regulatory requirements, but also deep-rooted corporate culture and personal integrity of the management and employees.

Rules for appointing and relieving of duty members of the Management Board are comprised in the Bank's Articles of Association. The Management Board of the Bank conducts business affairs of the Bank and manages its assets. While doing so, it is required and authorized to take all actions and make all decisions which it considers necessary for successful conduct of business affairs of the Bank and its operation.

The number of Management Board members is determined by the Supervisory Board. According to its decision, the Management Board is composed of seven members, a number estimated, keeping in mind the functions and the competence of the Management Board, as a good and rational solution ensuring that the Bank's operations are managed in the best interest of shareholders, customers, employees of the Bank, and all stakeholders. The composition of seven members corresponds to the established organisational structure of the Bank and ensures good functioning of all organisational units, synergy, communication, and responsibility from a vertical and a horizontal perspective.

At the proposal of the Nomination Committee, the Supervisory Board nominates candidates for president and members of the Management Board of the Bank, who have to meet the criteria laid down in the act governing banking business and other relevant regulations. Subject to the prior approval of the central bank, the Supervisory Board appoints the president and members of the Management Board to serve a term of office of three years, with the possibility of re-appointment. The number of terms of office of Management Board members is not limited. The Supervisory Board may revoke its decision on the appointment of a member of the Management Board of the Bank or of its president when, in accordance with the law currently in effect, there is an important reason for doing so.

The work and the authority of the general meeting and shareholders' rights are disclosed in the attached Annual Questionnaire and this Annual Report in the section concerning corporate governance.

In order to achieve diversity when selecting Management Board members and to ensure an efficient and prudent management of the Bank as a whole, the Bank adopted and applies the Policy on the Structure of the Management Board and the Supervisory Board of the Bank and the Decision on the distribution of authority among the president and members of the Management Board of the Bank.

In terms of the Management Board of the Bank, the Policy on the Structure of the Management Board and the Supervisory Board of the Bank lays down: (a) the target structure of the Management Board of the Bank with respect to the nature, scope and complexity of the Bank's operations, its risk profile, and business strategy, (b) detailed criteria for the president and members of the Management Board, keeping in mind the need for them to cover a specific area of competence and to have adequate knowledge, skills and experience, and (c) the requirement to ensure the targeted representation of the underrepresented gender in accordance with the decision of the Nomination Committee (at present 1/7 of Management Board members represent the underrepresented gender – women).

Specific criteria were laid down to ensure the diversity of knowledge, experience, skills, and competences of Management Board members so that they could perform their duties efficiently and professionally. Hence, the president and each member of the Management Board must have specific knowledge, skills, and expertise in the areas within their specific competence. Accordingly, Management Board members are selected in accordance with the prescribed criteria for the performance of duties of the president and member of the Management Board, thus ensuring a good and efficient management of the Bank.

The Decision on the distribution of authority among the president and members of the Management Board of the Bank defines the main business areas of the Bank and the PBZ Group and the authority of each Management Board member.

## **The statement on the implementation of corporate governance code (continued)**

### **Statement on the implementation of the Code of Corporate Governance of Privredna banka Zagreb dd (continued)**

According to the suitability assessment conducted in line with the adopted Policy (involving the responsible expert service of the Bank, the Nomination Committee, and the Supervisory Board), all the members of the Management Board of the Bank appointed in 2016 meet all the prescribed criteria from the perspective of the diversity of knowledge, expertise, experience, skills, and competences individually and collectively with other Management Board members.

Candidates for members of the Supervisory Board are nominated by the Nomination Committee. The General Meeting adopts a decision on the election of Supervisory Board members. The decision of the General Meeting of the Bank sets out that the Supervisory Board of the Bank is composed of six members (seven until 17 October 2016, before resignation of one Member of the Supervisory Board), a number estimated, keeping in mind the functions and the competence of the Supervisory Board, as a good solution ensuring high-quality supervision of the management of the Bank's operations which is aimed at protecting the interests of the Bank as a whole. Supervisory Board members elect the president of the Supervisory Board and its deputy.

In order to achieve diversity when selecting Supervisory Board members and to ensure an efficient and prudent management of the supervisory function at the Bank, the Bank adopted and applies the Policy on the Structure of the Management Board and the Supervisory Board of the Bank.

As regards the Supervisory Board of the Bank, the Policy on the Structure of the Management Board and the Supervisory Board of the Bank lays down: (a) the target structure of the Supervisory Board of the Bank with respect to the nature, scope and complexity of the Bank's operations, its risk profile, and business strategy, (b) criteria for supervisory board members according to which each Supervisory Board member must have adequate knowledge, skills, and expertise ensuring that the composition of the supervisory board is such that it ensures that all the relevant competences/fields of operation are represented therein, so that they might perform their function efficiently and professionally, and (c) the requirement to ensure the targeted representation of the underrepresented gender in accordance with the decision of the Nomination Committee (at present 1/6 of Supervisory Board members represent the underrepresented gender – women as of 31 December 2016).

Supervisory Board members are selected in accordance with the prescribed criteria for membership of the Supervisory Board, thus ensuring an optimal functioning of the Supervisory Board and performance of its duties.

According to the suitability assessment conducted in line with the adopted Policy (involving the responsible expert service of the Bank, the Nomination Committee, and the General Meeting of the Bank), all the members of the Supervisory Board of the Bank elected in 2016 meet all the prescribed criteria from the perspective of the diversity of knowledge, experience, skills, and competences individually and collectively with other Supervisory Board members.

Data on the composition and activities of the Management Board and the Supervisory Board of the Bank and their committees are disclosed in the attached Annual Questionnaire and this Annual Report in the section concerning corporate governance.

The Management Board of the Bank is not authorised to issue new shares of the Bank or to acquire treasury shares.

The rules for amending the Bank's Articles of Association are included in the very Articles of Association. A decision to amend the Articles of Association is adopted by the General Meeting of the Bank in line with the law and the Articles of Association, by a vote representing at least three quarters of the share capital represented at the General Meeting when the decision is made. Amendments to the Articles of Association are proposed by the Supervisory Board, the Management Board, and the Bank's shareholders. The Supervisory Board is authorised to amend the Articles of Association solely in the case of editorial amendments or establishment of the final text of the Articles of Association.

In order to protect the interests of all investors, shareholders, customers, employees and others interested parties, high corporate governance standards have been established at the Bank.

## **The statement on the implementation of corporate governance code (continued)**

### **Code of Corporate Governance – Annual questionnaire**

*All the questions contained in this questionnaire relate to the period of one business year to which annual financial statements also relate.*

#### **COMPANY HARMONIZATION TO THE PRINCIPLES OF CORPORATE GOVERNANCE CODE**

- 1. Did the Company accept the application of the Corporate Governance Code or did it accept its own policy of corporate governance?**  
Yes.
- 2. Does the Company have adopted principles of corporate governance within its internal policies?**  
Yes.
- 3. Does the Company announce within its annual financial reports the compliance with the principles of 'comply or explain'?**  
Yes.
- 4. Does the Company take into account the interest of all shareholders in accordance with the principles of Corporate Governance Code while making decisions?**  
Yes.

#### **SHAREHOLDERS AND GENERAL MEETING**

- 5. Is the company in a cross-shareholding relationship with another company or other companies? (If so, explain)**  
No.
- 6. Does each share of the company have one voting right? (If not, explain)**  
Yes.
- 7. Does the company treat all shareholders equally? (If not, explain)**  
Yes.
- 8. Has the procedure for issuing power of attorney for voting at the general assembly been fully simplified and free of any strict formal requirements? (If not, explain)**  
Yes.
- 9. Has the company ensured that the shareholders of the company who, for whatever reason, are not able to vote at the assembly in person, have proxies who are obliged to vote in accordance with instructions received from the shareholders, with no extra costs for those shareholders? (If not, explain)**  
No. There were no such initiatives by the shareholders but the Bank is prepared to provide proxies for the shareholders if such an initiative occurs. Participation of Shareholders at the General Assembly Bank facilitates in other ways – and thus their attendance at Assemblies do not have to pre-announce. Power of attorney that gives shareholders do not need to be notarized.
- 10. Did the management or Management Board of the company, when convening the assembly, set the date for defining the status in the register of shares, which will be relevant for exercising voting rights at the general assembly of the company, by setting that date prior to the day of holding the assembly and not earlier than 6 days prior to the day of holding the assembly? (If not, explain)**  
Yes.

## **The statement on the implementation of corporate governance code (continued)**

### **Code of Corporate Governance – Annual questionnaire (continued)**

- 11. Were the agenda of the assembly, as well as all relevant data and documentation with explanations relating to the agenda, announced on the website of the company and put at the disposal of shareholders on the company's premises as of the date of the first publication of the agenda? (If not, explain)**  
Yes.
- 12. Does the decision on dividend payment or advance dividend payment include information on the date when shareholders acquire the right to dividend payment, and information on the date or period during which the dividend will be paid? (If not, explain)**  
Yes.
- 13. Is the date of dividend payment or advance dividend payment set to be not later than 30 days after the date of decision making? (If not, explain)**  
Yes.
- 14. Were any shareholders favoured while receiving their dividends or advance dividends? (If so, explain)**  
No.
- 15. Are the shareholders allowed to participate and to vote at the general assembly of the company using modern communication technology? (If not, explain)**  
No. There were no such initiatives by the shareholders and it is not envisaged by the Articles of Association.
- 16. Have the conditions been defined for participating at the general assembly by voting through proxy voting (irrespective of whether this is permitted pursuant to the law and articles of association), such as registration for participation in advance, certification of powers of attorney etc.? (If so, explain)**  
No.
- 17. Did the management of the company publish the decisions of the general assembly of the company?**  
Yes.
- 18. Did the management of the company publish the data on legal actions, if any, challenging those decisions? (If not, explain)**  
No. There were no law suits contesting Decisions by the General Meeting.

### **MANAGEMENT AND SUPERVISORY BOARD**

#### ***NAMES OF MANAGEMENT BOARD MEMBERS AND THEIR FUNCTIONS***

Božo Prka, President;

Gabriele Pace, Deputy President;

Ivan Gerovac, Member;

Darko Drozdek, Member;

Dinko Lucić, Member;

Andrea Pavlović, Member;

Draženko Kopljar, Member.

## The statement on the implementation of corporate governance code (continued)

### Code of Corporate Governance – Annual questionnaire (continued)

#### *NAMES OF SUPERVISORY BOARD AND THEIR FUNCTIONS*

Giovani Gilli, President;

Draginja Đurić, Deputy President;

Paolo Sarcinelli, Member;

Christophe Velle, Member;

Fabrizio Centrone, Member;

Branko Jeren, Member;

Antonio Nucci, Member to 17. October 2016.

**19. Did the Supervisory or Management Board adopt a decision on the master plan of its activities, including the list of its regular meetings and data to be made available to Supervisory Board members, regularly and in a timely manner? (If not, explain)**

Yes. The schedule of the Supervisory Board meetings is determined in advance. Reports that are regularly and timely put at the disposal of Supervisory Board members are defined by the individual decisions of the Supervisory Board and by law.

**20. Did the Supervisory or Management Board pass its internal code of conduct? (If not, explain)**

Yes.

**21. Is the Supervisory Board composed of, i.e. are non-executive directors of the Management Board mostly independent members? (If not, explain)**

No. The Supervisory Board have one independent member as required by provisions of Credit Institutions Act. When conducting the supervision, the members who represent the majority of shareholder with knowledge and experience form different areas, with the profession placing above the interests of the shareholders they represent, impart a major contribution to quality management.

**22. Is there a long-term succession plan in the company? (If not, explain)**

Yes.

**23. Is the remuneration received by the members of the Supervisory or Management Board entirely or partly determined according to their contribution to the company's business performance? (If not, explain)**

Yes.

**24. Is the remuneration to the members of the Supervisory or Management Board determined by a decision of the general assembly or in the articles of association of the company? (If not, explain)**

Yes.

## **The statement on the implementation of corporate governance code (continued)**

### **Code of Corporate Governance – Annual questionnaire (continued)**

- 25. Have detailed records on all remunerations and other earnings of each member of the Supervisory or Management Board received from the company or from other persons related to the company, including the structure of such remuneration, been made public? (If not, explain)**

Yes. Data on all remunerations to the Supervisory Board members are published in the decisions of the General Meeting. Total remunerations paid to the members of the Management Board, key management employees and Bank's related persons are disclosed in the Annual Report which is prepared in accordance with the International Financial Reporting Standards as adopted by EU. The Annual report is available on the Bank's website.

- 26. Does every member of the Supervisory or Management Board inform the company of each change relating to their acquisition or disposal of shares of the company, or to the possibility to exercise voting rights arising from the company's shares, not later than five trading days, after such a change occurs (If not, explain)**

Yes. During 2016, there was no change (increase/decrease) the number of shares held by Management and Supervisory Board members.

- 27. Were all transactions involving members of the Supervisory or Management Board or persons related to them and the company and persons related to it clearly presented in reports of the company? (If not, explain)**

Yes. The Bank has not performed specific commercial transactions with the Supervisory or Management Board members. The Bank has commercial (deposits-loans) transactions with the members of Intesa Sanpaolo Group which has a representative on the Supervisory Board. All transactions are market-based in terms and conditions. In the Annual Report, the Bank discloses a separate note on related party transactions which is prepared in accordance with the International Financial Reporting Standards as adopted by EU. The Annual Report is available on the Bank's website.

- 28. Are there any contracts or agreements between members of the Supervisory or Management Board and the company?**

Yes, but only within the ordinary scope of business (e.g. employment contracts, deposit contracts, etc.).

- 29. Did they obtain prior approval of the Supervisory or Management Board? (If not, explain)**

Yes, to the extent where such prior approval was needed.

- 30. Are important elements of all such contracts or agreements included in the annual report? (If not, explain)**

Yes, to the extent required.

- 31. Did the Supervisory or Management Board establish the appointment committee?**

Yes.

- 32. Did the Supervisory or Management Board establish the remuneration committee?**

Yes.

- 33. Did the Supervisory or Management Board establish the audit committee?**

Yes.



## The statement on the implementation of corporate governance code (continued)

### Code of Corporate Governance – Annual questionnaire (continued)

34. **Was the majority of the committee members selected from the group of independent members of the Supervisory Board? (If not, explain)**  
No. In accordance to Credit Institutions Act the Supervisory Board have one independent member which is member of one Supervisory Board Committee.
35. **Did the committee monitor the integrity of the financial information of the company, especially the correctness and consistency of the accounting methods used by the company and the group it belongs to, including the criteria for the consolidation of financial reports of the companies belonging to the group? (If not, explain)**  
Yes.
36. **Did the committee assess the quality of the internal control and risk management system, with the aim of adequately identifying and publishing the main risks the company is exposed to (including the risks related to the compliance with regulations), as well as managing those risks in an adequate manner? (If not, explain)**  
Yes.
37. **Has the committee been working on ensuring the efficiency of the internal audit system, especially by preparing recommendations for the selection, appointment, reappointment and dismissal of the head of internal audit department, and with regard to funds at his/her disposal, and the evaluation of the actions taken by the management after findings and recommendations of the internal audit? (If not, explain)**  
Yes.
38. **If there is no internal audit system in the company, did the committee consider the need to establish it? (If not, explain)**  
No, since internal audit function is established.
39. **Did the committee monitor the independence and impartiality of the external auditor, especially with regard to the rotation of authorised auditors within the audit company and the fees the company is paying for services provided by external auditors? (If not, explain)**  
Yes.
40. **Did the committee monitor nature and quantity of services other than audit, received by the company from the audit company or from persons related to it? (If not, explain)**  
No. Limitations on providing services other than audit are regulated by law.
41. **Did the committee prepare rules defining which services may not be provided to the company by the external audit company and persons related to it, which services may be provided only with, and which without prior consent of the committee? (If not, explain)**  
Yes. Limitations on providing services other than audit are regulated by law.
42. **Did the committee analyse the efficiency of the external audit and actions taken by the senior management with regard to recommendations made by the external auditor? (If not, explain)**  
Yes.
43. **Did the audit committee ensure the submission of high quality information by dependent and associated companies, as well as by third parties (such as expert advisors)? (If not, explain)**  
Yes.

## **The statement on the implementation of corporate governance code (continued)**

### **Code of Corporate Governance – Annual questionnaire (continued)**

- 44. Was the documentation relevant for the work of the Supervisory Board submitted to all members on time? (If not, explain)**  
Yes.
- 45. Do Supervisory Board or Management Board meeting minutes contain all adopted decisions, accompanied by data on voting results? (If not, explain)**  
Yes.
- 46. Has the Supervisory or Management Board evaluated their work in the preceding period, including evaluation of the contribution and competence of individual members, as well as of joint activities of the Board, evaluation of the work of the committees established, and evaluation of the company's objectives reached in comparison with the objectives set?**  
Yes. For the most part into the report of the Supervisory Board for the past year.
- 47. Did the company publish a statement on the remuneration policy for the management, Management Board and the Supervisory Board as part of the annual report? (If not, explain)**  
No. There is no such legal obligation. Remuneration policy statement is disclosed separately from the annual report.
- 48. Is the statement on the remuneration policy for the management or executive directors permanently available on the website of the company? (If not, explain)**  
Yes.
- 49. Are detailed data on all earnings and remunerations received by each member of the management or each executive director from the company published in the annual report of the company? (If not, explain)**  
Yes. Total remunerations paid to member of the Management Board, key management employees and Bank's related persons are disclosed in the Annual Report, which is prepared in accordance with the International Financial Reporting Standards as adopted by EU. The Annual report is available on the Bank's website.
- 50. Are all forms of remuneration to the members of the management, Management Board and Supervisory Board, including options and other benefits of the management, made public, broken down by items and persons, in the annual report of the company? (If not, explain)**  
Yes. Total remunerations paid to the members of the Management Board and key management are disclosed within Annual report in aggregated amounts. Remunerations to members of the Supervisory Board are disclosed with in General Assembly decisions.
- 51. Are all transactions involving members of the management or executive directors, and persons related to them, and the company and persons related to it, clearly presented in reports of the company? (If not, explain)**  
Yes, in accordance with valid accounting standards.
- 52. Does the report to be submitted by the Supervisory or Management Board to the general assembly include, apart from minimum information defined by law, the evaluation of total business performance of the company, of activities of the management of the company, and a special comment on its cooperation with the management? (If not, explain)**  
Yes.

## **The statement on the implementation of corporate governance code (continued)**

### **Code of Corporate Governance – Annual questionnaire (continued)**

#### **AUDIT AND MECHANISMS OF INTERNAL AUDIT**

- 53. Does the company have an external auditor?**  
Yes.
- 54. Is the external auditor of the company related with the company in terms of ownership or interests?**  
No.
- 55. Is the external auditor of the company providing to the company, him/herself or through related persons, other services?**  
No.
- 56. Has the company published the amount of charges paid to the independent external auditors for the audit carried out and for other services provided? (If not, explain)**  
No. The amount of charges paid to the independent external auditor is considered as business secrecy.
- 57. Does the company have internal auditors and an internal audit system established? (If not, explain)**  
Yes.

#### **TRANSPARANCY AND THE PUBLIC OF ORGANIZATION OF BUSINESS**

- 58. Are the semi-annual, annual and quarterly reports available to the shareholders?**  
Yes.
- 59. Did the company prepare the calendar of important events?**  
Yes.
- 60. Did the company establish mechanisms to ensure that persons who have access to or possess inside information understand the nature and importance of such information and limitations related to it?**  
Yes.
- 61. Did the company establish mechanisms to ensure supervision of the flow of inside information and possible abuse thereof?**  
Yes.
- 62. Has anyone suffered negative consequences for pointing out to the competent authorities or bodies in the company or outside, shortcomings in the application of rules or ethical norms within the company? (If so, explain)**  
No.
- 63. Did the management of the company hold meetings with interested investors, in the last year?**  
No. The Bank has a stable shareholders structure and as a result, there was no need for additional meetings with the shareholders (investors) except the General Meeting.
- 64. Do all the members of the management, Management Board and Supervisory Board agree that the answers provided in this questionnaire are, to the best of their knowledge, entirely truthful?**  
Yes.

## Responsibilities of the Management and Supervisory Boards for the preparation and approval of the separate and consolidated financial statements and other information

The Management Board of the Bank is required to prepare separate financial statements of Privredna banka Zagreb dd ("the Bank") and consolidated financial statements of Privredna banka Zagreb Group ("the Group") for each financial year which give a true and fair view of the financial position of the Bank and Group and of the results of their operations and cash flows, in accordance with International Financial Reporting Standards as adopted by European Union, and is responsible for maintaining proper accounting records to enable the preparation of such separate and consolidated financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is also responsible for the preparation and content of the Management Board report for the Bank and the Management Board report for the Group and the Statement on the implementation of corporate governance code, as required by the Croatian Accounting Act, and the rest of other information (together "other information").

The Management Board is also responsible for the preparation and fair presentation of the supplementary information prepared in accordance with the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of Banks, dated 30 May 2008 (Official Gazette 62/08).

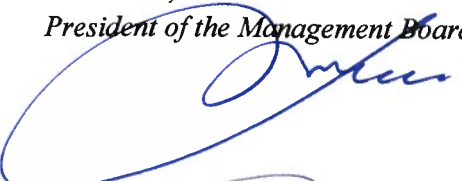
The Management Board is responsible for the submission to the Supervisory Board of its Annual report which includes the separate and consolidated financial statements and other information for acceptance. If the Supervisory Board approves the Annual report it is deemed confirmed by the Management Board and Supervisory Board.


The separate and consolidated financial statements on pages 59 to 198 and other information on pages 3 to 51 and 199 to 226 have been approved by the Management Board on 14 February 2017 as confirmed by the signatures below.


For and on behalf of Privredna banka Zagreb dd

Božo Prka, M.S.  
*President of the Management Board*

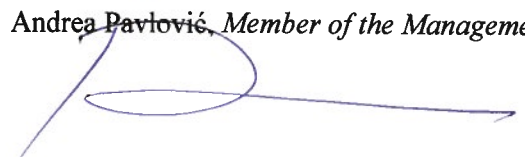
  
Gabriele Pace  
*Vice President of the Management Board*

  
Darko Drozdek, *Member of the Management Board*

  
Ivan Gerovac, *Member of the Management Board*

  
Draženko Kopljar, *Member of the Management Board*

  
Dinko Lucić, *Member of the Management Board*

  
Andrea Pavlović, *Member of the Management Board*



# Independent Auditors' report to the shareholders of Privredna banka Zagreb dd

## Report on the Audit of the Separate and Consolidated Financial Statements

### *Opinion*

We have audited the separate financial statements of Privredna banka Zagreb dd ("the Bank") and consolidated financial statements of Privredna banka Zagreb Group ("the Group"), which comprise, respectively, the separate and consolidated statement of financial position as at 31 December 2016, the separate and consolidated income statement, separate and consolidated statement of comprehensive income, separate and consolidated statement of cash flows and separate and consolidated statement of changes in equity for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank and the Group as at 31 December 2016 and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ("EU IFRS").

### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Separate and Consolidated Financial Statements* section of our report. We are independent of the Bank and the Group in accordance with the ethical requirements that are relevant to our audit of the separate and consolidated financial statements in Croatia and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Key Audit Matters*

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

#### **Impairment of loans and advances to customers**

As at 31 December 2016, in the consolidated financial statements gross loans and advances to customers amount to HRK 56,572 million, impairment allowance amounts to HRK 3,434 million and impairment loss recognised in the income statement amounts to HRK 436 million (31 December 2015: gross loans and advances: HRK 55,672 million, impairment allowance: HRK 4,103 million, impairment loss recognised in the income statement: HRK 148 million).

As at 31 December 2016, in the separate financial statements gross loans and advances to customers amount to HRK 48,764 million, impairment allowance amounts to HRK 2,877 million and impairment loss recognised in the income statement amounts to HRK 389 million (31 December 2015: gross loans and advances: HRK 48,274 million, impairment allowance: HRK 3,534 million, impairment loss recognised in the income statement: HRK 149 million).

Refer to pages 78 and 79 (Accounting policies), page 90 (Accounting estimates and judgements in applying accounting policies), page 109 (note 20 Loans and advances to customers), and pages 160 to 168 and 171 (credit risk section of the note 45 Financial risk management policies).



## Independent Auditors' report to the shareholders of Privredna banka Zagreb dd (continued)

### Report on the Audit of the Separate and Consolidated Financial Statements (continued)

Key audit matter	Our response
<p>Impairment allowances represent management's best estimate of the losses incurred within the loan portfolios at the reporting date. We focused on this area as the determination of impairment provisions requires a significant amount of judgment from the management over both the timing of recognition and the amounts of any such impairment.</p> <p>Impairment allowances for performing retail and corporate exposures, non-performing retail exposures and non-performing corporate exposures below HRK 3.8 million individually (together "collective impairment allowance") are determined by modelling techniques. Historical experience and management judgment are incorporated into the model assumptions. The Bank is continuously recalibrating the model parameters which also requires our increased attention in the audit.</p> <p>For non-performing corporate exposures exceeding HRK 3.8 million individually, the impairment assessment is based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Related impairment allowances are determined on an individual basis by means of a discounted cash flows analysis.</p>	<p>Our audit procedures in this area included, among others:</p> <ul style="list-style-type: none"> <li>● Assessing and testing of controls over the approval, recording and monitoring of loans and advances, including, but not limited to, those relating to the identification of loss events, appropriateness of classification between performing and non-performing loans and advances, calculation of days past due, calculation of the impairment allowances and controls over the collateral valuation estimates.</li> <li>● For impairment allowances that are calculated individually: <ul style="list-style-type: none"> <li>– Selecting a sample of individual loans, with focus on those with the greatest potential impact on the financial statements due to their magnitude and risk characteristics, as well as lower value items which we independently assessed as high-risk, such as watchlist, restructured or rescheduled exposures, loans to clients operating in higher risk industries, non-performing exposures with low provision coverage and unsecured exposures.</li> <li>– For the sample selected, critically assessing, by reference to the underlying documentation (loan files) and through discussion with the loan officers and credit risk management personnel the existence of any impairment triggers as at 31 December 2016.</li> <li>– For those loans where impairment trigger was identified, challenging key assumptions applied in the Bank's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values, where relevant, with the assistance of our property valuation specialists.</li> </ul> </li> <li>● For collective impairment allowance: <ul style="list-style-type: none"> <li>– Testing the underlying impairment models, including model approval, backtesting and validation processes and, using our internal IT specialists, testing the completeness and accuracy of underlying data for the calculation and validation of the key parameters such as the probability of default and loss given default.</li> <li>– Critically assessing the rationale for the changes made to the model parameters in 2016, by reference to our understanding of the business, current economic trends and market practices.</li> </ul> </li> <li>● Critically assessing the overall reasonableness of the impairment allowances, including both the share of the gross non-performing exposure in total gross exposure and the non-performing loans provision coverage, by benchmarking them against the publicly available industry data.</li> </ul>



## **Independent Auditors' report to the shareholders of Privredna banka Zagreb dd (continued)**

### **Report on the Audit of the Separate and Consolidated Financial Statements (continued)**

#### *Other Information*

Management is responsible for the other information. The other information comprises the information included in the Annual report but does not include the separate and consolidated financial statements and our auditor's report thereon.

Our opinion on the separate and 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 separate and consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate and 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 respect.

With respect to the Management Board report for the Bank and Management Board report for the Group ("Management reports") and the Statement of implementation of corporate governance code, we have also performed the procedures required by Article 20 of the Croatian Accounting Act. These procedures include considering whether the Management Reports and the Statement of implementation of corporate governance code include the disclosures required by Articles 21, 22 and 24 of the Croatian Accounting Act and obtaining evidence regarding specified information provided in the Management Reports and the Statement of implementation of corporate governance.

Based solely on the work required to be undertaken in the course of the audit of the separate and consolidated financial statements and the procedures above, in our opinion:

- The information given in the Management Reports and the relevant sections of the Statement of implementation of corporate governance code which contain the information referred to in Article 22, paragraph 1, items 3 and 4, and Article 24, paragraph 2 of the Croatian Accounting Act (furthermore, "extracts of the Statement of implementation of corporate governance code") for the financial year for which the separate and consolidated financial statements are prepared, is consistent, in all material respect, with the separate and consolidated financial statements.
- The Management Reports and the extracts of the Statement of implementation of corporate governance have been prepared in all material respect in accordance with the applicable legal requirements of the Croatian Accounting Act.
- The Statement on implementation of corporate governance code includes the information required by Article 22 paragraph 1, items 2, 5, 6 and 7 of the Croatian Accounting Act.
- In addition, in light of the knowledge and understanding of the Bank and the Group and the environment in which they operate, obtained in the course of our audit, we are required to report if we have identified material misstatements in the Management Reports and the Statement of implementation of corporate governance code and other information that we obtained prior to the date of this auditors' report. We have nothing to report in this respect.



## **Independent Auditors' report to the shareholders of Privredna banka Zagreb dd (continued)**

### **Report on the Audit of the Separate and Consolidated Financial Statements (continued)**

#### *Responsibilities of Management and Those Charged with Governance for the Separate and Consolidated Financial Statements*

Management is responsible for the preparation of the separate and consolidated financial statements that give a true and fair view in accordance with EU IFRS and for such internal control as management determines is necessary to enable the preparation of the separate and consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate and consolidated financial statements, management is responsible for assessing the Bank'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 management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

#### *Auditors' Responsibilities for the Audit of the Separate and Consolidated Financial Statements*

Our objectives are to obtain reasonable assurance about whether the separate and consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 International Standards on Auditing 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 separate and consolidated financial statements.

As part of an audit in accordance with International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the separate and 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.





## **Independent Auditors' report to the shareholders of Privredna banka Zagreb dd (continued)**

### **Report on the Audit of the Separate and Consolidated Financial Statements (continued)**

#### *Auditors' Responsibilities for the Audit of the Separate and Consolidated Financial Statements (continued)*

- Conclude on the appropriateness of management'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 Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the separate and 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 auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate and consolidated financial statements, including the disclosures, and whether the separate and 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 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 separate and consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' 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.



## Independent Auditors' report to the shareholders of Privredna banka Zagreb dd (continued)

### Report on Other Legal and Regulatory Requirements

Pursuant to the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of Banks, dated 30 May 2008 (Official Gazette 62/08), the Management Board of the Bank has prepared the schedules ("the Schedules"), which comprise an alternative presentation of the separate and consolidated statement of financial position as at 31 December 2016, and of the separate and consolidated income statements, separate and consolidated statements of cash flows and separate and consolidated statements of changes in equity for the year then ended, and a reconciliation ("the Reconciliation") of the Schedules with the separate and consolidated financial statements. The Schedules and the Reconciliation are presented on pages 199 to 223. The Management Board of the Bank is responsible for the Schedules and the Reconciliation. The financial information in the Schedules is derived from the financial statements of the Bank and the Group set out on pages 59 to 198 on which we have expressed an opinion as set out above.

The engagement partner on the audit resulting in this independent auditors' report is Goran Horvat.

**KPMG Croatia d.o.o. za reviziju**

Zagreb, 14 February 2017

Croatian Certified Auditors

Eurotower, 17th floor

Ivana Lučića 2a

10000 Zagreb

Croatia

For and on behalf of KPMG Croatia d.o.o. za reviziju:

Goran Horvat

*Director, Croatian Certified Auditor*

**KPMG Croatia**  
d.o.o. za reviziju  
Eurotower, 17. kat  
Ivana Lučića 2a, 10000 Zagreb

7

**Income statement***For the year ended 31 December*

(in HRK million)

	Notes	GROUP		BANK	
		2016	2015	2016	2015
Interest income	5	3,300	3,445	2,908	3,010
Interest expense	5	(676)	(930)	(573)	(817)
<b>Net interest income</b>		<b>2,624</b>	<b>2,515</b>	<b>2,335</b>	<b>2,193</b>
Fee and commission income	6a	1,491	1,521	754	758
Fee and commission expense	6b	(245)	(293)	(120)	(109)
<b>Net fee and commission income</b>		<b>1,246</b>	<b>1,228</b>	<b>634</b>	<b>649</b>
Dividend income	7	9	5	227	170
Net trading income and net gains on translation of monetary assets and liabilities	8	227	82	213	72
Other operating income	9	412	145	430	77
<b>Total operating income</b>		<b>4,518</b>	<b>3,975</b>	<b>3,839</b>	<b>3,161</b>
Impairment losses on loans and advances to customers	12a	(436)	(148)	(389)	(149)
Release/(loss) recognized on CHF conversion	20f	30	(1,311)	30	(1,311)
Other impairment losses and provisions	12b	16	(9)	24	4
Personnel expenses	10	(872)	(851)	(718)	(695)
Depreciation, amortisation and impairment of goodwill	13	(205)	(174)	(113)	(117)
Other operating expenses	11	(1,043)	(1,039)	(688)	(683)
Share of profits from associates	23	24	24	-	-
<b>Profit before income tax</b>		<b>2,032</b>	<b>467</b>	<b>1,985</b>	<b>210</b>
Income tax expense	14	(445)	(97)	(380)	(17)
<b>Profit for the year</b>		<b>1,587</b>	<b>370</b>	<b>1,605</b>	<b>193</b>
Attributable to:					
Equity holders of the Bank		1,582	365	1,605	193
Non-controlling interests		5	5	-	-
		<b>1,587</b>	<b>370</b>	<b>1,605</b>	<b>193</b>
		<b>in HRK</b>		<b>in HRK</b>	
Basic and diluted earnings per share	51	83.2	19.2	84.4	10.2

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

**Statement of comprehensive income***For the year ended 31 December*

(in HRK million)

	GROUP		BANK	
	2016	2015	2016	2015
<b>Profit for the year</b>	<b>1,587</b>	<b>370</b>	<b>1,605</b>	<b>193</b>
<b>Other comprehensive income</b>				
<b>Items that are or may be reclassified to profit or loss</b>				
<i>Net change in fair value on available-for-sale financial assets</i>	29	113	11	104
<i>Foreign exchange differences on translation of foreign operations</i>	(8)	-	-	-
<i>Net amount transferred to the income statement</i>	(94)	3	(95)	1
	<b>(73)</b>	<b>116</b>	<b>(84)</b>	<b>105</b>
Deferred tax on available-for-sale financial assets (Note 14f)	13	(23)	17	(21)
<b>Other comprehensive income for the year, net of tax</b>	<b>(60)</b>	<b>93</b>	<b>(67)</b>	<b>84</b>
<b>Total comprehensive income for the year, net of tax</b>	<b>1,527</b>	<b>463</b>	<b>1,538</b>	<b>277</b>
Attributable to:				
Equity holders of the Bank	1,522	458	1,538	277
Non-controlling interests	5	5	-	-
	<b>1,527</b>	<b>463</b>	<b>1,538</b>	<b>277</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

**Statement of financial position***As at 31 December*

(in HRK million)

Assets	Notes	GROUP		BANK	
		2016	2015	2016	2015
Cash and current accounts with banks	15	12,970	9,995	12,338	9,143
Balances with the Croatian National Bank	16	3,916	4,550	3,916	4,550
Financial assets at fair value through profit or loss	17	6,103	5,970	5,975	5,818
Derivative financial assets	18	25	4	19	4
Loans and advances to banks	19	2,806	3,450	1,731	2,966
Loans and advances to customers	20	52,885	50,985	45,667	44,186
Financial assets available for sale	21	1,405	1,118	370	293
Held-to-maturity investments	22	17	17	-	-
Investments in subsidiaries and associates	23	67	150	953	963
Intangible assets	24	158	182	124	106
Property and equipment	25	1,030	1,132	545	625
Investment property	26	62	23	50	10
Deferred tax assets	14c	130	141	88	100
Other assets	27	532	549	274	305
Tax prepayments		22	157	-	145
<b>Total assets</b>		<b>82,128</b>	<b>78,423</b>	<b>72,050</b>	<b>69,214</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

**Statement of financial position (continued)***As at 31 December*

(in HRK million)

	Notes	GROUP		BANK	
		2016	2015	2016	2015
<b>Liabilities</b>					
Current accounts and deposits from banks	28	1,125	1,083	1,376	1,373
Current accounts and deposits from customers	29	60,378	58,180	54,108	52,815
Derivative financial liabilities	18	11	15	5	15
Interest-bearing borrowings	30	3,571	3,884	2,747	2,838
Subordinated liabilities	31	1	2	-	-
Other liabilities	32	1,749	1,438	481	316
Accrued expenses and deferred income	33	264	238	137	123
Provisions for liabilities and charges	34	284	313	257	288
Deferred tax liabilities	14d	21	34	5	22
Current tax liability		165	11	165	-
<b>Total liabilities</b>		<b>67,569</b>	<b>65,198</b>	<b>59,281</b>	<b>57,790</b>
<b>Equity</b>					
Share capital	36a	1,907	1,907	1,907	1,907
Share premium	36b	1,570	1,570	1,570	1,570
Treasury shares	36c	(76)	(76)	(76)	(76)
Other reserves	36e	375	466	302	302
Fair value reserve	36f	56	108	19	86
Retained earnings	36g	11,025	9,553	9,047	7,635
Merger reserve	36h	(348)	(348)	-	-
<b>Total equity attributable to equity holders of the Bank</b>		<b>14,509</b>	<b>13,180</b>	<b>12,769</b>	<b>11,424</b>
<b>Non-controlling interests</b>		<b>50</b>	<b>45</b>	<b>-</b>	<b>-</b>
<b>Total equity</b>		<b>14,559</b>	<b>13,225</b>	<b>12,769</b>	<b>11,424</b>
<b>Total liabilities and equity</b>		<b>82,128</b>	<b>78,423</b>	<b>72,050</b>	<b>69,214</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

## Statement of cash flows

For the year ended 31 December

		(in HRK million)			
	Notes	GROUP		BANK	
		2016	2015	2016	2015
<b>Cash flows from operating activities</b>					
Profit before income tax		2,032	467	1,985	210
Impairment losses on loans and advances to customers	12a	436	148	389	149
Other impairment losses and provisions	12b	(16)	9	(24)	(4)
(Release)/loss recognized on CHF conversion	20f	(30)	1,311	(30)	1,311
Gain on disposal of property and equipment and intangible assets	9	(22)	(13)	(5)	(4)
Depreciation, amortisation and impairment of goodwill	13	205	174	113	117
Net (gains)/losses from securities at fair value through profit or loss		(14)	19	(14)	20
Share of profits from associates	23	(24)	(24)	-	-
Net interest income		(2,624)	(2,515)	(2,335)	(2,193)
Gain on disposal of associate	9	(162)	-	(241)	-
Net gain on disposal of available-for-sale securities	9	(125)	-	(125)	-
Dividend income	7	(9)	(5)	(227)	(170)
		<b>(353)</b>	<b>(429)</b>	<b>(514)</b>	<b>(564)</b>
<b>Decrease/(increase) in operating assets</b>					
Balances with the Croatian National Bank		634	198	634	198
Loans and advances to banks		(557)	31	48	77
Loans and advances to customers		(2,307)	(1,333)	(1,837)	(1,116)
Financial assets at fair value through profit or loss and financial assets available for sale		(390)	(223)	(215)	109
Other assets		(17)	(37)	7	(46)
<i>(Increase)/decrease in operating assets</i>		<b>(2,637)</b>	<b>(1,364)</b>	<b>(1,363)</b>	<b>(778)</b>
<b>Increase/(decrease) in operating liabilities</b>					
Current accounts and deposits from banks		36	(216)	(3)	(87)
Current accounts and deposits from customers		2,343	3,121	1,436	2,568
Other liabilities		328	(37)	165	(58)
<i>Increase/(decrease) in operating liabilities</i>		<b>2,707</b>	<b>2,868</b>	<b>1,598</b>	<b>2,423</b>
Interest received		3,327	3,521	2,931	3,023
Interest paid		(812)	(1,217)	(706)	(957)
Dividends received		27	21	227	170
<b>Net cash inflow from operating activities before income taxes paid</b>		<b>2,259</b>	<b>3,400</b>	<b>2,173</b>	<b>3,317</b>
Income tax paid		(146)	(257)	(58)	(178)
<b>Net cash from operating activities</b>		<b>2,113</b>	<b>3,143</b>	<b>2,115</b>	<b>3,139</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

**Statement of cash flows (continued)***For the year ended 31 December*

	Notes	(in HRK million)			
		GROUP		BANK	
		2016	2015	2016	2015
<b>Cash flows from investing activities</b>					
Purchase of property and equipment, intangible assets and investment property	24, 25	(160)	(137)	(98)	(73)
Disposal of property and equipment, intangible assets and investment property		64	43	12	4
Redemption of held-to-maturity investments		-	160	-	-
Purchase of subsidiary	23	-	(748)	-	(748)
Cash received from sale of associate	23	251	-	251	-
<b>Net cash used in investing activities</b>		<b>155</b>	<b>(682)</b>	<b>165</b>	<b>(817)</b>
<b>Cash flows from financing activities</b>					
Dividends paid to equity holders of the parent		(193)	(513)	(193)	(513)
Decrease in interest-bearing borrowings and subordinated liabilities		(317)	(1,685)	(95)	(1,700)
<b>Net cash used in financing activities</b>		<b>(510)</b>	<b>(2,198)</b>	<b>(288)</b>	<b>(2,213)</b>
<b>Net increase in cash and cash equivalents</b>		<b>1,758</b>	<b>263</b>	<b>1,992</b>	<b>109</b>
Cash and cash equivalents as at 1 January		12,989	12,733	12,019	11,917
Effect of exchange rate fluctuations on cash held		5	(7)	5	(7)
<b>Cash and cash equivalents as at 31 December</b>	37	<b>14,752</b>	<b>12,989</b>	<b>14,016</b>	<b>12,019</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.



## Statement of changes in equity

(in HRK million)

	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	Merger reserve	Non-controlling interest	Total
<b>Group</b>									
<b>Balance as at 1 January 2016</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>466</b>	<b>108</b>	<b>9,553</b>	<b>(348)</b>	<b>45</b>	<b>13,225</b>
<b>Other comprehensive income</b>									
Net change in fair value on available-for-sale financial assets	-	-	-	-	29	-	-	-	29
Net amount transferred to the income statement	-	-	-	-	(94)	-	-	-	(94)
Deferred tax on available-for-sale financial assets (Note 14f)	-	-	-	-	13	-	-	-	13
Foreign exchange differences on translation of foreign operations	-	-	-	(8)	-	-	-	-	(8)
<b>Total other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>(52)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(60)</b>
Profit for the year	-	-	-	-	-	1,582	-	5	1,587
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>(52)</b>	<b>1,582</b>	<b>-</b>	<b>5</b>	<b>1,527</b>
Dividends paid	-	-	-	-	-	(193)	-	-	(193)
Transfer of reserves	-	-	-	(83)	-	83	-	-	-
<b>Transactions with owners, recorded directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(83)</b>	<b>-</b>	<b>(110)</b>	<b>-</b>	<b>-</b>	<b>(193)</b>
<b>Balance as at 31 December 2016</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>375</b>	<b>56</b>	<b>11,025</b>	<b>(348)</b>	<b>50</b>	<b>14,559</b>
<b>Balance as at 1 January 2015</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>466</b>	<b>15</b>	<b>9,701</b>	<b>400</b>	<b>40</b>	<b>14,023</b>
<b>Other comprehensive income</b>									
Net change in fair value on available-for-sale financial assets	-	-	-	-	113	-	-	-	113
Net amount transferred to the income statement	-	-	-	-	3	-	-	-	3
Deferred tax on available-for-sale financial assets (Note 14f)	-	-	-	-	(23)	-	-	-	(23)
<b>Total other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>93</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>93</b>
Profit for the year	-	-	-	-	-	365	-	5	370
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>93</b>	<b>365</b>	<b>-</b>	<b>5</b>	<b>463</b>
Dividends paid	-	-	-	-	-	(513)	-	-	(513)
Acquisition of Intesa Sanpaolo Banka dd Bosnia (note 23)	-	-	-	-	-	-	(748)	-	(748)
<b>Transactions with owners, recorded directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(513)</b>	<b>(748)</b>	<b>-</b>	<b>(1,261)</b>
<b>Balance as at 31 December 2015</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>466</b>	<b>108</b>	<b>9,553</b>	<b>(348)</b>	<b>45</b>	<b>13,225</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

**Statement of changes in equity (continued)**

(in HRK million)

	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	Total
<b>Bank</b>							
<b>Balance as at 1 January 2016</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>302</b>	<b>86</b>	<b>7,635</b>	<b>11,424</b>
<b>Other comprehensive income</b>							
Net change in fair value on available-for-sale financial assets	-	-	-	-	11	-	11
Net amount transferred to the income statement	-	-	-	-	(95)	-	(95)
Deferred tax on available-for-sale financial assets (Note 14f)	-	-	-	-	17	-	17
<b>Total other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(67)</b>	<b>-</b>	<b>(67)</b>
Profit for the year	-	-	-	-	-	1,605	1,605
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(67)</b>	<b>1,605</b>	<b>1,538</b>
Dividends paid	-	-	-	-	-	(193)	(193)
<b>Transactions with owners, recorded directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(193)</b>	<b>(193)</b>
<b>Balance as at 31 December 2016</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>302</b>	<b>19</b>	<b>9,047</b>	<b>12,769</b>
<b>Balance as at 1 January 2015</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>302</b>	<b>2</b>	<b>7,955</b>	<b>11,660</b>
<b>Other comprehensive income</b>							
Net change in fair value on available-for-sale financial assets	-	-	-	-	104	-	104
Net amount transferred to the income statement	-	-	-	-	1	-	1
Deferred tax on available-for-sale financial assets (Note 14f)	-	-	-	-	(21)	-	(21)
<b>Total other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>84</b>	<b>-</b>	<b>84</b>
Profit for the year	-	-	-	-	-	193	193
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>84</b>	<b>193</b>	<b>277</b>
Dividends paid	-	-	-	-	-	(513)	(513)
<b>Transactions with owners, recorded directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(513)</b>	<b>(513)</b>
<b>Balance as at 31 December 2015</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>302</b>	<b>86</b>	<b>7,635</b>	<b>11,424</b>

The accompanying accounting policies and notes on pages 67 to 198 are an integral part of these financial statements.

## Notes to the financial statements

### 1 Reporting entity

Privredna banka Zagreb dd (“the Bank”) is a joint stock company incorporated and domiciled in the Republic of Croatia. The registered office is at Radnička cesta 50, Zagreb. The Bank is the parent of the Privredna banka Zagreb Group (“the Group”), which has operations in the Republic of Croatia and Bosnia and Herzegovina. The Group provides a full range of retail and corporate banking services, as well as treasury, investment banking, asset management and leasing services.

These financial statements comprise both the separate and the consolidated financial statements of the Bank as defined in International Accounting Standard 27 *Consolidated and Separate Financial Statements*.

A summary of the Group’s principal accounting policies are set out below.

### 2 Basis of preparation

#### a) Statement of compliance

These separate and consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union (“IFRS”).

These separate and consolidated financial statements were authorised for issue by the Management Board on 14 February 2017 for approval by the Supervisory Board.

#### b) Basis of measurement

The separate and consolidated financial statements are prepared on the fair value basis for financial assets and liabilities at fair value through profit or loss and financial assets available for sale, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

#### c) Functional and presentation currency

The separate and consolidated financial statements are presented in Croatian kuna (“HRK”) which is the functional and presentation currency of the Bank and the Group. Amounts are rounded to the nearest million, unless otherwise stated.

The exchange rates used for translation at 31 December 2016 amounted to EUR 1 = HRK 7.558, CHF 1 = HRK 7.036, USD 1 = HRK 7.169 and BAM 1 = HRK 3.857 (31 December 2015: EUR 1 = HRK 7.635, CHF 1 = HRK 7.060, USD 1 = HRK 6.992 and BAM 1 = HRK 3.915).

During 2016 and 2015 BAM (official currency of Bosnia and Herzegovina) was pegged with Euro at 1 EUR = 1.9558 BAM.

#### d) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities and disclosure of commitments and contingencies at the reporting date, as well as amounts of income and expense for the period and other comprehensive income. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Information about judgments made by management in the application of IFRS that have a significant effect on the financial statements and information about estimates with a significant risk of resulting in a material adjustment in the next financial year are included in Note 4.

## Notes to the financial statements (continued)

### 2 Basis of preparation (continued)

#### e) Acquisition of Intesa Sanpaolo Banka dd, Bosnia and Herzegovina

The structure of the Group was changed following a Group reorganisation in 2015.

As of 20 July 2015 the Bank purchased a 94.9359% stake in Intesa Sanpaolo Banka dd Bosnia and Herzegovina from its parent company Intesa Sanpaolo Holding International S.p.A. Since the ultimate owner of both banks is Intesa Sanpaolo s.p. A. the transaction was carried out in accordance with the requirements of IFRS for transactions under common control. In its consolidated financial statements for 2015 the Bank restated its comparatives and adjusted its current reporting period before the date of transaction as if the combination had occurred before the start of the earliest period presented. The excess of consideration paid over the carrying value of share capital at the time of combination is treated as a merger reserve in equity. The transaction costs for the combination were expensed in the income statement. For details, please refer to note 23 Investment in subsidiaries and associates.

#### f) Financial crisis impact

##### *The situation in global financial markets and impact on Croatia*

The global economy growth slowed down in 2016 to 3.1% according to the IMF forecast - the lowest level since the financial crisis (from 3.2% in 2015). The slowdown in growth mostly relates to developed countries (from 2.1% in 2015 to 1.6%), while the long-term trend of a slowdown in developing and emerging economies stopped (4.1% growth in 2016, as in 2015). The weakening of investment spending in many countries, particularly in China and commodities exporters, affected the global trade slowdown as well.

Financial markets in 2016 were characterized by somewhat higher volatility, especially following the UK vote for the exit from the European Union at a referendum held in late June, but also after the United States presidential elections in November. The prices of oil and other commodities have started to recover slowly during the year. By end 2016, divergent monetary policies of the US central bank (FED) and the European Central Bank (ECB) become more pronounced. In March, ECB cut its key reference rate from 0.05% to zero, simultaneously expanding the programme of unconventional monetary policy measures. The FED has, after a longer delay, raised its interest rate in December by 25 basis points. The monetary policy movements were also marked by divergent trends of the exchange rate of the euro against major world currencies, therefore, after the strengthening in the first part of the year, the euro mainly weakened against the US dollar in the second part of the year, especially following the US presidential elections. At the end of the year, the exchange rate of the British pound against the euro has started its recovery from a strong value loss recorded after the Brexit referendum.

The financing conditions for the European emerging economies, including Croatia, mostly improved during the year, with the exception of the short period immediately after the already mentioned UK referendum and the US elections. The economic movements in Croatia's major foreign trade partners over 2016 were rather encouraging, particularly in Germany, Austria and Slovenia, whereas Italy continued to see growth below the average.

## Notes to the financial statements (continued)

### 3 Significant accounting policies

#### a) Basis of consolidation

##### i) Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. The Group controls an entity if it 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. In reassessing its control conclusion, the Group has taken into consideration the structured entities and entities with receivables in default for which it reassessed whether the key decisions are made by the Group and whether the Group is exposed to variability of returns from those entities. Business combinations under common control are accounted for based on carrying values, with any effects directly recognised in equity.

##### *Acquisitions on or after 1 January 2010*

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; plus
- if the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the total is negative, a bargain purchase gain is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs related to the acquisition, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognised in the income statement.

##### *Acquisitions prior to 1 January 2010*

For acquisitions prior to 1 January 2010, goodwill represents the excess of the cost of the acquisition over the Group's interest in the recognised amount (generally fair value) of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess was negative, a bargain purchase gain was recognised immediately in the income statement. Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurred in connection with business combinations were capitalised as part of the cost of the acquisitions.

##### ii) Non-controlling interests

Non-controlling interests in the net assets (excluding goodwill) of the consolidated subsidiaries are identified separately from the Group's equity therein. For each business combination, the Group elects to measure any non-controlling interests in the acquiree either at fair value or at their proportionate share of the acquiree's identifiable net assets, which are generally at fair value.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as transactions with owners in their capacity as owners. Adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary. No adjustments are made to goodwill and no gain is recognised in the income statement.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### a) Basis of consolidation (continued)

##### iii) Subsidiaries

Financial statements are prepared for the Bank and the Group. Financial statements of the Group include consolidated financial statements of the Bank and its entities under control (subsidiaries). In the Bank's separate financial statements, investments in subsidiaries are accounted for at cost less impairment.

Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date of disposal. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between group companies have been eliminated in preparing the consolidated financial statements. Where necessary, the accounting policies used by subsidiaries have been changed to ensure consistency with the policies adopted by the Group. Losses applicable to the non-controlling interests in a subsidiary are allocated to the non-controlling interests even if doing so causes the non-controlling interests to have a deficit balance.

##### iv) Associates

Associates are entities over which the Group has significant influence but no control. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost. The Group's investments in associates include goodwill (net of any accumulated impairment loss) identified on acquisition. In the Bank's separate financial statements investments in associates are accounted at cost less impairment.

The Group's share of its associates' post-acquisition gains or losses is recognised in the income statement and its share of their post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise any further losses, unless it has incurred obligations or made payments on behalf of the associate.

Dividends received from associates are treated as a decrease of investment in the associate in the Group's consolidated statement of financial position and as dividend income in the Bank's unconsolidated income statement.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associate. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets transferred. The accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

##### v) Acquisition of entities under common control

Business combinations arising from transfers of interests in entities that are under the control of the shareholder that ultimately controls the Group are accounted for using book value accounting at the date of acquisition. The assets and liabilities acquired are recognised at the carrying amounts recognised previously in the financial statements of the acquired entities. The components of equity of the acquired entities are added to the same components within Group equity except for issued capital. Consolidated financial statements reflect the results of combining entities for all periods presented for which the entities were under the transferor's common control, irrespective of when the combination takes place.

##### vi) Loss of control

Upon the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interest and other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in the income statement. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or in accordance with the Group's accounting policy for financial instruments (refer to accounting policy 3.1 Financial instruments) depending on the level of influence retained.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### a) Basis of consolidation (continued)

##### vii) Transactions eliminated on consolidation

Intra-group balances, and income and expenses (except for foreign currency transaction gains or losses) arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

##### viii) Fund management

The Group manages and administers assets held in mutual funds on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements except when the Group controls the entity (there were no such cases at the reporting date). Information about the Group's fund management activities is set out in Note 38.

#### b) Foreign currency

##### i) Foreign currency translation

Transactions in foreign currencies are translated into the respective functional currencies of the operations at the spot exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the mid-market exchange rate of the Croatian National Bank. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date on which the fair value was determined.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on translation are recognised in the income statement, except for differences arising on the translation of available-for-sale equity instruments, which are recognised in other comprehensive income.

Changes in the fair value of securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences on monetary securities available for sale are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income. Translation differences on non-monetary securities denominated in foreign currency classified as available for sale are recognised directly in other comprehensive income along with other changes, net of deferred tax. The Group does not have qualifying cash flow hedges and qualifying net investment hedges as defined in International Accounting Standard 39 *Financial Instruments: Measurement and Recognition* ("IAS 39").

##### ii) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into euro at the exchange rates at the reporting date. The income and expenses of foreign operations are translated into euro at the exchange rates at the dates of the transactions.

Foreign currency differences are recognized in other comprehensive income and accumulated in the translation reserve, except to the extent that the translation difference is allocated to non-controlling interest.

When a foreign operation is disposed of in its entirety or partially such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. If the Group disposes of part of its interest in a subsidiary but retains control, then the relevant proportion of the cumulative amount is reattributed to non-controlling interest. When the Group disposes of only part of an associate or joint venture while retaining significant influence or joint control, the relevant proportion of the cumulative amount is reclassified to profit or loss.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### c) Interest income and expense

Interest income and expense are recognised in the income statement as they occur for all interest-bearing financial instruments, including those measured at amortised cost and those available for sale, using the effective interest rate method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate for its assets, the Group does not consider future credit losses. The calculation includes all fees and percentage points 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. Such income and expense is presented as interest income or interest expense in the income statement.

Interest income and expense also include fee and commission income and expense in respect of loans and advances to customers and banks, interest-bearing borrowings, finance and operating leases, premium or discount amortisation as well as other differences between the initial carrying amount of an interest-bearing financial instrument and its value at maturity, recognised on an effective interest basis. Interest income on debt securities at fair value through profit or loss is recognised using the nominal coupon rate and included in interest income.

#### d) Fee and commission income and expense

Loan commitment fees for loans and advances that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. Commitment fees in relation to facilities that are not likely to be drawn down are recognised over the term of the commitment. Fee and commission income and expense mainly comprise fees and commissions related to domestic and foreign payments, the issue of guarantees and letters of credit, credit card business and asset management, and are recognised in the income statement upon performance of the relevant service, unless they have been included in the effective interest calculation.

Loan syndication fees are recognised as revenue when the syndication has been completed and the Group has retained no part for itself, or has retained a part at the same effective interest rate as the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts. Asset management fees related to investment fund management are recognised on an accruals basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

#### e) Net trading income and net gains and losses on translation of monetary assets and liabilities

Net trading income and net gains and losses on translation of monetary assets and liabilities include spreads earned from foreign exchange spot trading, trading income from forward and swap contracts, realised and unrealised gains on securities at fair value through profit or loss and net gains and losses from the translation of monetary assets and liabilities denominated in foreign currency.

#### f) Other operating income

Other operating income includes net gains on disposal of securities classified as financial assets available for sale, net gains on disposal of property and equipment, rental income from investment property and assets under operating lease and other income.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased assets and recognised on a straight-line basis over the lease term.



## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### g) Employee benefits

Employee entitlements to annual leave are recognised when they accrue. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the reporting date.

##### i) Personnel social contributions

According to local legislation, the Group is obliged to pay contributions to the Pension Fund and the State Health Care Fund. This obligation relates to full-time employees and provides for paying contributions in the amount of certain percentages determined on the basis of gross salary which are in the Republic of Croatia as follows:

	from April 2014	up to April 2014
Contributions to the Pension Fund	20.00%	20.00%
Contributions to the State Health Care Fund	15.00%	13.00%
Contributions to the Unemployment Fund	1.70%	1.70%
Injuries at work	0.50%	0.50%

The Group is also obliged to withhold contributions from the gross salary on behalf of the employee for the same funds. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefits in the income statement as they accrue.

##### ii) Termination benefits

Termination benefits are recognised as an expense when the Group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan either to terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting date, then they are discounted to their present value.

##### iii) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

##### iv) Share-based payment transactions

The Group has a share-based payment agreement which entitle the key employees to receive the cash payment, based on the price of the equity instrument (cash-settled transactions). The liability is initially measured by reference to the fair value of equity instruments at the grant date and remeasured until settlement. The fair value is determined as the market value of shares. The cost of cash-settled transactions is recognised over the period in which the performance and/or service conditions are fulfilled.

#### h) Direct acquisition costs related to housing savings

Direct acquisition expenses related to housing savings contracts are deferred, to the extent that they are estimated to be recoverable, and amortised to the income statement on a straight-line basis over the life of the related contracts.

#### i) Dividend income

Dividend income on equity securities is credited to the income statement when the right to receive the dividend is established except for dividend income from associates which is on consolidation credited to the carrying values of investments in associates in the Group's statement of financial position.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### j) Income tax

The income tax expense comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

##### i) Current income tax

Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the reporting date, and any adjustments to tax payable in respect of previous years.

##### ii) Deferred income tax

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the enterprise expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities, based on tax rates enacted or substantially enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Deferred tax assets and liabilities are not discounted and are classified as non-current and/or long-term assets in the statement of financial position. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each reporting date, the Group reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

#### k) Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with original maturity of less than 90 days, including cash and current accounts with banks and loans and advances to banks up to 90 days.

#### l) Financial instruments

##### i) Recognition

The Group initially recognises loans and advances and other financial liabilities on the date at which they are originated, i.e. advanced to borrowers or received from lenders.

Regular way transactions with financial instruments are recognised at the date when they are transferred (settlement date). Under settlement date accounting, while the underlying asset or liability is not recognised until the settlement date, changes in fair value of the underlying asset or liability are recognised starting from the trade date. All other financial assets and liabilities (derivatives) are recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### 1) Financial instruments (continued)

##### ii) Classification

Financial instruments are classified in categories depending on the purpose for which the Group initially acquired the financial instrument or upon reclassification and in accordance with the Group's investment strategy. Financial assets and financial liabilities are classified in the following portfolios: "at fair value through profit or loss"; "held to maturity"; "available for sale"; or "loans and receivables" and "other financial liabilities". The main difference between the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements as described below.

##### *Financial assets and financial liabilities at fair value through profit or loss*

This category has two sub-categories: financial instruments held for trading (including derivatives), and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the short term, for the purpose of short-term profit-taking, or designated as such by management.

The Group designates financial assets and liabilities at fair value through profit or loss when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

Financial instruments at fair value through profit or loss include debt and equity securities and units in investment funds, as well as derivatives.

##### *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are carried at amortised cost using the effective interest rate method, less any impairment losses. A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Group from classifying investments as held-to-maturity for the current and the following two financial years. Held-to-maturity investments comprise debt securities.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

- (a) those that the Group intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- (b) those that the Group upon initial recognition designates as available for sale; or
- (c) those for which the Group may not recover substantially all of the initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Loans and receivables include loans and advances to banks, loans and advances to customers, finance lease receivables, receivables from operating leases, obligatory reserve with the Croatian National Bank and trade and other receivables.

##### *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. Financial assets designated as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or equity prices. Available-for-sale financial assets include debt and equity securities. Unquoted equity securities whose fair value cannot be measured reliably are carried at cost. All other available-for-sale investments are measured at fair value after initial recognition.

##### *Other financial liabilities*

Other financial liabilities comprise all financial liabilities which are not held for trading or designated at fair value through profit or loss.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### l) Financial instruments (continued)

##### iii) Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets, that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability in the statement of financial position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred) and consideration received (including any new asset obtained less any new liability assumed) is recognised in the income statement. In addition, any cumulative gain or loss that had been recognised in other comprehensive income is also recognised in the income statement.

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset. If transfer does not result in derecognition because the Group retained all or substantially all risks and rewards of ownership, the assets are not derecognised and liabilities secured with collateral are recognised in the amount of consideration received.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire. If the terms of a financial liability are significantly modified, the Group will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions. Realised gains and losses from the disposal of financial instruments are calculated using the weighted average cost method.

##### iv) Reclassification

No transfers of derivatives and financial instruments initially designated as at fair value through profit and loss are allowed to other portfolios. Financial assets held for trading may be reclassified from this category in the case when both of the following two conditions are met: a change in the intended purpose of the assets and an extraordinary event. In such case, the fair value at the reclassification date becomes the new cost/amortised cost. Reclassification is possible to the available-for-sale portfolio, the held-to-maturity portfolio and the loans and receivables portfolio. Transfers from other portfolios to the portfolio at fair value through profit and loss are not possible.

Financial asset classified as available for sale that would have met the definition of loans and receivables (if it had not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity. For a financial asset reclassified out of the available-for-sale category, any previous gain or loss on that asset that has been recognised in other comprehensive income shall be amortised to profit or loss over the remaining life of the asset using the effective interest method.

##### v) Offsetting of financial instruments

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

Income and expenses are presented on a net basis only when permitted by the accounting regulations, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

##### vi) Initial and subsequent measurement

When a financial asset or financial liability is recognised initially, the Group measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs which are directly attributable to the acquisition or issue of the financial asset or financial liability. Financial assets at fair value through profit or loss are initially recognised at fair value, and transaction costs are immediately charged to the income statement.

After initial recognition, the Group measures financial instruments at fair value through profit or loss and available for sale at their fair value, without any deduction for selling costs. Equity instruments classified as available for sale that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost less impairment.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### l) Financial instruments (continued)

##### vi) Initial and subsequent measurement (continued)

Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortised cost (less any impairment for the assets) using the effective interest method.

##### vii) Gains and losses

Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss as well as all related realised gains and losses arising upon a sale or other derecognition of such assets and liabilities are recognised in the income statement.

Gains and losses from a change in the fair value of available-for-sale financial assets are recognised directly in a fair value reserve in other comprehensive income, net of deferred tax, and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount using the effective interest method on available-for-sale monetary assets are recognised in the income statement. Impairment losses on non-monetary available-for-sale assets are also recognised in the income statement. Foreign exchange differences on non-monetary financial assets available for sale are recognised in other comprehensive income, net of deferred tax. Dividend income is recognised in the income statement. Upon sale or other derecognition of available-for-sale financial assets, any cumulative gains or losses are transferred from other comprehensive income to the income statement.

Gains and losses on financial instruments carried at amortised cost may also arise, and are recognised in the income statement, when a financial instrument is derecognised or when its value is impaired.

##### viii) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

##### ix) Fair value measurement principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Group measures the fair value of an instrument using the quoted price in an active market for the instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques (except for certain unquoted equity securities). Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### l) Financial instruments (continued)

##### ix) Fair value measurement principles (continued)

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate.

The fair values of quoted investments are based on current closing bid prices.

The fair value of non-exchange-traded derivatives is estimated at the amount that the Group would receive or pay to terminate the contract at the reporting date taking into account current market conditions and the current creditworthiness of the counterparties.

##### x) Impairment of financial assets

*Impairment of financial assets identified as impaired*

##### a) Financial assets carried at amortised cost

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets not carried at fair value through profit or loss is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

- i) significant financial difficulty of the borrower or issuer;
- ii) a breach of contract, such as a default or delinquency in interest or principal payments;
- iii) the restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider;
- iv) significant restructuring due to financial difficulty or expected bankruptcy;
- v) the disappearance of an active market for the financial asset because of financial difficulties;
- vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows discounted at the financial asset’s original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor’s credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

When possible, the Bank seeks to restructure loans rather than to take possession of collateral. If the terms of the financial assets are renegotiated or modified or an existing financial asset is replaced with the new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated assets are substantially different, then the contractual rights to cash flows from the original financial assets are deemed to have expired. Once the terms have been renegotiated any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective assessment, calculated using the loan’s original effective interest rate.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### l) Financial instruments (continued)

##### x) Impairment of financial assets (continued)

###### *Impairment of financial assets identified as impaired (continued)*

###### a) *Financial assets carried at amortised cost (continued)*

Individually significant financial assets are tested for impairment on an individual basis. Those individually significant assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. Loans and advances to customers and held-to-maturity investments that are not individually significant are collectively assessed for impairment by grouping the assets on the basis of similar credit risk characteristics (i.e. on the basis of the Group's internal rating system that considers asset type, collateral type, past-due status and other relevant factors).

###### b) *Financial assets carried at fair value*

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the investment below its cost is considered in determining whether the assets are impaired. In general, the Group considers a decline of 20% to be significant and a period of nine months to be prolonged. However, in specific circumstances a smaller decline or a shorter period may be appropriate. If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognised in equity.

###### c) *Financial assets carried at cost*

These include equity securities classified as available for sale for which there is no reliable fair value. The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash receipts discounted by the current market interest rate for similar financial assets.

Impairment losses on such instruments, recognised in the income statement, are not subsequently reversed through the income statement.

###### *Impairment of financial assets not identified as impaired*

If no objective evidence of impairment exists for a financial asset, whether significant or not, the Group includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment that has been incurred but not reported ("IBNR"). Assets that are assessed for specific impairment on individual or collective basis, and for which an impairment loss is or continues to be recognised, are not included in the collective assessment of IBNR impairment.

In assessing collective impairment for IBNR, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Group's internal rating system, which considers asset type, counterparty type, and other relevant factors). In assessing IBNR impairment the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries, and the amount of loss incurred, adjusted for management's judgment and current economic conditions. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### m) Derivative financial instruments

Derivative financial instruments are initially recognised in the statement of financial position in accordance with the policy for initial recognition of financial instruments and subsequently remeasured at their fair value. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and options pricing models, as appropriate.

All derivatives are carried as assets when their fair value is positive and as liabilities when negative. Changes in the fair value of derivatives and gains and losses on derivatives based on securities are included in the income statement under "Net trading gains from forward foreign exchange contracts and swaps". All derivatives are classified as held for trading.

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed an embedded derivative. When the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised and realised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value.

The Group has receivables and liabilities originating in HRK, which are linked to foreign currencies with a one-way currency clause (disclosed as other embedded derivatives in Note 18). Due to this clause, the Group has an option to revalue the asset by the higher of the foreign exchange rate valid as of the date of repayments of the receivables by the debtors, or the foreign exchange rate valid as of the date of origination of the financial instrument. In case of a liability linked to this clause, the counterparty has this option. Due to the specific conditions of the market in the Republic of Croatia, the fair value of this option cannot be calculated given forward rates for Croatian kuna for periods over 9 months are generally not available. As such, the Group revalues its receivables and liabilities linked to this clause by the agreed reference rate valid at the reporting date or foreign exchange rate agreed through the option (rate valid at origination), whichever is higher.

Derivative financial instruments include foreign exchange forward contracts, foreign exchange swaps and embedded derivatives with a one-way currency clause.

#### n) Sale and repurchase agreements

The Group enters into purchases and sales of securities under agreements to resell or repurchase substantially identical securities at a certain date in the future at a fixed price. Investments purchased subject to such commitments to resell them at future dates are not recognised in the statement of financial position. The amounts paid are recognised as loans and advances to either banks or customers. The receivables are presented as collateralised by the underlying security. Securities sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of the securities are reported as collateralised liabilities to either banks or customers.

The difference between the sale and repurchase consideration is recognised on an accrual basis over the period of the transaction and is included in interest income or expense.

#### o) Investments in subsidiaries and associates

Investments in subsidiaries and associates are accounted at cost less impairment in the separate financial statements of the Bank. Investments in subsidiaries are fully consolidated in the consolidated financial statements whilst investments in associates are accounted for under the equity method.

#### p) Interest-bearing borrowings and subordinated debt

Interest-bearing borrowings and subordinated debt are initially recognised at their fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

#### q) Current accounts and deposits from banks and customers

Current accounts and deposits are initially measured at fair value plus transaction costs, and subsequently stated at their amortised cost using the effective interest method.



## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### r) Leases

##### *Finance - Group as lessor*

Leases where the Group, as lessor, transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee are classified as finance leases. When assets are leased under finance lease arrangements, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Initial direct costs, such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease are included in the initial measurement of the finance lease receivable and reduce the amount of income recognised over the lease term. Finance lease receivables are included in the statement of financial position within loans and advances to customers.

##### *Operating - Group as lessor*

The Group, as lessor, classifies all leases other than finance leases as operating leases. Operating leases are included in the statement of financial position within property and equipment at cost net of accumulated depreciation. Such assets are depreciated over their expected useful lives which are based on the lease term. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Operating lease receivables are included in loans and advances to customers.

##### *Operating - Group as lessee*

Leases of assets under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating lease arrangements. Lease payments under operating lease are recognised as expenses on a straight-line basis over the lease term and included in other operating expenses.

#### s) Property and equipment

Property and equipment are stated at historical cost or deemed cost less accumulated depreciation and impairment losses. Historical cost includes its purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Property and equipment are tangible items that are held for use in the provision of services, for rental or other administrative purposes.

Subsequent cost is included in the asset's carrying amount or is recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the period in which they have incurred.

Assets not yet brought into use are not depreciated until the relevant assets are completed and put into operational use and reclassified to the appropriate category of property and equipment.

Depreciation is provided on all assets except land and assets not yet brought into use on a straight-line basis at prescribed rates designed to write-off the cost over the estimated useful life of the asset. The estimated useful lives are as follows:

Buildings	40 years
Office furniture	5 years
Computers	4 years
Motor vehicles	5 years
Equipment and other assets	2 to 10 years

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

When the use of property changes from owner-occupied to rented, the property is reclassified to investment property.

When assets are sold or retired, their cost and accumulated depreciation are eliminated and any gain or loss resulting from their disposal is included in the income statement.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### t) Intangible assets

##### *Intangible assets*

Intangible assets are measured initially at cost. Intangible assets are recognised if it is probable that the future economic benefits attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably.

Subsequently, intangible assets are measured at cost less accumulated amortisation and any accumulated impairment losses. Intangible assets are amortised on a straight line basis over their estimated useful lives, which is 4 years.

The useful lives, residual values and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

##### *Goodwill*

According to IFRS 3 “Business Combinations”, any excess of the cost of the acquisition over the acquirer’s interest in the fair value of the identifiable assets and liabilities acquired on the date of the acquisition is presented as goodwill and recognised as an asset. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (or the group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then pro-rata to the other assets of the unit on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Upon the legal merger of the Bank’s former subsidiary, Medimurska banka, goodwill formerly arising on consolidation was transformed into purchased goodwill recognised in the Bank’s separate statement of financial position. Goodwill on acquisition of subsidiaries and purchased goodwill is included in intangible assets. Goodwill on acquisition of associates is included within investments in associates.

#### u) Investment property

Investment property is property held by the Group to earn rentals or for capital appreciation or for both, but not for sale in the ordinary course of business or for administrative purposes.

Investment property is measured initially at its cost, including transaction costs. Subsequently, investment property is stated at cost less accumulated depreciation and any impairment loss.

Investment property is depreciated on a straight-line basis over a period of 40 years.

Investment property is derecognised when either it has been disposed of or permanently withdrawn from use or no future economic benefits are expected from its disposal. Any gains or losses on the retirement or disposal of investment property are recognised in the income statement in the year of retirement or disposal.

#### v) Non-current assets and disposal groups classified as held for sale

The Group classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and the sale should be expected to be completed within one year from the date of classification.

Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group’s accounting policies. Thereafter, the assets (or disposal group of assets and liabilities) are measured at the lower of their carrying amount and fair value less cost to sell.

A non-current asset classified as held for sale is no longer depreciated. Impairment losses on initial classification as held for sale are included in the income statement, as well as gains and losses on subsequent measurement.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### w) Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortisation and are tested for impairment whenever there are indications that these may be impaired or at least annually. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets that are not yet available for use are assessed at each reporting date. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount of property and equipment, investment property and intangible assets is the higher of the asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (cash-generating units). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

Other previously impaired non-financial assets, other than goodwill, are reviewed for possible reversal of the impairment at each reporting date. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

#### x) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions for liabilities and charges are maintained at the level that the Group's management considers sufficient for absorption of losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses are not provided for.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with the contract.

Provisions are released only for expenditure for which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

#### y) Issued share capital

Issued share capital represents the nominal value of paid-in ordinary shares and is denominated in HRK.

Dividends are recognised as a liability in the period in which they are declared.

#### z) Treasury shares

When any Group company purchases the Bank's equity share capital (treasury shares), the consideration paid is deducted from equity attributable to the Bank's equity holders and classified as treasury shares until the shares are cancelled, reissued or disposed of. When such shares are subsequently sold or reissued, any consideration received, net of transaction costs, is included in equity attributable to the Bank's equity holders.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### aa) Retained earnings

Any profit for the year retained after appropriations is classified within retained earnings.

#### bb) Off-balance-sheet commitments and contingent liabilities

In the ordinary course of business, the Group enters into credit-related commitments which are recorded in off-balance-sheet accounts and primarily comprise guarantees, letters of credit, undrawn loan commitments and credit-card limits. Such financial commitments are recorded in the Group's statement of financial position if and when they become payable.

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, being the premium received, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee becomes probable). Financial guarantees are included within Other liabilities.

#### cc) Managed funds for and on behalf of third parties

The Group manages funds for and on behalf of corporate and retail customers, banks and other institutions. These amounts do not represent the Group's assets and are excluded from the statement of financial position. For the services rendered the Group charges a fee. For details please refer to Note 36.

#### dd) Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the Management Board of the Bank (being the chief operating decision maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

For management purposes, the Bank is organised into 3 primary operating segments: Retail, Corporate and Finance banking accompanied with a central supporting structure. Furthermore, the management of the Bank monitors performance of its subsidiaries on an individual basis. However, for the purpose of presentation of the operating segments for the Group, with the exception of PBZ Card and Intesa Sanpaolo Banka, all subsidiaries have been grouped into one segment. The primary segmental information is based on the internal reporting structure of business segments. Segmental results are measured by applying internal prices (Note 44).

#### ee) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS are determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

#### ff) Foreclosed assets

The Group occasionally acquires real estate and other asset in settlement of certain loans and advances. Real estate and other asset are stated at the lower of the cost of the related loans and advances and the current fair value of such assets. The Group's intention is mainly to sell such assets, which, however, in certain limited cases may end up being used by the Group.

Gains or losses on disposal are recognised in the income statement.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### gg) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2017 and earlier application is permitted; however, the Group has not early adopted them in preparing these financial statements. Except for IFRS 9 which is explained below the Bank believes that other new standards and amendments will not affect consolidated and separated financial statements.

#### IFRS 9 Financial Instruments

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 *Financial Instruments*.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group and the Bank currently plans to apply IFRS 9 initially on 1 January 2018.

The actual impact of adopting IFRS 9 on the separate and consolidated financial statements in 2018 is not known and cannot be reliably estimated because it will be dependent on the financial instruments that the Group and the Bank hold and economic conditions at that time as well as accounting elections and judgements that it will make in the future. The new standard will require the Group and the Bank to revise its accounting processes and internal controls related to reporting financial instruments and these changes are not yet complete.

The IFRS 9 is divided into three different areas of the classification and measurement of financial instruments, impairment and hedge accounting.

#### *Classification and measurement of financial instruments*

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The standard eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

With regard to the Classification and Measurement, the ongoing activities are mainly aimed at defining the business models and at testing the contractual characteristics of cash flows (the so-called SPPI Test).

With regard to the SPPI test of financial assets, the internal methodology has been defined and is based on decision trees

As for debt securities, a detailed examination of the characteristics of cash flows of instruments classified at amortized cost and in the category of financial assets available for sale in accordance with IAS 39 has been carried out, in order to identify securities which, if they don't pass the SPPI test, shall be measured at fair value with impacts on profit or loss according to IFRS 9. For this purpose, specific support tools were used. From the analysis conducted on the abovementioned perimeter so far, the Group did not detect any securities that would fall the SPPI test.

For the loans and advances to customers, the project has initiated modular analyses by taking into account the significance of the portfolios, their consistency and business division. In this regard, differentiated approaches were used for retail and corporate loan portfolios.

- For retail loans, which can be mainly attributable to standard contracts (current or historical product catalogue), the analysis was carried out on clusters of homogeneous loans, by extending the outcome of the SPPI test to all contracts included in the cluster.
- For corporate loans and Investment Banking Division loans, which cannot be mainly attributable to standard contracts, the ongoing in-depth analyses include the execution of the test on individual loans, identified based on the representative samples of operations of each business unit according to the significance of the amounts, also including the involvement of the relevant business structures. At the current state of the progress of analyses, only those contracts which, by virtue of specific clauses, would potentially cause the failure of the SPPI test were revealed. Therefore, even for the loans division, no significant impacts are expected

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### gg) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements (continued)

As for financial assets, both loans and advances to customers and debt securities, which show a mismatch between the frequency of the instalment and the tenor of the rate, passing of a SPPI test will be verified also by performing the Benchmark Cash Flow Test, the methodology of which is in progress of refinement.

As for the second classification driver of financial assets (business model), the analysis and the identification of current business models have been mainly completed and the identification of the business model for the future was initiated. In this regard the operational rules are currently being prepared for the execution of the business model assessment and for an ongoing monitoring of portfolios affected by the requirements IFRS 9. Based on the analyses performed, the securities portfolios classified today at amortized cost will generally remain unchanged, coherent with the management strategy of a Hold to Collect business model. With regard to debt securities currently classified as available-for-sale assets the identification of a business model Hold to Collect and Sell for most of the portfolio is being assumed; only in limited cases with respect to marginal amounts, the transfers towards the business model Hold to Collect are being assumed.

In general terms, the current credit management method, both to retail and corporate counterparts, is attributable to a business model Hold to Collect; however, the identification of the classification category will be subject to confirmation in the light of the methods of management of the financial instruments at the date of initial application of IFRS 9. In summary, according to the in-depth analyses conducted so far, no significant impacts at the moment of the first application are expected.

For the division of derivative contracts neither the reclassification effects, nor the measuring effects are expected.

#### *Impairment*

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model in order to recognize the losses more quickly. This will require considerable judgement as to how changes in economic factors affect ECLs, which will be determined on a probability-weighted basis.

The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments, and to contract assets.

Under IFRS 9, loss allowances will be measured on either of the following bases:

- 12-month ECLs. These are ECLs that result from possible default events within the 12 months after the reporting date; and
- lifetime ECLs. These are ECLs that result from all possible default events over the expected life of a financial instrument.

Lifetime ECL measurement applies if the credit risk of a financial asset at the reporting date has increased significantly since initial recognition and 12-month ECL measurement applies if it has not. An entity may determine that a financial asset's credit risk has not increased significantly if the asset has low credit risk at the reporting date. However, lifetime ECL measurement always applies for trade receivables and contract assets without a significant financing component; an entity may choose to apply this policy also for trade receivables and contract assets with a significant financing component.

IFRS 9 requires from companies to account the expected losses over the next 12 months (stage 1) since initial recognition of the financial instrument. The time horizon for calculating the expected loss becomes the entire remaining life of the asset being evaluated, when the credit quality of the financial instrument suffers a "material" deterioration compared to the initial measurement (stage 2) or in case it is considered to be "impaired" (stage 3).

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### gg) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements (continued)

The main elements that may be mentioned in context of impairment are the following:

- the methods for tracking the credit quality of portfolios of financial assets measured at amortized cost or at fair value through OCI need to be defined;
- the parameters for the determination of significant deterioration of credit risk, for the purposes of the proper allocation of performing exposures in the stage 1 or in the stage 2 are in the definition phase. However, with reference to the impaired exposures, the alignment of definitions of accounting and regulatory default - already present to date - allows to consider the current rules of classification of exposures among "non-performing" identical to the future logics of classification of exposures within the stage 3;
- the models - which include the forward-looking information - for staging (regarding the use of lifetime PD as a relative indicator of non-performance) and for calculating the expected credit loss (ECL) to one year (to be applied to exposures in stage 1) and lifetime (to be applied to exposures in stage 2 and stage 3), are in advanced stage of finalization. In the context of the definition of forward-looking information there are ongoing in-depth analyses in progress aimed at defining the use, of the different macroeconomic scenarios in which the bank may be operating.

With reference to the so-called "tracking" of the credit quality, that is the identification of significant deterioration of credit risks, the choice made requires, case by case and at each reporting date, the comparison - for the purposes of "staging" - between the credit quality of the financial instrument at the time of the evaluation and the quality at the moment of initial disbursement or purchase. With reference to the moment of the first application of the standard, for certain categories of exposures, the so-called "low credit risk exemption" required by the same IFRS 9 will presumably be activated, the use of which would lead to put in the stage 1 those expositions which, at the date of the transition to the new standard, will turn out to be "investment grade" (or of similar quality) and in the stage 2 the remaining performing exposures.

Even in connection with the above mentioned, the elements that will constitute the main drivers to be taken into account for the purposes of the assessments on movements between different stages are as follows:

- the variation in the lifetime probability of default in relation to the moment of initial recognition of the financial instrument;
- the presence of an overdue debt - without prejudice to the materiality thresholds established by the regulation - turns out to be of at least 30 days. In case of such particular case the credit exposure riskiness is presumptively deemed "significantly increased" and, therefore, it is transferred to the stage 2 (if the exposure was previously included in the stage 1);
- the potential presence of other conditions (e.g.: a renegotiation with the characteristics of the "forbearance measures") which - always on a presumptive basis - involve the qualification of exposure whose credit risk turns out to be "significantly increased" compared to the initial recognition;
- finally, for the banks belonging to the foreign perimeter, certain indicators of credit monitoring systems specifically used by each bank - for the purposes of the transition between the "stages" and where appropriate - may be taken into account.

Furthermore, some particular considerations apply to the so-called "staging" of the securities. Unlike loans, in fact, for this type of exposures, the purchase and sales activities after the first purchase (carried out with reference to the same ISIN) may normally fall within the ordinary activity of position management. In this context, it was deemed that the use of the methodology "first-in-first-out" or "FIFO" (for the derecognition of sales) contributed to a more transparent management of the portfolio, even from the point of view of the front office operators, allowing, at the same time, a continuous update of the assessment of creditworthiness based on new purchases.

Finally, a very important element for the purpose of estimates of expected losses is the inclusion of forward-looking factors and, in particular, the macroeconomic scenarios. From a methodological point of view, several possible alternative approaches have been analysed in order to take into account those elements.

## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### gg) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements (continued)

The rules on impairment introduced by IFRS 9 undoubtedly represent a considerable change compared to the logics of IAS 39. As regards the new metrics of exposure assessment, it is estimated that, for the Bank and the Group, the impact of the first application of the standard despite being "significant", will not result in any case critical compared to the current capital levels of financial statements and regulations of the Group. More specifically, it was not possible to provide specific indications of quantitative impact because the estimates available at the time of preparing these Financial Statements show a non-marginal width of the range within which it was expected for the capital impact of the new rules on impairment to be situated, depending, obviously, on the composition of the loan portfolios at the transition date, on the macroeconomic forecasts for future fiscal years that will be prepared at the date of transition to IFRS 9, as well as on the elements not yet fully defined, with regard to the finalization both of certain interpretation of the regulations and their implementation (still the subject of a debate at national and international level) both of certain choices regarding the organizational and information systems, which will be completed in the near future. In this context, therefore, the diffusion of an actual "impact assessment" would not be of use to the readers of the financial statements, as it does not indicate neither the current situation neither the consolidated choices able to influence future results. In this regard, it is noted that the methods of management of this particular case for prudential purposes are still under the definition phase.

According to standard parameters, the following can be envisaged:

- a greater profit or loss volatility, due to the passage of financial instruments from the stage 1 to stage 2 and vice versa, because of the different methods for determining the adjustments and write-downs compared to the current methodologies;
- the impact on the measurement of impairment for the determination of the "lifetime" expected loss on performing loans classified at the stage 2, which will be as greater as the duration of the individual reports.

#### *Hedge accounting*

With regard to hedge accounting, the new model relating to hedges - which does not apply though to the so-called "macro hedges" - tends to align the accounting presentation with risk management activities and to strengthen the disclosure of risk management activities undertaken by the reporting entity.

The Group and the Bank do not use hedge accounting and this change will not have the impact on them.

#### *Disclosures*

IFRS 9 will require extensive new disclosures, in particular about hedge accounting, credit risk and expected credit losses. The Group's preliminary assessment included an analysis to identify data gaps against current processes and the Group plans to implement the system and controls changes that it believes will be necessary to capture the required data.

#### *Transition*

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively, except as described below.

- The Group plans to take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 generally will be recognised in retained earnings and reserves as at 1 January 2018.
- The following assessments have to be made on the basis of the facts and circumstances that exist at the date of initial application.
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL
  - The designation of certain investments in equity instruments not held for trading as at FVOCI.

The process of a rational and effective implementation of the changes introduced by IFRS 9 regarding the Classification and Measurement and, above all, the Impairment, implies interventions extremely impacting on the area of Information Technology. For this purpose, analyses aimed at identifying the main areas of impact have been carried out, with the aim, on the one hand, to outline the target application architectures to be implemented and, on the other, to identify the applications and the procedures to be adapted (and, where appropriate, to be purchased), as well as the amendments to be made.



## Notes to the financial statements (continued)

### 3 Significant accounting policies (continued)

#### gg) Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements (continued)

Simultaneously with IT implementations, similar organizational analyses and interventions are currently in progress. More specifically, the main organizational impacts include the revision and adjustment of the existing operating processes, the design and implementation of new processes as well as the revision of the dimensioning and expansion of the available competences within the different structures both operational, administrative and control ones.

Finally, the introduction of IFRS 9 will presumably have impacts even in terms of commercial offer (and, consequently, and as already partially anticipated, in terms of revision of the product catalogue). In this regard, during 2016, some identifying and defining activities of the perimeter of possible mitigating actions were initiated. These activities are expected to continue and deepen during 2017.

The Group intends to perform the so-called "parallel running" of the application of the new standard starting from the second semester of 2017, based on the information available at that date.

## Notes to the financial statements (continued)

### 4 Accounting estimates and judgments in applying accounting policies

The Group makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors such as the expected flow of future events that can be rationally assumed in the existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Group's credit risk portfolio and, as part of this, the estimation of the fair value of real estate collateral represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

These disclosures supplement the commentary on fair values of financial assets and liabilities (Note 43) and financial risk management (Note 45).

#### *a) Impairment losses on loans and advances*

The Group reviews its portfolios of loans and advances to assess whether there is an evidence of impairment on an ongoing basis.

The Group first assesses whether evidence of impairment exists individually for assets that are individually significant, corporate exposures with total balance exceeding HRK 3.8 million, (2015: corporate exposure with total balance exceeding HRK 1.5 million) and collectively for assets that are not individually significant (retail). Those assets which are not identified as specifically impaired are subsequently included in the basis for collective impairment assessment, on the basis of similar credit risk characteristics.

Impairment allowance on assets individually assessed is based on the management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collective impairment for the group of homogenous assets that are not individually significant is established using statistical methods based on the historical loss rate experience. Management applies judgement to ensure that the estimate of loss arrived at on the basis of historical information is appropriately adjusted to reflect the current economic conditions. Loss rates are regularly benchmarked against actual loss experience.

In addition to losses on an individual basis, the Group continuously monitors and recognizes impairments which are known to exist at the reporting date, but which have not yet been identified. In estimating unidentified impairment losses for collectively assessed portfolios, the Group seeks to collect reliable data on appropriate loss rates based on historical experience related to and adjusted for current conditions, and the emergence period for the identification of these impairment losses. The accuracy of the allowance depends on the model assumptions and parameters used in determining the collective allowance.

During 2016 Bank has been intensively working on project initiated to align IFRS asset classification methodology and provisioning processes with ISP Group standards and implement common IT tool for asset classification and impairment, which has been successfully implemented and operational starting from September 2016. As part of this process the Bank also recalibrated collective impairment loss model parameters.

## Notes to the financial statements (continued)

### 4 Accounting estimates and judgments in applying accounting policies (continued)

#### b) *Impairment of available-for-sale equity investments*

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. In this respect, the Group regards a decline in fair value in excess of 20% to be significant and a decline in quoted market price that persisted for 9 months or longer to be prolonged. In making this judgement, the Group evaluates among other factors, the nominal volatility in the share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

#### c) *Held-to-maturity investments*

The Group follows the guidance of International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity.

#### d) *Classification of lease contracts*

The Group acts as a lessor in operating and finance leases. Where the Group, as a lessor, transfers substantially all the risks and rewards incidental to ownership to the lessee, the leases are classified as finance leases. All other leases are classified as operating and related assets are included in property and equipment under operating leases at cost net of accumulated depreciation. In determining whether leases should be classified as operating or finance, the Group considers the requirements of International Accounting Standard 17 *Leases*.

#### e) *Impairment of goodwill*

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Information about assumptions and estimation uncertainties regarding impairment of goodwill recognised in 2016 are explained in Note 24.

#### f) *Fair value of financial instruments*

If a market for a financial instrument is not active, or, if for any reason, fair value cannot be reasonably measured by market price, the Group establishes fair value using a valuation technique (except for certain unquoted equity securities). Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent to the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data. The chosen valuation techniques are periodically reviewed by an independent expert who has not participated in their formation. All models are certified before use.

#### g) *Reclassification of financial instruments*

The Group identified that the market conditions for Croatian government bonds no longer demonstrated active trading during the first half of 2009. In general, the fixed income market in Croatia was adversely impacted by the global recession which led to a standstill in trading, interrupted only by occasional forced transactions. In such circumstances, the Group could not actively trade these instruments and there were no observable elements on which the Group could reliably determine the fair value. In that context, in April and May 2009 the Group decided to reclassify the aforementioned financial instruments from the portfolio of financial instruments at fair value through profit and loss and available-for-sale portfolio to the loans and receivables portfolio. Overall, the Group has the intention and ability to hold the reclassified financial instruments for the foreseeable future. For more details refer to Note 43.

#### h) *Taxation*

The Group provides for tax liabilities in accordance with the tax laws of the Republic of Croatia. Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayers' records.

## Notes to the financial statements (continued)

### 4 Accounting estimates and judgments in applying accounting policies (continued)

#### *i) Regulatory requirements*

The Croatian National Bank and the Croatian Financial Services Supervisory Agency are entitled to carry out regulatory inspections of the Group's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

#### *j) Litigation and claims*

The Group makes an individual assessment of all court cases. The assessment is made by the Legal Department of the Bank or its relevant subsidiaries and in certain cases external lawyers are engaged. As stated in Note 34 the Group and the Bank provided HRK 63 million (2015: HRK 54 million) and HRK 46 million (2015: HRK 39 million) respectively for principal and interest in respect of liabilities for court cases, which the management estimates as sufficient. The above amounts represent the Group's best estimate of loss in respect of legal cases, although the actual outcome of court cases initiated against the Group can be significantly different. It is not practicable for management to estimate the financial impact of changes to the assumptions based on which management assesses the need for provisions.

#### *k) Fair value of property and equipment and investment property*

The Group uses the cost model for property and equipment and investment property. Carrying values are reviewed for impairment at least annually. The management considers that there are no indications of impairment at the reporting date based on these analyses.

#### *l) Foreclosed assets*

The Group occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the cost of the related loans and advances and the current fair value of such assets. Gains or losses on disposal are recognised in the income statement.

#### *m) Determination of control over investees*

Management applies its judgement to determine whether the Group controls investees. In assessing whether the Group controls the investees, the Group performs the power analysis and takes into consideration purpose and design of the investee, the evidence of practical ability to direct the relevant activities of the investees etc.

As a result, the Group concluded that it does not control and therefore should not consolidate its special purpose vehicles and entities with receivables in default, as the Group does not have power over the relevant activities of those entities.

#### *n) Law on Financial Transactions and Pre-bankruptcy Settlement*

The Law on Financial Transactions and Pre-bankruptcy Settlement came into force on 1 October 2012. The Law sets out criteria for the determination as to when the management of a business has an obligation to commence the process of pre-bankruptcy settlement. In accordance with the Law an application for pre-bankruptcy settlement has to include a restructuring plan and should be filed with the Financial Agency. The Law was designed to help debtors that are in financial difficulties to restructure their operations, thus allowing them to continue with their business activities. During the period of the pre-bankruptcy process, the company is protected from its creditors, who during this period are unable to block bank accounts or take steps to push the debtor into bankruptcy or otherwise seek to realise collateral. The implementation of a restructuring plan is subject to approval by certain majorities of creditors in various classes. At the same time, creditors may be in an improved position for the collection of their receivables than would otherwise be the case had they initiated bankruptcy proceedings against the debtor.

## Notes to the financial statements (continued)

### 4 Accounting estimates and judgments in applying accounting policies (continued)

#### *n) Law on Financial Transactions and Pre-bankruptcy Settlement (continued)*

Regulation relating to prebankruptcy settlement was amended in 2015 with the new Law on bankruptcy which regulates prebankruptcy and bankruptcy conditions and activities.

The Group has set up an internal function which closely monitors clients that have filed for pre-bankruptcy settlement and assists these borrowers in developing and implementing a restructuring plan in order to facilitate the collection of the Group's assets. At the same time, although a majority of debtors that have filed for pre-bankruptcy settlement have been already identified by the Group as non-performing, the Group reassesses the adequacy of their provisions.

Up to December 2016, 288 debtors of the Group have filed an application with the Agency with total balance and off-balance-sheet exposure of HRK 445 million, net of impairment allowance. The impairment allowance accounts for 48% of the gross total value of those exposures.

Out of this, for 146 clients which were debtors of the Bank, the pre-bankruptcy settlement has been successfully agreed and these clients are currently in the process of restructuring. The total exposure for those clients amounts to HRK 247 million, net of impairment allowance.

For 101 clients with net exposure of HRK 112 million, the pre-bankruptcy settlement was not successful and for those receivership proceedings have been initiated.

The management is unable to determine the effect of the pre-bankruptcy settlement process on the realisable value of its credit-risk exposures, and expects that the consequences of the application of the Law will be visible in the following years.

## Notes to the financial statements (continued)

### 5 Net interest income

#### a) Interest income – analysis by source

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Retail	1,930	2,011	1,696	1,765
Corporate	843	872	702	702
Public sector and other institutions	510	540	493	519
Banks	17	22	17	24
	<b>3,300</b>	<b>3,445</b>	<b>2,908</b>	<b>3,010</b>

#### b) Interest income – analysis by product

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Loans and advances to customers	3,100	3,231	2,740	2,834
Financial assets initially designated at fair value through profit or loss	69	101	68	100
Debt securities classified as loans and receivables	62	58	59	49
Loans and advances to banks	17	24	17	24
Financial assets available for sale	34	25	7	1
Held-to-maturity investments	1	4	-	-
Financial assets held for trading	17	2	17	2
	<b>3,300</b>	<b>3,445</b>	<b>2,908</b>	<b>3,010</b>

Interest income includes collected interest income from impaired loans of the Group of HRK 190 million (2015: HRK 251 million) and of the Bank of HRK 172 million (2015: HRK 214 million).

**Notes to the financial statements (continued)**

**5 Net interest income (continued)**

**c) Interest expense – analysis by recipient**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Retail	516	735	437	648
Banks	95	111	90	111
Public sector and other institutions	26	30	21	29
Corporate	39	54	25	29
	<b>676</b>	<b>930</b>	<b>573</b>	<b>817</b>

**d) Interest expense – analysis by product**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Current accounts and deposits from retail customers	516	735	437	648
Interest-bearing borrowings	69	107	59	93
Current accounts and deposits from corporate customers and public sector	62	84	44	58
Current accounts and deposits from banks	29	4	33	18
	<b>676</b>	<b>930</b>	<b>573</b>	<b>817</b>

## Notes to the financial statements (continued)

### 6 Net fee and commission income

#### a) Fee and commission income

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Credit cards	807	836	119	133
Payment transactions	378	364	360	348
Customer services	101	103	79	84
Investment management, brokerage and consultancy	58	69	58	68
Customer loans	43	44	37	38
Guarantees	47	45	39	38
Other	57	60	62	49
	<b>1,491</b>	<b>1,521</b>	<b>754</b>	<b>758</b>

#### b) Fee and commission expense

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Credit cards	174	224	74	67
Payment transactions	30	30	29	28
Bank charges	8	7	6	6
Other	33	32	11	8
	<b>245</b>	<b>293</b>	<b>120</b>	<b>109</b>

### 7 Dividend income

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Dividends from associates	-	-	18	15
Dividends from subsidiaries	-	-	200	150
Dividends from other equity securities	9	5	9	5
	<b>9</b>	<b>5</b>	<b>227</b>	<b>170</b>



## Notes to the financial statements (continued)

### 8 Net trading income and net gains on translation of monetary assets and liabilities

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Net trading (expense) from forward foreign exchange contracts and swaps	58	(180)	58	(180)
Net gain from translation of monetary assets and liabilities denominated in foreign currency	(46)	53	(48)	57
Foreign exchange spot trading	201	228	189	215
Net gains /(losses) on financial assets held for trading	22	(23)	22	(23)
Net gains / (losses) from securities initially designated at fair value through profit or loss	(8)	4	(8)	3
	<b>227</b>	<b>82</b>	<b>213</b>	<b>72</b>

### 9 Other operating income

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Rental income from investment property and assets under operating lease	45	50	8	8
Net gain on disposal of available-for-sale securities	125	1	125	1
Gain on disposal of property and equipment and intangible assets	22	13	5	4
Gain on disposal of associate Intesa Sanpaolo Card (note 23)	162	-	241	-
Other income	58	81	51	64
	<b>412</b>	<b>145</b>	<b>430</b>	<b>77</b>

## Notes to the financial statements (continued)

### 10 Personnel expenses

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Net salaries	452	453	359	359
Contributions for pension insurance	128	127	104	103
Taxes and surtaxes	92	89	82	79
Contributions for health insurance	98	99	80	80
Other personnel expenses	102	83	93	74
	<b>872</b>	<b>851</b>	<b>718</b>	<b>695</b>

During the year the average number of employees within the Group based on full-time employment equivalence was 3,593 (2015: 3,580) of which the Bank accounted for 2,855 employees (2015: 2,870).

### 11 Other operating expenses

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Materials and services	442	451	350	340
Deposit insurance premium	135	143	122	131
Rental expenses	55	59	69	75
Indirect and other taxes	20	18	16	16
Other expenses	391	368	131	121
	<b>1,043</b>	<b>1,039</b>	<b>688</b>	<b>683</b>

## Notes to the financial statements (continued)

### 12 Impairment losses and provisions

#### a) Impairment losses on loans and advances to customers

		(in HRK million)			
		GROUP		BANK	
Notes		2016	2015	2016	2015
Movement in impairment losses on loans and advances to customers	20c	413	109	373	130
Legal expenses related to loans and advances to customers		23	39	16	19
		<b>436</b>	<b>148</b>	<b>389</b>	<b>149</b>

Movement in impairment losses on loans and advances to customers for the Group includes HRK 1 million of profit from receivables sold during the year (2015: profit of HRK 129 million) and for the Bank HRK 1 million (2015: profit of HRK 80 million).

#### b) Other impairment losses and provisions

		(in HRK million)			
		GROUP		BANK	
Notes		2016	2015	2016	2015
Provisions for loans and advances to banks	19b	(15)	3	(15)	3
Movement in impairment loss on financial assets available for sale	21	9	1	9	1
Movement in impairment losses on other assets	27	13	18	9	8
Provisions for off-balance-sheet items	34	(33)	18	(34)	15
(Release of provisions)/provisions for court cases	34	11	(32)	8	(36)
Provisions for other items	34	(1)	1	(1)	5
		<b>(16)</b>	<b>9</b>	<b>(24)</b>	<b>(4)</b>

The impairment loss on financial assets available for sale in the amount of HRK 9 million (2015: HRK 1 million) relates to further impairment losses on previously impaired financial assets.

## Notes to the financial statements (continued)

### 13 Depreciation and amortisation and impairment of goodwill

		(in HRK million)			
		GROUP		BANK	
Notes		2016	2015	2016	2015
Depreciation and impairment of property and equipment	25	114	129	69	79
Impairment of goodwill	24	40	-	-	-
Amortisation of intangible assets	24	48	44	42	37
Depreciation of investment property	26	3	1	2	1
		<b>205</b>	<b>174</b>	<b>113</b>	<b>117</b>

Depreciation of property and equipment includes HRK 34 million of depreciation of assets under operating lease (2015: HRK 40 million). Depreciation of property and equipment in 2016 does not include impairment loss for both the Group and the Bank (2015: HRK 1 million).

### 14 Income tax expense

#### a) Income tax expense recognised in the income statement

		(in HRK million)			
		GROUP		BANK	
		2016	2015	2016	2015
Current income tax charge		434	94	368	19
Net deferred tax charge		11	3	12	(2)
<b>Income tax expense recognised in the income statement</b>		<b>445</b>	<b>97</b>	<b>380</b>	<b>17</b>

## Notes to the financial statements (continued)

### 14 Income tax expense (continued)

#### b) Reconciliation of income tax expense

The reconciliation between the accounting profit and income tax expense is set out below:

(in HRK million)

	GROUP		BANK	
	2016	2015	2016	2015
<b>Accounting profit before tax</b>	<b>2,032</b>	<b>467</b>	<b>1,985</b>	<b>210</b>
Tax calculated at rate of 20% (2015: 20%)	406	93	397	42
Effect of different tax rates in Bosnia and Herzegovina	(11)	(11)	-	-
<i>Tax effects of:</i>				
Non-deductible expenses	63	22	30	11
Tax exempt income	(12)	(8)	(46)	(36)
Expenses/income included directly in income tax expense	(1)	1	(1)	-
<b>Total income tax expense</b>	<b>445</b>	<b>97</b>	<b>380</b>	<b>17</b>
<b>Effective income tax rate</b>	<b>21.9%</b>	<b>20.8%</b>	<b>19.1%</b>	<b>8.1%</b>

#### c) Deferred tax assets

(in HRK million)

	GROUP		BANK	
	2016	2015	2016	2015
<i>Timing differences</i>				
On deferred fees	29	41	26	36
On impairment of real estate	13	13	10	10
On unrealised losses on financial assets at fair value through profit or loss	39	42	39	42
On other items	16	12	13	12
On impairment of loans	33	33	-	-
<b>Deferred tax assets</b>	<b>130</b>	<b>141</b>	<b>88</b>	<b>100</b>

## Notes to the financial statements (continued)

### 14 Income tax expense (continued)

#### d) Deferred tax liabilities

(in HRK million)

	GROUP		BANK	
	2016	2015	2016	2015
<i>Timing differences</i>				
On unrealised gains on available-for-sale financial assets	21	34	5	22
<b>Deferred tax liabilities</b>	<b>21</b>	<b>34</b>	<b>5</b>	<b>22</b>

#### e) Movement in deferred tax assets

##### Group

(in HRK million)

	Total	Deferred fees	Impairment of real estate	Unrealised losses on financial assets at fair value through profit or loss	Other items	Impairment of loans
<b>Balance as at 1 January 2016</b>	<b>141</b>	<b>41</b>	<b>13</b>	<b>42</b>	<b>12</b>	<b>33</b>
<i>Increase credited to income statement</i>	<i>43</i>	<i>12</i>	<i>-</i>	<i>4</i>	<i>24</i>	<i>3</i>
<i>Charge due to decrease of tax rate (from 20% to 18%)</i>	<i>(11)</i>	<i>(5)</i>	<i>-</i>	<i>(4)</i>	<i>(1)</i>	<i>(1)</i>
<i>Utilisation charged to income statement</i>	<i>(43)</i>	<i>(19)</i>	<i>-</i>	<i>(3)</i>	<i>(19)</i>	<i>(2)</i>
Net amount charged to income statement	<b>(11)</b>	<b>(12)</b>	<b>-</b>	<b>(3)</b>	<b>4</b>	<b>-</b>
<b>Balance as at 31 December 2016</b>	<b>130</b>	<b>29</b>	<b>13</b>	<b>39</b>	<b>16</b>	<b>33</b>
<b>Balance as at 1 January 2015</b>	<b>144</b>	<b>45</b>	<b>13</b>	<b>40</b>	<b>9</b>	<b>37</b>
<i>Increase credited to income statement</i>	<i>42</i>	<i>14</i>	<i>1</i>	<i>3</i>	<i>24</i>	<i>-</i>
<i>Utilisation charged to income statement</i>	<i>(45)</i>	<i>(18)</i>	<i>(1)</i>	<i>(1)</i>	<i>(21)</i>	<i>(4)</i>
Net amount charged to income statement	<b>(3)</b>	<b>(4)</b>	<b>-</b>	<b>2</b>	<b>3</b>	<b>(4)</b>
<b>Balance as at 31 December 2015</b>	<b>141</b>	<b>41</b>	<b>13</b>	<b>42</b>	<b>12</b>	<b>33</b>

**Notes to the financial statements (continued)**

**14 Income tax expense (continued)**

**e) Movement in deferred tax assets (continued)**

**Bank**

(in HRK million)

	Total	Deferred fees	Impairment of real estate	Unrealised losses on financial assets at fair value through profit or loss	Other items
<b>Balance as at 1 January 2016</b>	<b>100</b>	<b>36</b>	<b>10</b>	<b>42</b>	<b>12</b>
<i>Increase credited to income statement</i>	<i>38</i>	<i>12</i>	<i>-</i>	<i>4</i>	<i>22</i>
<i>Charge due to decrease of tax rate (from 20% to 18%)</i>	<i>(10)</i>	<i>(4)</i>	<i>-</i>	<i>(4)</i>	<i>(2)</i>
<i>Utilisation charged to income statement</i>	<i>(40)</i>	<i>(18)</i>	<i>-</i>	<i>(3)</i>	<i>(19)</i>
Net amount charged to income statement	(12)	(10)	-	(3)	1
<b>Balance as at 31 December 2016</b>	<b>88</b>	<b>26</b>	<b>10</b>	<b>39</b>	<b>13</b>
<b>Balance as at 1 January 2015</b>	<b>98</b>	<b>40</b>	<b>10</b>	<b>40</b>	<b>8</b>
<i>Increase credited to income statement</i>	<i>41</i>	<i>14</i>	<i>-</i>	<i>3</i>	<i>24</i>
<i>Utilisation charged to income statement</i>	<i>(39)</i>	<i>(18)</i>	<i>-</i>	<i>(1)</i>	<i>(20)</i>
Net amount charged to income statement	2	(4)	-	2	4
<b>Balance as at 31 December 2015</b>	<b>100</b>	<b>36</b>	<b>10</b>	<b>42</b>	<b>12</b>

**Notes to the financial statements (continued)**

**14 Income tax expense (continued)**

**f) Movement in deferred tax liabilities**

(in HRK million)

	<b>GROUP</b>	<b>BANK</b>
	<b>Unrealised gains on available-for-sale fi- nancial assets</b>	<b>Unrealised gains on available-for-sale fi- nancial assets</b>
<b>Balance as at 1 January 2016</b>	<b>34</b>	<b>22</b>
Increase charged to other comprehensive income	(13)	(17)
<b>Balance as at 31 December 2016</b>	<b>21</b>	<b>5</b>
<b>Balance as at 1 January 2015</b>	<b>11</b>	<b>1</b>
Increase charged to other comprehensive income	23	21
<b>Balance as at 31 December 2015</b>	<b>34</b>	<b>22</b>



**Notes to the financial statements (continued)****15 Cash and current accounts with banks**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Cash in hand	2,014	1,982	1,520	1,430
Current accounts with the CNB	6,600	3,420	6,600	3,420
Current accounts with foreign banks	4,339	4,580	4,209	4,281
Current accounts with domestic banks	16	12	8	11
Other cash items	1	1	1	1
	<b>12,970</b>	<b>9,995</b>	<b>12,338</b>	<b>9,143</b>

**16 Balances with the Croatian National Bank**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Obligatory reserve	3,916	4,550	3,916	4,550
	<b>3,916</b>	<b>4,550</b>	<b>3,916</b>	<b>4,550</b>

The CNB determines the requirement for banks to calculate an obligatory reserve, which is required to be deposited with the CNB and held in the form of other liquid receivables. The obligatory reserve requirement as at 31 December 2016 amounted to 12% (2015: 12%) of kuna and foreign currency deposits and borrowings.

As at 31 December 2016, the required rate for the part of the obligatory reserve calculated based on kuna liabilities to be deposited with the CNB amounted to 70% (2015: 70%), while the remaining 30% (2015: 30%) had to be held in the form of other liquid receivables. This includes the part of foreign currency obligatory reserve required to be held in HRK.

In accordance with Decision on reserve requirements (136/2015), banks are not required to hold the foreign currency obligatory reserve deposited with the CNB, but 100% must be held in form of other liquid receivables. As at 31 December 2015, Bank held foreign currency reserve with the CNB, allocated during 2015 ending at 30 November 2015, while at 31 December 2016 entire foreign currency obligatory reserve was held in the form of other liquid receivables which resulted in a decrease of obligatory reserve.

From May 2016, the Bank must maintain at least 2% of the part of the foreign currency obligatory reserve for maintenance, of point XI. paragraph 1 of the Decision on reserve requirements (136/2015), an average daily balance of funds on their own foreign currency euro settlement accounts with the CNB.

The obligatory reserve did not earn any interest in 2016 (2015: nil).

**Notes to the financial statements (continued)**

**17 Financial assets at fair value through profit or loss**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Financial assets held for trading</b>				
Republic of Croatia bonds	493	30	493	30
Equity securities	22	17	20	16
Domestic corporate bonds	-	28	-	28
Accrued interest	5	1	5	1
	<b>520</b>	<b>76</b>	<b>518</b>	<b>75</b>
Listed securities	520	76	518	75
	<b>520</b>	<b>76</b>	<b>518</b>	<b>75</b>
<b>Financial assets initially designated at fair value through profit or loss</b>				
Ministry of Finance treasury bills	5,452	5,677	5,418	5,618
Bonds issued by domestic corporate issuers	6	33	6	33
Municipal bonds	5	27	5	27
Equity securities	6	10	6	10
Accrued interest	22	55	22	55
	<b>5,491</b>	<b>5,802</b>	<b>5,457</b>	<b>5,743</b>
Listed securities	17	71	17	71
Unlisted securities	5,474	5,731	5,440	5,672
	<b>5,491</b>	<b>5,802</b>	<b>5,457</b>	<b>5,743</b>
Units in investment funds - quoted	92	92	-	-
	<b>92</b>	<b>92</b>	<b>-</b>	<b>-</b>
<b>Financial assets at fair value through profit or loss</b>				
	<b>6,103</b>	<b>5,970</b>	<b>5,975</b>	<b>5,818</b>

**Notes to the financial statements (continued)****18 Derivative financial assets and liabilities**

(in HRK million)

**Derivatives classified as held for trading**

	<b>GROUP</b>		<b>BANK</b>	
	2016	2015	2016	2015
<b>Assets</b>				
<i>Fair value:</i>				
Forward foreign exchange contracts and swaps	25	4	19	4
	<b>25</b>	<b>4</b>	<b>19</b>	<b>4</b>
<i>Notional amount:</i>				
Forward foreign exchange contracts and swaps	2,346	2,892	2,269	2,892
Other embedded derivatives	-	1	-	1
	<b>2,346</b>	<b>2,893</b>	<b>2,269</b>	<b>2,893</b>
<b>Liabilities</b>				
<i>Fair value:</i>				
Forward foreign exchange contracts and swaps	11	15	5	15
	<b>11</b>	<b>15</b>	<b>5</b>	<b>15</b>
<i>Notional amount:</i>				
Forward foreign exchange contracts and swaps	2,332	2,904	2,254	2,904
Other embedded derivatives	-	1	-	1
	<b>2,332</b>	<b>2,905</b>	<b>2,254</b>	<b>2,905</b>

The Group uses foreign currency forward and swap contracts to manage its exposure to foreign currency risk. Other embedded derivatives relate to loans with single-sided currency clause.

As the Bank has not implemented hedge accounting the related derivatives are classified as financial instruments held for trading.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of instruments and, therefore, do not indicate the Group's exposure to credit or price risks.

## Notes to the financial statements (continued)

### 19 Loans and advances to banks

a) Analysis by type of product	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Term deposits and placements	2,091	2,900	1,557	2,783
Obligatory reserve with CBBH	578	367	-	-
Loans	178	239	215	239
	<b>2,847</b>	<b>3,506</b>	<b>1,772</b>	<b>3,022</b>
Impairment allowance	(41)	(56)	(41)	(56)
	<b>2,806</b>	<b>3,450</b>	<b>1,731</b>	<b>2,966</b>

Term deposits mainly relate to short-term deposits with local and foreign banks bearing an average annual interest rate in the range of 0.3% and 2.5% (2015: in the range of 0.2% and 2.3%).

The obligatory reserve with the Bosnia and Herzegovina central bank ("CBBH") represents amounts required to be deposited with CBBH. The obligatory reserve is calculated on the basis of deposits and borrowings taken, regardless of the currency (excluding borrowings taken from foreign entities and funds from governments of Bosnia and Herzegovina entities for development projects).

#### b) Movement in impairment allowance

	Note	(in HRK million)			
		GROUP		BANK	
		2016	2015	2016	2015
<b>Balance at 1 January</b>		<b>56</b>	<b>53</b>	<b>56</b>	<b>53</b>
Net charge for the year	12b	(15)	3	(15)	3
<b>Balance at 31 December</b>		<b>41</b>	<b>56</b>	<b>41</b>	<b>56</b>

## Notes to the financial statements (continued)

### 19 Loans and advances to banks (continued)

c) Geographical analysis	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Republic of Croatia	253	298	286	291
Italy	105	75	-	-
Germany	252	813	252	811
France	185	385	185	385
Great Britain	98	94	98	94
Austria	36	685	-	650
Switzerland	502	101	503	101
Belgium	417	610	417	610
Other countries	999	445	31	80
	<b>2,847</b>	<b>3,506</b>	<b>1,772</b>	<b>3,022</b>
Impairment allowance	(41)	(56)	(41)	(56)
	<b>2,806</b>	<b>3,450</b>	<b>1,731</b>	<b>2,966</b>

As at 31 December 2016 loans and advances to banks included reverse repurchase agreements in the amount of HRK 165 million for the Group and HRK 202 million for the Bank (2015: HRK 20 million for both the Group and the Bank). Such agreements are secured with government bonds and treasury bills. For details on sale and repurchase agreements please refer to Note 45(a).

### 20 Loans and advances to customers

a) Analysis by type of customer	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Retail customers	29,106	28,742	23,843	23,949
Corporate customers	17,122	17,515	14,154	14,518
Public sector and other institutions	8,957	8,515	9,439	8,964
Debt securities	1,387	900	1,328	843
	<b>56,572</b>	<b>55,672</b>	<b>48,764</b>	<b>48,274</b>
Impairment allowance	(3,434)	(4,103)	(2,877)	(3,534)
Deferred interest and fees recognised as an adjustment to the effective yield	(232)	(260)	(199)	(230)
CHF conversion not yet finalised (note 20f)	(21)	(324)	(21)	(324)
	<b>52,885</b>	<b>50,985</b>	<b>45,667</b>	<b>44,186</b>

Debt securities of the Group and the Bank include HRK 74 million (2015: HRK 83 million) and HRK 16 million (2015: HRK 23 million), respectively, of Croatian bonds reclassified from available-for-sale financial assets in 2009, as well as HRK 616 million (2015: HRK 607 million) for the Group and the Bank of Croatian government bonds reclassified in 2009 from the held-for-trading category as described in Notes 21 and 43(d).

**Notes to the financial statements (continued)****20 Loans and advances to customers (continued)**

(in HRK million)

b) Analysis by sector	GROUP		BANK	
	2016	2015	2016	2015
Individuals	29,106	28,742	23,843	23,949
Construction	5,790	5,404	5,403	5,015
Public administration and defence	4,988	5,110	4,784	4,931
Wholesale and retail trade	4,313	4,357	3,128	3,275
Manufacturing	3,385	3,605	2,650	2,792
Energy products and water supplies	1,058	1,060	1,010	1,023
Hotels and restaurants	1,738	1,944	1,629	1,758
Professional, scientific and technical services	801	816	730	750
Transport and communication	1,337	1,680	1,080	1,450
Real estate, renting and business services	1,412	1,063	1,376	978
Agriculture, forestry and fishing	870	947	766	832
Other	1,774	944	2,365	1,521
	<b>56,572</b>	<b>55,672</b>	<b>48,764</b>	<b>48,274</b>
Impairment allowance	(3,434)	(4,103)	(2,877)	(3,534)
Deferred interest and fees recognised as an adjustment to the effective yield	(232)	(260)	(199)	(230)
CHF conversion not yet finalised	(21)	(324)	(21)	(324)
	<b>52,885</b>	<b>50,985</b>	<b>45,667</b>	<b>44,186</b>

Loans and advances to customers also include finance lease receivables. For a more detailed analysis of finance lease receivables please refer to Note 39 *Leases*.

**Notes to the financial statements (continued)**
**20 Loans and advances to customers (continued)**
**c) Movement in impairment allowance on loans and advances to customers**

(in HRK million)

	Retail		Corporate		Public sector and other institutions		Total
	Specific	IBNR	Specific	IBNR	Specific	IBNR	
<b>Group</b>							
<b>Balance at 1 January 2016</b>	<b>1,591</b>	<b>227</b>	<b>1,913</b>	<b>350</b>	<b>6</b>	<b>16</b>	<b>4,103</b>
Net charge in the income statement	118	(12)	335	(39)	4	7	413
Amounts written off and amortization of discounts	(253)	-	(812)	-	-	-	(1,065)
Foreign exchange loss	(12)	-	(5)	-	-	-	(17)
<b>Balance at 31 December 2016</b>	<b>1,444</b>	<b>215</b>	<b>1,431</b>	<b>311</b>	<b>10</b>	<b>23</b>	<b>3,434</b>
<b>Balance at 1 January 2015</b>	<b>1,975</b>	<b>220</b>	<b>1,963</b>	<b>438</b>	<b>9</b>	<b>14</b>	<b>4,619</b>
Net charge in the income statement	146	7	45	(88)	(3)	2	109
Amounts written off and amortization of discounts	(548)	-	(97)	-	-	-	(645)
Foreign exchange gain	18	-	2	-	-	-	20
<b>Balance at 31 December 2015</b>	<b>1,591</b>	<b>227</b>	<b>1,913</b>	<b>350</b>	<b>6</b>	<b>16</b>	<b>4,103</b>
<b>Bank</b>							
<b>Balance at 1 January 2016</b>	<b>1,380</b>	<b>181</b>	<b>1,600</b>	<b>347</b>	<b>5</b>	<b>21</b>	<b>3,534</b>
Net charge in the income statement	99	(21)	311	(27)	4	7	373
Amounts written off and amortization of discounts	(235)	-	(778)	-	-	-	(1,013)
Foreign exchange loss	(12)	-	(5)	-	-	-	(17)
<b>Balance at 31 December 2016</b>	<b>1,232</b>	<b>160</b>	<b>1,128</b>	<b>320</b>	<b>9</b>	<b>28</b>	<b>2,877</b>
<b>Balance at 1 January 2015</b>	<b>1,486</b>	<b>169</b>	<b>1,639</b>	<b>444</b>	<b>8</b>	<b>15</b>	<b>3,761</b>
Net charge in the income statement	170	12	42	(97)	(3)	6	130
Amounts written off and amortization of discounts	(294)	-	(84)	-	-	-	(378)
Foreign exchange gain	18	-	3	-	-	-	21
<b>Balance at 31 December 2015</b>	<b>1,380</b>	<b>181</b>	<b>1,600</b>	<b>347</b>	<b>5</b>	<b>21</b>	<b>3,534</b>

## Notes to the financial statements (continued)

### 20 Loans and advances to customers (continued)

#### d) Loans and contingencies under guarantee

The Republic of Croatia has in the past issued guarantees for the repayment of loans and advances to qualifying customers in certain key industries which were provided for by the state budget. In addition, the Republic of Croatia has issued guarantees for a certain number of the Bank's loans and off-balance-sheet credit risks.

The support and guarantee of the Republic of Croatia was taken into consideration when determining the level of provisions required against loans and off-balance-sheet credit risk exposure to certain entities.

Total Group balance-sheet and off-balance-sheet credit risks guaranteed by the Republic of Croatia or repayable from the state budget amounted to HRK 6,135 million (2015: HRK 5,545 million). Exposure to Croatian municipalities is included in the above analysis.

#### e) Collateral repossessed

During the year, the Group and the Bank foreclosed on assets previously charged to them as collateral, and thereby recognised foreclosed assets with a carrying value of HRK 1 million and HRK 0 million, respectively (2015: HRK 34 million and HRK 8 million respectively). The repossessed collateral, which the Group is in the process of selling, is disclosed as foreclosed assets within Other assets (Note 27). In general, the Group does not occupy repossessed properties for business use.

#### f) CHF loans conversion

In the period from 2005 to 2008 the Bank granted retail loans linked to or denominated in Swiss franc (CHF).

At loan inception, clients took advantage of favourable rates in CHF. However, from 2006 CHF LIBOR rates started to increase, as a result of which the Bank started to increase interest rates on CHF loans. In addition, in 2009 and then in 2015, CHF appreciated sharply against HRK (and EUR), which further increased monthly instalments, while CHF LIBOR rates fell markedly.

Due to the above noted changes, the civil rights group "Potrošač" brought a lawsuit against seven banks in the Republic of Croatia, including the Bank, alleging the miss-selling by the defendant banks of loans linked to CHF to retail customers, and thereby the infringement of the consumer protection rights of those customers ("CHF loans").

A first-instance court ruled against the defendant banks on 4 July 2013 and instructed them to offer to consumers amendments to the original contractual provisions of the CHF loans by expressing these loans in local currency at the exchange rate applicable at the date of loan disbursement and by fixing the rate of interest applicable at the date of loan origination for the duration of the loan. The defendant banks have each appealed separately against this decision claiming that the ruling was not legally well founded, citing a number of procedural and factual weaknesses. The High Commercial Court on 16 July 2014 issued a decision which partially rejected and partially upheld the above ruling issued by first-instance court. The Bank has sought extraordinary legal remedy – a revision (both regular and extraordinary).

Meanwhile, in response to a sudden appreciation of CHF, in January 2015 the Consumer Credit Act was changed and as a temporary measure the CHF exchange rate was fixed at 6.39 HRK for 1 CHF for the duration of one year for regular repayment annuities.

On 22 September 2015 the Act Amending the Consumer Credit Act ("the Amendment") was approved, by which, as a permanent measure, the conversion of CHF loans into EUR was regulated. The Amendment came into force on 30 September 2015. In accordance with the Amendment, the conversion of CHF loans into EUR is carried out in such a way that the position of the borrowers with loans denominated in CHF is matched to the position in which the borrower would have been if the loan was originally denominated in EUR, and the position of borrowers with loans denominated in HRK which contain a currency clause linking payments to CHF is matched to the position in which the borrower would have been if the loan was originally denominated in HRK containing a currency clause linking payments to EUR. The Amendment gave the banks a period of 45 days from when the Amendment came into force to deliver to the consumer the loan conversion calculation as at 30 September 2015. The consumer had 30 days to respond if the conversion is accepted. The time limit for the conversion itself, after the conversion had been accepted, was not specified.



## Notes to the financial statements (continued)

### 20 Loans and advances to customers (continued)

#### f) CHF loans conversion (continued)

Total loss for the Bank and the Group recognized in 2015 as the result of the conversion was HRK 1,311 million and is presented in the position Loss recognized on CHF conversion.

In 2016 the Bank recognized a release in provision of HRK 30 million representing the difference between estimated amount and actual conversion loss. As at 31 December 2016 129 loan contracts for which the Bank offered the conversion were not yet converted into EUR (2015: conversion was offered to 10,574 loan contracts, 9,818 loan contracts accepted the conversion and 8,036 loan contracts were converted). The CHF provision for unconverted loan contracts as at 31 December 2016 amounts to HRK 21 million (31 December 2015: HRK 324 million) and is presented as a reduction of loans to customers in a separate line in note 20a.

#### g) Sale of receivables

In 2016, both, the Group and the Bank sold HRK 1,241 million gross receivables (HRK 279 million net receivables) to a third party for HRK 280 million what resulted with a release of specific impairment allowance of HRK 1 million.

In 2015, the Group sold HRK 656 million gross receivable (HRK 43 million net receivable) to a third party for HRK 169 million what resulted with a release of specific impairment allowance of HRK 126 million and the Bank sold HRK 402 million gross receivables (impaired in full amount at the moment of sale) for HRK 80 million what resulted with a release of specific impairment allowance of HRK 80 million.

**Notes to the financial statements (continued)**

**21 Financial assets available for sale**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Debt securities	1,310	900	276	76
Equity securities	95	218	94	217
	<b>1,405</b>	<b>1,118</b>	<b>370</b>	<b>293</b>

**a) Available-for-sale debt securities**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Republic of Croatia bonds	960	735	274	76
Foreign government treasury bills	245	80	-	-
Foreign government bonds	98	80	-	-
	<b>1,303</b>	<b>895</b>	<b>274</b>	<b>76</b>
Accrued interest	7	5	2	-
	<b>1,310</b>	<b>900</b>	<b>276</b>	<b>76</b>
Listed securities	1,212	820	276	76
Unlisted securities	98	80	-	-
	<b>1,310</b>	<b>900</b>	<b>276</b>	<b>76</b>

**b) Available-for-sale equity securities**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Listed securities	26	33	26	33
Unlisted securities	69	185	68	184
	<b>95</b>	<b>218</b>	<b>94</b>	<b>217</b>

## Notes to the financial statements (continued)

### 21 Financial assets available for sale (continued)

Following the start of the global financial crisis, the Group considered, during 2009, that market conditions for Croatian corporate, municipal and government bonds no longer enabled active trading.

As the Group had the ability and intention to hold these assets to maturity and they satisfied the definition of loans and receivables at the time, the Group decided to reclassify these securities from the available-for-sale portfolio to loans and receivables.

For details, please refer to Note 43(d) Fair values of financial assets and liabilities - reclassification of financial assets. There were no further reclassifications after 2009.

#### *Unlisted equity securities carried at cost*

Unlisted equity securities whose fair value cannot be measured reliably are carried at cost or fair value at acquisition, less any impairment losses.

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Cost/fair value at acquisition	81	129	80	128
Impairment losses	(47)	(47)	(47)	(47)
<b>Carrying value of unlisted equity securities carried at cost</b>	<b>34</b>	<b>82</b>	<b>33</b>	<b>81</b>

#### *Movement in impairment losses*

##### Group and the Bank

	Note	(in HRK million)		
		Unlisted equity securities	Listed equity securities	Total
<b>Balance at 1 January 2015</b>		46	-	46
Impairment loss charged to income statement	12b	1	-	1
<b>Balance at 31 December 2015</b>		47	-	47
Impairment loss charged to income statement	12b	-	9	9
<b>Balance at 31 December 2016</b>		<b>47</b>	<b>9</b>	<b>56</b>

The Group holds 29% (2015: 29%) of the ordinary issued share capital of Quaestus Private Equity Kapital, a private equity investment fund ("the Fund"). The Group does not consider itself to have a significant influence over the Fund because the Group does not have the power to participate in the Fund's financial and operating policy decisions.

## Notes to the financial statements (continued)

### 22 Held-to-maturity investments

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Republic of Croatia bonds	17	17	-	-
Accrued interest	-	-	-	-
	<b>17</b>	<b>17</b>	<b>-</b>	<b>-</b>

Republic of Croatia bonds relate to bonds issued by the Ministry of Finance of the Republic of Croatia. They are denominated in EUR, bear interest rates 5.38% and mature 2019.

### 23 Investments in subsidiaries and associates

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Consolidated subsidiaries	-	-	925	925
Associates accounted for under the equity method by the Group and at cost by the Bank	67	150	28	38
	<b>67</b>	<b>150</b>	<b>953</b>	<b>963</b>
<b>Movements</b>				
<b>Balance at 1 January</b>	<b>150</b>	<b>142</b>	<b>963</b>	<b>215</b>
Share of profits from associates	24	24	-	-
Acquisition of Intesa Sanpaolo Bank dd	-	-	-	748
Disposal of associate Intesa Sanpaolo Card	(89)	-	(10)	-
Receipt of dividend	(18)	(16)	-	-
<b>Balance at 31 December</b>	<b>67</b>	<b>150</b>	<b>953</b>	<b>963</b>

## Notes to the financial statements (continued)

### 23 Investments in subsidiaries and associates (continued)

The principal investments in subsidiaries and associates as at 31 December are as follows:

	COUNTRY	NATURE OF BUSINESS	2016 holding %	2015
<b>CONSOLIDATED SUBSIDIARIES</b>				
PBZ Card doo	Croatia	card services	100	100
PBZ Leasing doo	Croatia	leasing	100	100
PBZ Nekretnine doo	Croatia	real estate agency	100	100
PBZ Stambena Štedionica dd	Croatia	housing savings bank	100	100
Intesa Sanpaolo Banka dd	Bosnia and Herzegovina	credit institution	95	95
<b>ASSOCIATES</b>				
PBZ Croatia osiguranje dd	Croatia	pension management	50	50
Intesa Sanpaolo Card doo	Croatia	card processing services	-	31

The Group considers that its 50% investment in PBZ Croatia osiguranje dd represent investment in associates (31 December 2015: 50% investment in PBZ Croatia osiguranje and 31% investment in Intesa Sanpaolo Card), as the Group does not have control over the companies. Consequently, PBZ Croatia osiguranje dd is accounted for using the equity method in the consolidated financial statements.

The following table illustrates summarised financial information of the PBZ Croatia osiguranje dd and Intesa Sanpaolo Card doo Zagreb:

(in HRK million)

	2016		2015	
	PBZ Croatia osiguranje	Intesa Sanpaolo Card Zagreb	PBZ Croatia osiguranje	Intesa Sanpaolo Card Zagreb
<b>Associates' statement of financial position</b>				
Current assets	141	-	135	171
Non-current assets	1	-	2	141
Current liabilities	(5)	-	(7)	(28)
Non-current liabilities	(3)	-	(2)	(4)
<b>Net assets of associates'</b>	<b>134</b>	<b>-</b>	<b>128</b>	<b>280</b>
<b>Attributable to PBZ Group</b>	<b>67</b>	<b>-</b>	<b>63</b>	<b>87</b>
<b>Associates' income statements</b>				
Revenue	64	287	64	298
Expenses	(40)	(250)	(37)	(265)
<b>Profit</b>	<b>24</b>	<b>37</b>	<b>27</b>	<b>33</b>
<b>Attributable to PBZ Group</b>	<b>12</b>	<b>12</b>	<b>14</b>	<b>10</b>

## Notes to the financial statements (continued)

### 23 Investments in subsidiaries and associates (continued)

#### *Involvement in unconsolidated structured entities*

The Group is involved in financing several special purpose entities that carry out various activities, such as real estate construction, tourism, etc. The Group concluded that it does not control, and therefore should not consolidate, the special purpose entities and its involvement is in all cases limited to providing finance with aim of collecting interest. Taken as a whole, the Group does not have power over the relevant activities of those entities.

#### **Disposal of associate Intesa Sanpaolo Card**

As of 15 December 2016 Privredna Banka Zagreb dd sold its stake of 31.2% in the company Intesa Sanpaolo Card Ltd. to the company wholly owned by Mercury UK Holdco Limited. for HRK 251 million.

In the Bank's financial statements, investment in ISP Card was carried at cost which amounted to HRK 10 million.

The carrying values of assets and liabilities of ISP Card, at the date that preceded the disposal, were as follows:

	(in HRK million)
<b>Associates' statement of financial position</b>	
Current assets	105
Non-current assets	211
Current liabilities	(25)
Non-current liabilities	(4)
<b>Net assets of associates'</b>	<b>287</b>
<b>Attributable to PBZ Group</b>	<b>89</b>

Effect of disposal on the financial position of the Bank and the Group in 2016:

	(in HRK million)	
	GROUP	BANK
<b>Associates' statement of financial position</b>		
Sales price (consideration received satisfied in cash)	251	251
Net assets of associates' attributable to PBZ Group at the date of disposal/Cost of investment by the Bank	(89)	(10)
<b>Profit on disposal (note 9)</b>	<b>162</b>	<b>241</b>
Income tax	(48)	(48)
<b>Profit on disposal, net of tax</b>	<b>114</b>	<b>193</b>

## Notes to the financial statements (continued)

### 23 Investments in subsidiaries and associates (continued)

#### *Acquisition of Intesa Sanpaolo Banka dd – common control transaction*

As of 20 July 2015 the Bank purchased a 94.9359% stake in Intesa Sanpaolo Banka dd Bosnia and Herzegovina (425,142 ordinary shares with 94.9486% voting rights) from Intesa Sanpaolo Holding International S.p.A.

The sales price was determined based on the carrying value of the net asset of the purchased bank as of 31 December 2014 and amounted to HRK 748 million.

The date of acquisition was considered to be 1 July 2015, the date when the Bank assumed financial and operational control over the subsidiary.

Since the ultimate owner of both banks is Intesa Sanpaolo S.p.A. Turin the transaction was accounted for out in accordance with the requirements of IFRS 3 for transactions under common control. In accordance with the aforementioned in the consolidated financial statements, the excess of consideration paid over the carrying value of share capital at the time of the combination was treated as a merger reserve in equity. In addition, in its consolidated financial statements the Bank restated its comparatives and adjusted its current reporting period before the date of transaction as if the combination had occurred before the start of the earliest period presented.

## Notes to the financial statements (continued)

### 23 Investments in subsidiaries and associates (continued)

#### *Acquisition of Intesa Sanpaolo Banka dd – common control transaction (continued)*

The carrying values of assets and liabilities of Intesa Sanpaolo Banka dd Bosnia and Herzegovina as at 1 July 2015 were as follows:

	1 July 2015*
Cash and current accounts with banks	1,027
Financial assets at fair value through profit or loss	1
Loans and advances to banks	433
Loans and advances to customers	4,247
Financial assets available for sale	161
Intangible assets	18
Property and equipment	48
Other assets	62
Tax prepayments	9
<b>Total assets</b>	<b>6,006</b>
Current accounts and deposits from banks	227
Current accounts and deposits from customers	4,039
Interest-bearing borrowings	790
Subordinated liabilities	2
Other liabilities	87
Provisions for liabilities and charges	16
Deferred tax liabilities	7
Current tax liability	-
<b>Total liabilities</b>	<b>5,168</b>
<b>Net assets and liabilities</b>	<b>838</b>
Minority interest	42
Negative goodwill	48
Consideration paid and payable	748
Cash acquired	1,199
Net cash inflow	451

(\*) reported figures not adjusted for intercompany transactions, consolidation and reclassification adjustments.



## Notes to the financial statements (continued)

## 24 Intangible assets

(in HRK million)

	Goodwill	Software	Other intangible assets	Assets acquired but not brought into use	Total
<b>Group</b>					
<b>Acquisition cost</b>					
<b>Balance at 1 January 2015</b>	<b>69</b>	<b>507</b>	<b>16</b>	<b>12</b>	<b>604</b>
Additions	-	-	-	63	<b>63</b>
Transfer into use	-	47	9	(56)	-
Disposals and eliminations	-	(2)	-	-	<b>(2)</b>
<b>Balance at 31 December 2015</b>	<b>69</b>	<b>552</b>	<b>25</b>	<b>19</b>	<b>665</b>
Additions	-	-	-	64	<b>64</b>
Transfer into use	-	62	2	(64)	-
Impairment of goodwill	(40)	-	-	-	<b>(40)</b>
<b>Balance at 31 December 2016</b>	<b>29</b>	<b>614</b>	<b>27</b>	<b>19</b>	<b>689</b>
<b>Accumulated amortisation</b>					
<b>Balance at 1 January 2015</b>	-	<b>426</b>	<b>14</b>	-	<b>440</b>
Charge for the year	-	42	2	-	<b>44</b>
Disposals and eliminations	-	(1)	-	-	<b>(1)</b>
<b>Balance at 31 December 2015</b>	-	<b>467</b>	<b>16</b>	-	<b>483</b>
Charge for the year	-	45	3	-	<b>48</b>
<b>Balance at 31 December 2016</b>	-	<b>512</b>	<b>19</b>	-	<b>531</b>
<b>Carrying value</b>					
<b>Balance at 31 December 2015</b>	<b>69</b>	<b>85</b>	<b>9</b>	<b>19</b>	<b>182</b>
<b>Balance at 31 December 2016</b>	<b>29</b>	<b>102</b>	<b>8</b>	<b>19</b>	<b>158</b>

Goodwill represents goodwill arising from the acquisition of Međimurska banka in the amount of HRK 15 million (2015: HRK 15 million), recognised as a purchased goodwill following the merger of Međimurska banka into Privredna banka Zagreb dd as at 1 December 2012 and goodwill arising from the acquisition of American Express card business in the amount of HRK 14 million (2015: HRK 54 million).

In 2016, PBZ Card impaired its goodwill in the amount of HRK 40 million. Company's goodwill has been created during the purchase and takeover of the company for credit card transactions Atlas American Express by PBZ that is PBZ American Express in November 1998. Considering the fact that American Express Ltd reached the business decision about changing the current business model in the countries of the European Union, based on the principles of caution and applying the accounting regulations, PBZ Card performed Goodwill value adjustment based on the application of such business model.

Goodwill recoverable amount is determined by calculating the value in use using cashflow projections from financial budgets approved by the company's Management Board. The business unit relating to the issuing and acceptance of American Express Cards, according to the current model, is considered as cash generating unit. The discount rate applied for discounting is 9.9% (2015: 10.93%).

## Notes to the financial statements (continued)

## 24 Intangible assets (continued)

(in HRK million)

	Goodwill	Software	Other intangible assets	Assets acquired but not brought into use	Total
<b>Bank</b>					
<b>Acquisition cost</b>					
<b>Balance at 1 January 2015</b>	14	449	-	5	468
Additions	-	-	-	53	53
Transfer into use	-	41	3	(44)	-
<b>Balance at 31 December 2015</b>	14	490	3	14	521
Additions	-	-	-	60	60
Transfer into use	-	60	-	(60)	-
<b>Balance at 31 December 2016</b>	14	550	3	14	581
<b>Accumulated amortisation</b>					
<b>Balance at 1 January 2015</b>	-	378	-	-	378
Charge for the year	-	37	-	-	37
<b>Balance at 31 December 2015</b>	-	415	-	-	415
Charge for the year	-	41	1	-	42
<b>Balance at 31 December 2016</b>	-	456	1	-	457
<b>Carrying value</b>					
<b>Balance at 31 December 2015</b>	14	75	3	14	106
<b>Balance at 31 December 2016</b>	14	94	2	14	124

Following the legal merger of Međimurska banka into the Bank as at 1 December 2012, the goodwill formerly arising on consolidation of Međimurska banka was transformed into purchased goodwill and recognised in the Bank's separate statement of financial position.

Notes to the financial statements (continued)

25 Property and equipment

(in HRK million)

	Land and buildings	Furniture and other equipment	Motor vehicles	Computer equipment	Assets acquired but not brought into use	Total
<b>Group</b>						
<b>Acquisition cost</b>						
<b>Balance at 1 January 2015</b>	<b>1,291</b>	<b>475</b>	<b>142</b>	<b>446</b>	<b>61</b>	<b>2,415</b>
Additions	-	-	-	-	74	74
Disposals	-	(18)	(53)	(20)	-	(91)
Transfer into use	17	24	40	29	(110)	-
<b>Balance at 31 December 2015</b>	<b>1,308</b>	<b>481</b>	<b>129</b>	<b>455</b>	<b>25</b>	<b>2,398</b>
Additions	-	-	-	-	96	96
Disposals	(9)	(14)	(60)	(16)	-	(99)
Transfer into use	3	10	44	35	(92)	-
Transfer to investment property	(98)	-	-	-	-	(98)
<b>Balance at 31 December 2016</b>	<b>1,204</b>	<b>477</b>	<b>113</b>	<b>474</b>	<b>29</b>	<b>2,297</b>
<b>Accumulated depreciation</b>						
<b>Balance at 1 January 2015</b>	<b>354</b>	<b>417</b>	<b>62</b>	<b>366</b>	<b>-</b>	<b>1,199</b>
Charge for the year	32	30	24	42	-	128
Impairment	1	-	-	-	-	1
Disposals	-	(12)	(31)	(19)	-	(62)
<b>Balance at 31 December 2015</b>	<b>387</b>	<b>435</b>	<b>55</b>	<b>389</b>	<b>-</b>	<b>1,266</b>
Charge for the year	31	19	21	43	-	114
Disposals	(2)	(14)	(31)	(16)	-	(63)
Transfer to investment property	(50)	-	-	-	-	(50)
<b>Balance at 31 December 2016</b>	<b>366</b>	<b>440</b>	<b>45</b>	<b>416</b>	<b>-</b>	<b>1,267</b>
<b>Carrying value</b>						
<b>Balance at 31 December 2015</b>	<b>921</b>	<b>46</b>	<b>74</b>	<b>66</b>	<b>25</b>	<b>1,132</b>
<b>Balance at 31 December 2016</b>	<b>838</b>	<b>37</b>	<b>68</b>	<b>58</b>	<b>29</b>	<b>1,030</b>

## Notes to the financial statements (continued)

## 25 Property and equipment (continued)

(in HRK million)

	Land and buildings	Furniture and other equip- ment	Motor ve- hicles	Computer equip- ment	Assets ac- quired but not brought into use	Total
<b>Bank</b>						
<b>Acquisition cost</b>						
<b>Balance at 1 January 2015</b>	<b>842</b>	<b>404</b>	<b>5</b>	<b>308</b>	<b>59</b>	<b>1,618</b>
Additions	-	-	-	-	20	20
Disposals	-	(6)	(3)	(8)	-	(17)
Transfer into use	8	18	1	27	(54)	-
<b>Balance at 31 December 2015</b>	<b>850</b>	<b>416</b>	<b>3</b>	<b>327</b>	<b>25</b>	<b>1,621</b>
Additions	-	-	-	-	38	38
Disposals	-	(9)	(1)	(9)	-	(19)
Transfer into use	2	7	-	27	(36)	-
Transfer to investment property	(98)	-	-	-	-	(98)
<b>Balance at 31 December 2016</b>	<b>754</b>	<b>414</b>	<b>2</b>	<b>345</b>	<b>27</b>	<b>1,542</b>
<b>Accumulated depreciation</b>						
<b>Balance at 1 January 2015</b>	<b>309</b>	<b>360</b>	<b>4</b>	<b>261</b>	<b>-</b>	<b>934</b>
Charge for the year	21	25	1	32	-	79
Disposals	-	(6)	(3)	(8)	-	(17)
<b>Balance at 31 December 2015</b>	<b>330</b>	<b>379</b>	<b>2</b>	<b>285</b>	<b>-</b>	<b>996</b>
Charge for the year	22	15	-	32	-	69
Disposals	-	(8)	(1)	(9)	-	(18)
Transfer to investment property	(50)	-	-	-	-	(50)
<b>Balance at 31 December 2016</b>	<b>302</b>	<b>386</b>	<b>1</b>	<b>308</b>	<b>-</b>	<b>997</b>
<b>Carrying value</b>						
<b>Balance at 31 December 2015</b>	<b>520</b>	<b>37</b>	<b>1</b>	<b>42</b>	<b>25</b>	<b>625</b>
<b>Balance at 31 December 2016</b>	<b>452</b>	<b>28</b>	<b>1</b>	<b>37</b>	<b>27</b>	<b>545</b>

Real estate, furniture and other equipment and motor vehicles of the Group include assets leased under operating leases with a carrying value of HRK 375 million (2015: HRK 400 million).

The carrying amount of the non-depreciable land within land and buildings is HRK 72 million for the Group and HRK 7 million for the Bank (2015: HRK 75 million and HRK 7 million, respectively).

**Notes to the financial statements (continued)****26 Investment property**

	(in HRK million)	
	GROUP	BANK
<b>Acquisition cost</b>		
<b>Balance at 1 January 2015</b>	<b>44</b>	<b>30</b>
Transfer from property and equipment	-	-
<b>Balance at 31 December 2015</b>	<b>44</b>	<b>30</b>
Additions		-
Disposals	(25)	(25)
Transfer from property and equipment	98	98
<b>Balance at 31 December 2016</b>	<b>117</b>	<b>103</b>
<b>Accumulated depreciation</b>		
<b>Balance at 1 January 2015</b>	<b>20</b>	<b>19</b>
Charge for the year	1	1
<b>Balance at 31 December 2015</b>	<b>21</b>	<b>20</b>
Charge for the year	3	2
Disposals and eliminations	(19)	(19)
Transfer from property and equipment	50	50
<b>Balance at 31 December 2016</b>	<b>55</b>	<b>53</b>
<b>Carrying value</b>		
<b>Balance at 31 December 2015</b>	<b>23</b>	<b>10</b>
<b>Balance at 31 December 2016</b>	<b>62</b>	<b>50</b>

The estimated fair value of investment property held by the Group as at 31 December 2016 amounted to HRK 107 million (2015: HRK 40 million) and for the Bank HRK 86 million (2015: HRK 19 million). The fair value was estimated by PBZ Nekretnine, a wholly owned subsidiary of the Bank, engaged in real estate management and by an independent appraiser. Both PBZ Nekretnine and independent valuers provide the fair values of the Group's investment property portfolio on at least yearly basis. The fair value measurements for all of the investment properties have been categorised as Level 3 fair value measurements. There were no transfers between levels during the year.

The property rental income earned by the Group and the Bank from its investment property, all of which was leased out under operating leases, amounted to HRK 8.2 million (2015: HRK 4.5 million) and HRK 5.2 million (2015: HRK 1.7 million) respectively, and was presented within other operating income (Note 9).

**Notes to the financial statements (continued)**

**27 Other assets**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Receivables from card business	258	198	66	63
Receivables based on foreign currency transactions	-	3	-	3
Receivables from debtors	8	9	1	1
Foreclosed assets	115	164	68	69
Accrued fees	45	56	54	67
Advance payments	13	4	9	2
Prepaid expenses	44	30	29	19
Receivables in course of collection	6	4	2	1
Other assets	93	169	76	146
Leasehold improvements	25	27	18	21
	<b>607</b>	<b>664</b>	<b>323</b>	<b>392</b>
Impairment	(75)	(115)	(49)	(87)
	<b>532</b>	<b>549</b>	<b>274</b>	<b>305</b>

**Movement in impairment**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Balance at 1 January</b>	<b>115</b>	<b>107</b>	<b>87</b>	<b>84</b>
Net charge for the year	13	18	9	8
Amounts written off	(53)	(10)	(47)	(5)
<b>Balance at 31 December</b>	<b>75</b>	<b>115</b>	<b>49</b>	<b>87</b>

Movement in impairment on other assets is presented as part of Provisions for other items and other assets (Note 12b).

**Notes to the financial statements (continued)**

**28 Current accounts and deposits from banks**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Term deposits	174	161	466	487
Demand deposits	951	922	910	886
	<b>1,125</b>	<b>1,083</b>	<b>1,376</b>	<b>1,373</b>

**29 Current accounts and deposits from customers**

*a) Analysis by term*

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Term deposits	30,805	33,096	28,489	30,861
Demand deposits	29,573	25,084	25,619	21,954
	<b>60,378</b>	<b>58,180</b>	<b>54,108</b>	<b>52,815</b>

*b) Analysis by source*

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Retail deposits	43,134	42,592	39,444	39,148
Corporate deposits	12,137	10,322	10,800	9,818
Public sector and other institutions	5,107	5,266	3,864	3,849
	<b>60,378</b>	<b>58,180</b>	<b>54,108</b>	<b>52,815</b>

**Notes to the financial statements (continued)**

**30 Interest-bearing borrowings**

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Domestic borrowings	1,714	1,596	1,638	1,569
Foreign borrowings	1,863	2,293	1,115	1,274
Accrued fee	(6)	(5)	(6)	(5)
	<b>3,571</b>	<b>3,884</b>	<b>2,747</b>	<b>2,838</b>

*a) Domestic borrowings*

Domestic borrowings of the Group mainly consist of loans received from the Croatian Bank for Reconstruction and Development (“HBOR”) in the amount of HRK 1.6 billion (2015: HRK 1.6 billion).

In accordance with the overall agreement, borrowings from HBOR are used to fund loans to customers for eligible construction and development projects at preferential interest rates.

*b) Foreign borrowings*

Foreign borrowings of the Group include short-term and long-term loans received from foreign banks and non-financial institutions denominated mostly in EUR and CHF and with floating interest rates.



## Notes to the financial statements (continued)

### 31 Subordinated liabilities

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Ministry of Finance of Bosnia and Herzegovina	1	2	-	-
	<b>1</b>	<b>2</b>	<b>-</b>	<b>-</b>

With the approval of the Banking Agency of Federation of Bosnia and Herzegovina, the subordinated debt may be classified as Tier 2 capital in the calculation of capital adequacy.

### 32 Other liabilities

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Payables to suppliers	1,198	1,060	32	38
Items in the course of settlement and other liabilities	399	255	317	173
Salaries and other personnel costs	152	123	132	105
	<b>1,749</b>	<b>1,438</b>	<b>481</b>	<b>316</b>

### 33 Accrued expenses and deferred income

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Accrued expenses	183	159	114	103
Deferred income	81	79	23	20
	<b>264</b>	<b>238</b>	<b>137</b>	<b>123</b>

**Notes to the financial statements (continued)****34 Provisions for liabilities and charges****Group**

	(in HRK million)			
	Total	Provisions for off-balance- sheet items	Provisions for court cases	Provisions for other items
<b>Balance as at 1 January 2016</b>	<b>313</b>	<b>248</b>	<b>54</b>	<b>11</b>
Net charge/(release) in the income statement	(23)	(33)	11	(1)
Provisions used during the year	(6)	-	(2)	(4)
<b>Balance as at 31 December 2016</b>	<b>284</b>	<b>215</b>	<b>63</b>	<b>6</b>
<b>Balance as at 1 January 2015</b>	<b>329</b>	<b>230</b>	<b>89</b>	<b>10</b>
Net charge in the income statement	(13)	18	(32)	1
Provisions used during the year	(3)	-	(3)	-
<b>Balance as at 31 December 2015</b>	<b>313</b>	<b>248</b>	<b>54</b>	<b>11</b>

**Bank**

	(in HRK million)			
	Total	Provisions for off-bal- ance-sheet items	Provisions for court cases	Provisions for other items
<b>Balance as at 1 January 2016</b>	<b>288</b>	<b>241</b>	<b>39</b>	<b>8</b>
Net charge/(release) in the income statement	(27)	(34)	8	(1)
Provisions used during the year	(4)	-	(1)	(3)
<b>Balance as at 31 December 2016</b>	<b>257</b>	<b>207</b>	<b>46</b>	<b>4</b>
<b>Balance as at 1 January 2015</b>	<b>306</b>	<b>226</b>	<b>77</b>	<b>3</b>
Net charge/(release) in the income statement	(16)	15	(36)	5
Provisions used during the year	(2)	-	(2)	-
<b>Balance as at 31 December 2015</b>	<b>288</b>	<b>241</b>	<b>39</b>	<b>8</b>

Provisions for off-balance-sheet items, court cases and other items are recognised in other impairment losses and provisions in the income statement (Note 12b).

Provision for off-balance-sheet items relates to specific and collective provisions on credit-related contingencies as disclosed in Note 35.

As at 31 December 2016 there were several litigation cases taken against the Group. In the opinion of management, there is a probability that the Group may lose certain cases, in respect of which management has recognised provisions for court cases as at 31 December 2016 in the amount of HRK 63 million (31 December 2015: HRK 54 million) for the Group and HRK 46 million (31 December 2015: HRK 39 million), for the Bank, respectively.

## Notes to the financial statements (continued)

### 35 Contingent liabilities and commitments

#### Credit-related contingencies and commitments

Credit-related contingencies and commitments arise from various banking products, the primary purpose of which is to ensure that funds are available to a customer when required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that customers cannot meet their obligations to third parties, carry the same credit risk as loans and advances. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorising a third party to draw funds on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly lower risk. Management has assessed that a provision of HRK 215 million for the Group and HRK 207 million for the Bank (2015: HRK 248 million and HRK 241 million respectively) is sufficient to cover risks due to the default of the respective counterparties (refer to Note 34).

The aggregate amounts of outstanding guarantees, letters of credit and other commitments at the end of the year were as follows:

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Undrawn lending commitments	10,826	9,864	10,094	9,104
Performance guarantees	2,476	1,883	2,256	1,703
Kuna payment guarantees	342	286	342	286
Foreign currency payment guarantees	626	861	456	770
Foreign currency letters of credit	210	168	190	155
Factoring and forfaiting	2	2	2	1
Other contingent liabilities	1	4	1	4
	<b>14,483</b>	<b>13,068</b>	<b>13,341</b>	<b>12,023</b>

On 31 December 2016 the Group and the Bank had long-term commitments as lessees in respect of rent for business premises and equipment lease agreements expiring between 2017 and 2021. The future minimum commitments for each of the next five years are presented below:

	(in HRK million)						
	2016	2017	2018	2019	2020	2021	Total
<b>Group</b>							
Premises	44	47	47	47	47	47	235
Equipment	4	7	9	11	10	13	50
	<b>48</b>	<b>54</b>	<b>56</b>	<b>58</b>	<b>57</b>	<b>60</b>	<b>285</b>
<b>Bank</b>							
Premises	70	73	73	73	73	73	365
Equipment	12	13	13	13	13	13	65
	<b>82</b>	<b>86</b>	<b>86</b>	<b>86</b>	<b>86</b>	<b>86</b>	<b>430</b>

**Notes to the financial statements (continued)****36 Share capital***a) Issued share capital*

Issued share capital as at 31 December 2016 amounted to HRK 1,907 million (31 December 2015: HRK 1,907 million). The total number of authorised registered shares at 31 December 2016 was 19,074,769 (2015: 19,074,769) with a nominal value of HRK 100 per share (2015: HRK 100 per share). The parent company of the Bank is Intesa Sanpaolo Holding International and the ultimate controlling party is Intesa Sanpaolo S.p.A.

Until June 2015, the second largest shareholder of the Bank was the EBRD which held 20.9% of equity stake. At that time, EBRD sold their stake in PBZ to the Intesa Sanpaolo Holding International.

The ownership structure as at 31 December 2016 and 31 December 2015 was as follows:

	<b>REGISTERED SHARES</b>			
	31 December 2016		31 December 2015	
	Number of shares	Percentage of ownership	Number of shares	Percentage of ownership
Intesa Sanpaolo Holding International	18,591,522	97.5%	18,591,522	97.5%
Non-controlling shareholders	418,574	2.2%	418,574	2.2%
Treasury shares	64,673	0.3%	64,673	0.3%
	<b>19,074,769</b>	<b>100.0%</b>	<b>19,074,769</b>	<b>100.0%</b>

The Bank's shares are listed on the Zagreb Stock Exchange. As at 31 December 2016 the share price of the Bank's ordinary shares quoted on the Zagreb Stock Exchange was HRK 769 (31 December 2015: HRK 599).

On 31 December 2016, the President of the Management Board Mr Božo Prka held 361 shares (31 December 2015: 361) of Privredna banka Zagreb dd, and of the other members of the Management Board, Mr Ivan Gerovac held 120 shares (31 December 2015: 120) and Mr Draženko Kopljar held 108 shares (31 December 2015: 108).

*b) Share premium*

The Bank recognises share premium in an amount of HRK 1,570 million (31 December 2015: HRK 1,570 million) representing the excess of the paid-in amount over the nominal value of the issued shares.

*c) Treasury shares*

During 2015 and 2016 there were no movements in treasury shares.

*d) Own shares held as collateral*

The Bank holds 2,508 (31 December 2015: 2,508) of its own shares as collateral for loans to third parties.

*e) Other reserves*

Other reserves comprise legal, capital gains and treasury shares reserves.

*Legal reserve*

As required by the Companies Act, companies in Croatia are required to appropriate 5% of their annual net profit into legal reserves until they, together with capital reserves, reach 5% of issued share capital.

*Capital gains*

Capital gain is a result of transactions with treasury shares of the Bank in previous periods.

## Notes to the financial statements (continued)

### 36 Share capital (continued)

#### e) *Other reserves (continued)*

##### *Treasury share reserve*

During 2016 the Bank did not purchase any treasury shares on the open market for its own purposes.

##### *Translation reserves*

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign subsidiaries. As at 31 December 2016 translation reserve amounted to HRK 8 million (2015: nil) for the Group.

#### f) *Fair value reserve*

Fair value reserve includes unrealised gains and losses on changes in the fair value of financial assets available for sale, net of income tax.

#### g) *Retained earnings*

Retained profits are generally available to shareholders, subject to their approval.

The amount of dividends distributed to equity holders during 2016 in respect of 2015 is HRK 10 (2015 in respect of 2014: HRK 27) per share.

#### h) *Merger reserve*

Merger reserve is a reserve arising from common control transaction and includes any difference between the consideration paid and the share capital of the acquiree.

#### i) *Non-distributable reserves*

Management considers that the fair value reserve and other reserves may not be distributed to shareholders. As at 31 December 2016 non-distributable reserves amount to HRK 430 million (31 December 2015: HRK 574 million) and HRK 321 million (31 December 2015: HRK 388 million), for the Group and the Bank, respectively.

#### j) *Return on assets*

Return on asset measures the net profit earned in relation to total assets and for 2016 amounted to 1.93% (2015: 0.47%) and 2.23% (2015: 0.28%) for the Group and the Bank, respectively.

## Notes to the financial statements (continued)

### 37 Cash and cash equivalents

The table below presents an analysis of cash and cash equivalents for the purposes of the cash flows statement:

		(in HRK million)			
		GROUP		BANK	
Note		2016	2015	2016	2015
Cash and current accounts with banks	15	12,970	9,995	12,338	9,143
Loans and advances to banks with maturity of up to 90 days		1,782	2,994	1,678	2,876
		<b>14,752</b>	<b>12,989</b>	<b>14,016</b>	<b>12,019</b>

### 38 Managed funds for and on behalf of third parties

		(in HRK million)			
		GROUP		BANK	
		2016	2015	2016	2015
Assets under custody		6,843	6,609	6,843	6,609
Assets under custody - investment funds		3,211	1,903	3,211	1,903
Assets under portfolio management		906	830	737	744
		<b>10,960</b>	<b>9,342</b>	<b>10,791</b>	<b>9,256</b>

The Group and the Bank provide custody services to banks and customers, including investment and pension funds. These assets are accounted for separately from those of the Group and kept off-balance sheet. The Group is compensated for its services by fees chargeable to the clients.

Funds under management in the obligatory pension fund managed by the Bank's associate PBZ Croatia osiguranje dd amount to HRK 13,888 million as at 31 December 2016 (31 December 2015: HRK 11,978 million). These funds are held by a custody bank which is not a member of the Group.

**Notes to the financial statements (continued)****39 Leases**

PBZ Leasing doo, a company wholly-owned by the Bank, is engaged in providing finance and operating lease arrangements to its clients of various items of vehicles, vessels, real estate and equipment. Net investment in finance leases as at 31 December 2016 amounted to HRK 587 million (31 December 2015: HRK 591.0 million) which is included within loans and advances to customers (Note 20) in the Group financial statements. The carrying value of leased property and equipment under operating lease as at 31 December 2016 amounted to HRK 375 million (31 December 2015: HRK 400.35 million) and are classified within property and equipment (Note 25).

Future minimum lease payments under finance leases together with the present value of the net minimum lease payments are set out below:

	(in HRK million)			
	Minimum payments	Present value of payments	Minimum payments	Present value of payments
	2016	2016	2015	2015
Less than one year	282	254	275	243
Between one and five years	372	312	348	278
More than five years	174	136	234	179
<b>Gross investment in finance lease</b>	<b>828</b>	<b>702</b>	<b>857</b>	<b>700</b>
Unearned finance income	(126)	-	(157)	-
	<b>702</b>	<b>702</b>	<b>700</b>	<b>700</b>
Less: Impairment allowance	(115)	(115)	(109)	(109)
<b>Net investment in finance lease</b>	<b>587</b>	<b>587</b>	<b>591</b>	<b>591</b>

Future minimum lease payments at undiscounted amounts under non-cancellable operating leases where the Group is the lessor are as follows:

	(in HRK million)	
	2016	2015
Less than one year	80	192
Between one and five years	236	164
More than five years	176	161
	<b>492</b>	<b>517</b>

The above is for illustrative purposes considering there are no non-cancellable leases.

## Notes to the financial statements (continued)

### 40 Related party transactions

The parent company of Privredna banka Zagreb dd and its subsidiaries is Intesa Sanpaolo Holding International which holds 97.5% of the Bank's share capital as at 31 December 2016 (97.5% as at 31 December 2015). The ultimate controlling party is Intesa Sanpaolo S.p.A., a bank incorporated in Italy. The remaining shareholders are shareholders of publicly held shares (2.2%).

The Bank considers that it has an immediate related party relationship with: its ultimate parent and its affiliates; other key shareholders and their affiliates; its subsidiaries and associates and the pension fund managed by its associate, PBZ Croatia osiguranje dd; Supervisory Board members, Management Board members and other executive management (together "key management personnel") and close family members of key management personnel, in accordance with the International Accounting standard 24 "Related party Disclosures" ("IAS 24").

The Bank grants loans to or places deposits with related parties in the ordinary course of business.

The volumes of related party transactions during the year and outstanding balances at the year-end were as follows:  
(in HRK million)

	Key management personnel	Ultimate controlling party - Intesa Sanpaolo S.p.A	Associates	Other shareholders and their affiliates and affiliates of ultimate controlling party
<b>Group</b>				
<b>Deposits and loans given</b>				
Balance at 1 January 2016	13	112	-	6
Changes during the year	1	32	-	28
<b>Balance at 31 December 2016</b>	<b>14</b>	<b>144</b>	<b>-</b>	<b>34</b>
<b>Interest income for the year ended 31 December 2016</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Interest income for the year ended 31 December 2015	-	1	-	-
<b>Deposits and loans received</b>				
Balance at 1 January 2016	38	30	87	1,645
Changes during the year	3	21	6	(951)
<b>Balance at 31 December 2016</b>	<b>41</b>	<b>51</b>	<b>93</b>	<b>694</b>
<b>Interest expense for the year ended 31 December 2016</b>	<b>(1)</b>	<b>-</b>	<b>(1)</b>	<b>(13)</b>
Interest expense for the year ended 31 December 2015	(1)	-	(1)	(47)
<b>Contingent liabilities and commitments at 31 December 2016</b>	<b>1</b>	<b>4</b>	<b>1</b>	<b>142</b>
Contingent liabilities and commitments at 31 December 2015	2	2	4	41
<b>Fees and other income for the year ended 31 December 2016</b>	<b>-</b>	<b>4</b>	<b>1</b>	<b>46</b>
Fees and other income for the year ended 31 December 2015	-	1	1	52
<b>Fees and other expense for the year ended 31 December 2016</b>	<b>-</b>	<b>(2)</b>	<b>-</b>	<b>(10)</b>
Fees and other expense for the year ended 31 December 2015	-	(7)	(57)	(2)



## Notes to the financial statements (continued)

## 40 Related party transactions (continued)

	(in HRK million)				
	Key man- agement personnel	Bank's sub- sidiaries	Ultimate controlling party - Intesa Sanpaolo S.p.A	Associates	Other share- holders and their affili- ates and af- filiates of ultimate controlling party
<b>Bank</b>					
<b>Deposits and loans given</b>					
Balance at 1 January 2016	9	656	1	-	2
Changes during the year	2	117	13	-	29
<b>Balance at 31 December 2016</b>	<b>11</b>	<b>773</b>	<b>14</b>	<b>-</b>	<b>31</b>
<b>Interest income for the year ended</b>					
<b>31 December 2016</b>	<b>-</b>	<b>23</b>	<b>-</b>	<b>-</b>	<b>-</b>
Interest income for the year ended 31 December 2015	-	29	1	-	-
<b>Deposits and loans received</b>					
Balance at 1 January 2016	30	533	13	87	622
Changes during the year	2	(20)	30	6	36
<b>Balance at 31 December 2016</b>	<b>32</b>	<b>513</b>	<b>43</b>	<b>93</b>	<b>658</b>
<b>Interest expense for the year ended</b>					
<b>31 December 2016</b>	<b>(1)</b>	<b>(5)</b>	<b>-</b>	<b>(1)</b>	<b>(13)</b>
Interest expense for the year ended 31 December 2015	(1)	(18)	-	(1)	(47)
<b>Contingent liabilities and commitments at</b>					
<b>31 December 2016</b>	<b>1</b>	<b>44</b>	<b>4</b>	<b>1</b>	<b>142</b>
Contingent liabilities and commitments at 31 December 2015	1	17	2	4	41
<b>Lease expense for the year ended</b>					
<b>31 December 2016</b>	<b>-</b>	<b>(5)</b>	<b>-</b>	<b>-</b>	<b>-</b>
Lease expense for the year ended 31 December 2015	-	(9)	-	-	-
<b>Fees and other income for the year ended</b>					
<b>31 December 2016</b>	<b>-</b>	<b>296</b>	<b>4</b>	<b>19</b>	<b>45</b>
Fees and other income for the year ended 31 December 2015	-	236	-	16	52
<b>Fees and other expense for the year ended</b>					
<b>31 December 2016</b>	<b>-</b>	<b>(17)</b>	<b>(1)</b>	<b>-</b>	<b>(9)</b>
Fees and other expense for the year ended 31 December 2015	-	(64)	(6)	(50)	-

No provisions were recognised in respect of deposits and loans given to related parties as at 31 December 2016 (31 December 2015: nil).

## Notes to the financial statements (continued)

### 40 Related party transactions (continued)

Annual key management remuneration:

	(in HRK million)	
	GROUP	
	2016	2015
Personnel compensation (gross)	26	22
Bonuses (gross)	10	14
Contributions to pension insurance	4	2
	<b>40</b>	<b>38</b>

Key management personnel include Management Board and senior executive directors as well as executive directors responsible for areas of strategic relevance. The total number of key management personnel of the Group and the Bank as at 31 December 2016 was 25 (31 December 2015: 19) and 20 (31 December 2015: 18), respectively.

All bonuses in 2016 and 2015 were mostly paid in cash, while for two executives bonuses also included share allocations on a deferred basis.

#### Share-based payments

In July 2012, the Board of Directors of Intesa Sanpaolo S.p.A. launched a long-term scheme, in favour of 2 executives holding key positions in the Group, aimed at achieving business plan objectives and increasing the value of the Intesa Sanpaolo Group.

This scheme entitles the key executives to a cash payment, based on the price of Intesa Sanpaolo S.p.A. shares, if certain performance conditions are fulfilled. The fair value of services received from key executives is measured by reference to the fair value of the instrument granted which is based on the quoted market prices of Intesa Sanpaolo S.p.A. shares.

	Number of instruments held (in units)		The carrying amount of liabilities for cash-settled arrangements (in HRK million)	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Awards granted	399,334	471,951	7	11

## Notes to the financial statements (continued)

### 41 Capital

The Bank maintains an actively managed capital base to cover risks in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Regulation of the European parliament on prudential requirements for credit institutions (hereafter: CRR) and Croatian National Bank in supervising the Bank. This Regulation came to force as of 1 January 2014 laying down uniform rules concerning general prudential requirements for EU credit institutions.

#### Capital management

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payments to shareholders, return capital to shareholders or issue capital securities.

Regulatory capital and capital ratios according to EBA requirements and CNB national discretions, calculated for the Bank only (as of the date of issuance of these financial statements information on regulatory capital and risk-weighted assets and other risk elements is unaudited), are as follows:

#### Regulatory capital (unaudited)

	(in HRK million)	
	<b>BANK</b>	
	2016	2015
Issued share capital	1,907	1,907
Share premium	1,570	1,570
Treasury shares (net of share premium on treasury shares)	(18)	(18)
Retained earnings (excluding profit for the period)	7,442	7,442
Profit for the period, decreased by proposed dividend	-	-
Accumulated other comprehensive income	9	7
Other reserves	234	234
Deductions in accordance with EBA regulations	(181)	(248)
<b>Common Equity Tier 1 capital</b>	<b>10,963</b>	<b>10,894</b>
Additional Tier 1	-	-
<b>Tier 1 capital</b>	<b>10,963</b>	<b>10,894</b>
Tier 2 capital	-	-
<b>Total regulatory capital (unaudited)</b>	<b>10,963</b>	<b>10,894</b>
Risk weighted assets and other risk elements (unaudited)	<b>48,751</b>	<b>48,928</b>
<b>Common Equity Tier 1 capital ratio</b>	22.49%	22.27%
<b>Tier 1</b>	22.49%	22.27%
<b>Total capital ratio</b>	22.49%	22.27%

In 2014, regulation introduced a new structure of capital requirements for credit institutions by laying down minimum level of three capital ratios: Common Equity Tier 1 capital ratio of 4.5%, Tier 1 capital ratio of 6% and total capital ratio of 8%.

**Notes to the financial statements (continued)****42 Leverage ratio**

In accordance with Article 429 of the CRR, from 1 January 2014, credit institutions are obliged to calculate the leverage ratio as the institution's capital measure (Tier 1 capital), divided by that institutions' total exposure measure, expressed as a percentage. A minimum requirement for the leverage ratio is 3%.

**Leverage ratio (unaudited)**

	(in HRK million)	
	BANK	
	2016	2015
<b>Exposure and capital values in December</b>		
Securities Financing Transactions (SFT) exposure	27	30
Derivatives: Market value and Add-on Mark-to-Market Method	42	33
Other off-balance sheet items	5,756	5,224
Other assets	72,080	69,258
<b>Exposure values</b>	<b>77,905</b>	<b>74,545</b>
Common Equity Tier 1 capital	10,963	10,894
Tier 1 capital	-	-
Regulatory adjustments of Tier 1 capital	-	-
<b>Capital</b>	<b>10,963</b>	<b>10,894</b>
<b>Leverage ratio (unaudited)</b>	<b>14.1%</b>	<b>14.6%</b>

## Notes to the financial statements (continued)

### 43 Fair values of financial assets and liabilities

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis.

Financial assets and financial liabilities at fair value through profit or loss are measured at fair value. Loans and advances to customers and held-to-maturity investments are measured at amortised cost less impairment. Available-for-sale instruments are generally measured at fair value with the exception of some equity investments which are carried at cost less impairment given that their fair value cannot be reliably measured.

#### a) Financial instruments measured at fair value and fair value hierarchy

The determination of fair value of financial assets and liabilities for which there is no observable market price requires the use of valuation techniques. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and for this reason, when calculating the fair value of a financial asset or liability all material risks that affect them must be identified and taken into consideration.

When measuring fair values the Bank takes into account the IFRS fair value hierarchy that reflects the significance of the inputs used in making the measurement. Each instrument is individually evaluated. The levels are determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

The financial instruments carried at fair value have been categorised under the three levels of the IFRS fair value hierarchy as follows:

Level 1: Instruments valued using quoted (unadjusted) prices in active markets for identical assets or liabilities; these are instruments where the fair value can be determined directly from prices which are quoted in active, liquid markets.

- These instruments include: liquid debt and equity securities traded on liquid markets, and quoted units in investment funds.

Level 2: Instruments valued using valuation techniques using observable market data. These are instruments where the fair value can be determined by reference to similar instruments trading in active markets, or where a technique is used to derive the valuation but where all inputs to that technique are observable.

- These instruments include: less-liquid debt and equity securities valued by a model which uses Level 1 inputs.

Level 3: Instruments valued using valuation techniques using market data which is not directly observable: these are instruments where the fair value cannot be determined directly by reference to market-observable information, and some other pricing technique must be employed. Instruments classified in this category have an element which is unobservable and which has a significant impact on the fair value.

- These instruments include: illiquid debt securities and illiquid equity securities.

**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****a) Financial instruments measured at fair value and fair value hierarchy (continued)**

The following table presents an analysis of financial instruments carried at fair value by the level of hierarchy:

(in HRK million)

Group	2016				2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative financial assets	-	25	-	25	-	4	-	4
Financial assets held for trading	520	-	-	520	48	-	28	76
Financial assets initially designated at fair value through profit or loss	98	5,474	11	5,583	102	5,731	61	5,894
Financial assets available for sale*	994	343	34	1,371	772	161	103	1,036
<b>Financial assets</b>	<b>1,612</b>	<b>5,842</b>	<b>45</b>	<b>7,499</b>	<b>922</b>	<b>5,896</b>	<b>192</b>	<b>7,010</b>
Derivative financial liabilities	-	11	-	11	-	15	-	15
<b>Financial liabilities</b>	<b>-</b>	<b>11</b>	<b>-</b>	<b>11</b>	<b>-</b>	<b>15</b>	<b>-</b>	<b>15</b>

\* unlisted equity securities carried at cost are not included.

(in HRK million)

Bank	2016				2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative financial assets	-	19	-	19	-	4	-	4
Financial assets held for trading	518	-	-	518	47	-	28	75
Financial assets initially designated at fair value through profit or loss	6	5,440	11	5,457	10	5,672	61	5,743
Financial assets available for sale*	303	-	34	337	109	-	103	212
<b>Financial assets</b>	<b>827</b>	<b>5,459</b>	<b>45</b>	<b>6,331</b>	<b>166</b>	<b>5,676</b>	<b>192</b>	<b>6,034</b>
Derivative financial liabilities	-	5	-	5	-	15	-	15
<b>Financial liabilities</b>	<b>-</b>	<b>5</b>	<b>-</b>	<b>5</b>	<b>-</b>	<b>15</b>	<b>-</b>	<b>15</b>

\* unlisted equity securities carried at cost are not included.

## Notes to the financial statements (continued)

### 43 Fair values of financial assets and liabilities (continued)

#### a) Financial instruments measured at fair value and fair value hierarchy (continued)

During the year 2016, no transfers from Level 1 to Level 2 or from Level 2 to Level 1 occurred, as there were no changes to the methodology used in determining levels of the fair value hierarchy, while the market activity of financial instruments in the Group's portfolios remained unchanged.

The existence of published prices quotations in an active market is the best evidence of fair value and these quoted prices (Effective Market Quotes) shall therefore be used as the primary method for measuring financial assets and liabilities in the trading portfolio. If the market for a financial instrument is not active, the Group determines the fair value by using a valuation technique. Valuation techniques include:

- using market values which are indirectly connected to the instrument being measured, deriving from products with similar risk characteristics (Comparable Approach);
- valuations conducted using (even only in part) inputs not deriving from parameters observable on the market, for which estimates and assumptions formulated by the assessor are used (Mark-to-Model).

Given the uncertainties of the domestic market, primarily characterised by low liquidity where market conditions do not show active trading but rather inactive, the Group primarily uses valuation techniques based on the following principles:

- Used yield curves are created from interest rate quotations observed on the market;
- An appropriate yield curve (the one that is associated with the same currency in which the security, whose price is modelled, is denominated) is used in discounting of all the security's cash flows in order to determine its present value;
- In determining the fair value of bonds issued by corporate issuers and municipality bonds, the Group additionally uses the spreads associated with the internal credit rating of the issuer, which is then added to the yield curve for valuation thus capturing credit risk and various other counterparty related risks. Range of estimates for unobservable input was 2.7% to 6.7% with weighted average used of 3.6%. Significant increases in those inputs would result in lower fair values, while significant reduction would result in higher fair values. Considering the relatively small size of the financial instruments classified as Level 3, changing one or more of the assumptions would have insignificant effects on the overall financial statements.

The following table presents a reconciliation from the beginning balances to the ending balances from fair value measurements in Level 3 of the fair value hierarchy.

	Group			(in HRK million) Bank		
	Financial as- sets held for trading	Financial as- sets initially designated at fair value through profit or loss	Financial in- struments available for sale	Financial as- sets held for trading	Financial as- sets initially designated at fair value through profit or loss	Financial in- struments available for sale
<b>Balance at 1 January 2016</b>	<b>28</b>	<b>61</b>	<b>103</b>	<b>28</b>	<b>61</b>	<b>103</b>
Total gains/(losses):	-	1	47	-	1	47
<i>in profit or loss</i>	-	1	45	-	1	45
<i>in other comprehensive income</i>	-	-	2	-	-	2
Purchases	-	-	34	-	-	34
Sale	-	-	(150)	-	-	(150)
Settlements	(28)	(51)	-	(28)	(51)	-
<b>Balance at 31 December 2016</b>	<b>-</b>	<b>11</b>	<b>34</b>	<b>-</b>	<b>11</b>	<b>34</b>

## Notes to the financial statements (continued)

### 43 Fair values of financial assets and liabilities (continued)

#### a) Financial instruments measured at fair value and fair value hierarchy (continued)

	(in HRK million)					
	Group			Bank		
	Financial as- sets held for trading	Financial as- sets initially designated at fair value through profit or loss	Financial in- struments available for sale	Financial as- sets held for trading	Financial as- sets initially designated at fair value through profit or loss	Financial in- struments available for sale
<b>Balance at 1 January 2015</b>	-	100	20	-	100	20
Total gains/(losses):	-	(1)	103	-	(1)	103
<i>in profit or loss</i>	-	(1)	-	-	(1)	-
<i>in other comprehensive income</i>	-	-	103	-	-	103
Purchases	28	-	-	28	-	-
Sale	-	(10)	(20)	-	(10)	(20)
Settlements	-	(28)	-	-	(28)	-
<b>Balance at 31 December 2015</b>	<b>28</b>	<b>61</b>	<b>103</b>	<b>28</b>	<b>61</b>	<b>103</b>

There were no transfers from or to Level 3 in 2016 and 2015.



**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****b) Financial instruments not measured at fair value**

The following table sets out the fair values of financial instruments not measured at fair value for the Group and the Bank and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorised.

(in HRK million)

**Group**

	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
<b>31 December 2016</b>					
<b>Assets</b>					
Cash and current accounts with banks	-	-	12,970	12,970	12,970
Balances with CNB	-	-	3,916	3,916	3,916
Loans and advances to banks	-	2,228	578	2,806	2,806
Loans and advances to customers	-	51,054	2,518	53,572	52,885
Held to maturity investments	13	-	-	13	17
<b>Liabilities</b>					
Current accounts and deposits from banks	-	1,107	-	1,107	1,125
Current accounts and deposits from customers	-	60,819	-	60,819	60,378
Interest-bearing borrowings and subordinated liabilities	-	3,613	-	3,613	3,572

**Group**

	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
<b>31 December 2015</b>					
<b>Assets</b>					
Cash and current accounts with banks	-	-	9,995	9,995	9,995
Balances with CNB	-	-	4,550	4,550	4,550
Loans and advances to banks	-	3,083	367	3,450	3,450
Loans and advances to customers	-	48,448	3,137	51,585	50,985
Held to maturity investments	21	-	-	21	17
<b>Liabilities</b>					
Current accounts and deposits from banks	-	1,032	-	1,032	1,083
Current accounts and deposits from customers	-	58,526	-	58,526	58,180
Interest-bearing borrowings and subordinated liabilities	-	3,950	2	3,952	3,886

**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****b) Financial instruments not measured at fair value (continued)**

(in HRK million)

**Bank**

	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
<b>31 December 2016</b>					
<b>Assets</b>					
Cash and current accounts with banks	-	-	12,338	12,338	12,338
Balances with CNB	-	-	3,916	3,916	3,916
Loans and advances to banks	-	1,731	-	1,731	1,731
Loans and advances to customers	-	44,251	2,199	46,450	45,667
<b>Liabilities</b>					
Current accounts and deposits from banks	-	1,376	-	1,376	1,376
Current accounts and deposits from customers	-	54,482	-	54,482	54,108
Interest-bearing borrowings	-	2,788	-	2,788	2,747

**Bank**

	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
<b>31 December 2015</b>					
<b>Assets</b>					
Cash and current accounts with banks	-	-	9,143	9,143	9,143
Balances with CNB	-	-	4,550	4,550	4,550
Loans and advances to banks	-	2,966	-	2,966	2,966
Loans and advances to customers	-	42,113	2,761	44,874	44,186
<b>Liabilities</b>					
Current accounts and deposits from banks	-	1,373	-	1,373	1,373
Current accounts and deposits from customers	-	53,237	-	53,237	52,815
Interest-bearing borrowings	-	2,904	-	2,904	2,838

## Notes to the financial statements (continued)

### 43 Fair values of financial assets and liabilities (continued)

#### b) Financial instruments not measured at fair value (continued)

The following methods and assumptions have been made in estimating the fair value of financial instruments:

- There are no significant differences between carrying value and fair value of cash and current accounts with banks and balances with the Croatian National Bank given the short maturity of such assets.
- Loans and advances to banks and customers are presented net of impairment allowance. The estimated fair value of loans and advances represents the discounted amount of the estimated future cash flows expected to be received. Expected future cash flows are discounted at current market rates. Valuation of non-performing loans includes estimation and is therefore classified as Level 3 in fair value hierarchy, while performing part of the portfolio represents Level 2 due to observable market parameters used for valuation. Expected future impairment losses are not taken into account. The fair value of debt securities classified as loans and receivables, representing Croatian Government bonds, is measured using valuation techniques based on the yield curves created from interest rate quotations observed on the market and are consequently classified as Level 2 in the fair value hierarchy, while fair value of other debt securities classified as loans and receivables is measured using spreads associated with internal credit ratings of the issuers and these securities are classified as Level 3 in the fair value hierarchy.
- The fair value of securities held to maturity is calculated based on their quoted market price.
- The estimated fair value of fixed-interest term deposits is based on the expected cash flows discounted using current market rates. For demand deposits and deposits with no defined maturity, the fair value is determined to be the amount payable on demand. The value of customer relationships has not been taken into account. Deposits and loans received are classified as Level 2 in the fair value hierarchy since the parameters used in valuation are market observable.
- The majority of interest-bearing borrowings carry floating interest rates which are linked to market and repriced regularly. As such, the management believes that their carrying values approximate their fair values.

**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****c) Classification of financial assets and financial liabilities**

The table below provides reconciliation between line items in the statement of financial position and categories of financial instruments.

Group	(in HRK million)						Total
	Trading	Designated at fair value	Held-to- maturity	Loans and re- ceiva- bles	Available- for-sale	Other amortised cost	
<b>As at 31 December 2016</b>							
<b>Assets</b>							
Cash and current accounts with banks	-	-	-	12,970	-	-	<b>12,970</b>
Balances with the Croatian National Bank	-	-	-	3,916	-	-	<b>3,916</b>
Financial assets at fair value through profit or loss	520	5,583	-	-	-	-	<b>6,103</b>
Derivative financial assets	25	-	-	-	-	-	<b>25</b>
Loans and advances to banks	-	-	-	2,806	-	-	<b>2,806</b>
Loans and advances to customers	-	-	-	52,885	-	-	<b>52,885</b>
Financial assets available for sale	-	-	-	-	1,405	-	<b>1,405</b>
Held-to-maturity investments	-	-	17	-	-	-	<b>17</b>
<b>Total assets</b>	<b>545</b>	<b>5,583</b>	<b>17</b>	<b>72,577</b>	<b>1,405</b>	<b>-</b>	<b>80,127</b>
<b>Liabilities</b>							
Current accounts and deposits from banks	-	-	-	-	-	1,125	<b>1,125</b>
Current accounts and deposits from cus- tomers	-	-	-	-	-	60,378	<b>60,378</b>
Derivative financial liabilities	11	-	-	-	-	-	<b>11</b>
Interest-bearing borrowings	-	-	-	-	-	3,571	<b>3,571</b>
Subordinated liabilities	-	-	-	-	-	1	<b>1</b>
<b>Total liabilities</b>	<b>11</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>65,075</b>	<b>65,086</b>

**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****c) Classification of financial assets and financial liabilities (continued)**

(in HRK million)

Group As at 31 December 2015	Trading	Designated at fair value	Held-to- maturity	Loans and re- ceiva- bles	Availa- ble-for- sale	Other amor- tised cost	Total
<b>Assets</b>							
Cash and current accounts with banks	-	-	-	9,995	-	-	<b>9,995</b>
Balances with the Croatian National Bank	-	-	-	4,550	-	-	<b>4,550</b>
Financial assets at fair value through profit or loss	76	5,894	-	-	-	-	<b>5,970</b>
Derivative financial assets	4	-	-	-	-	-	<b>4</b>
Loans and advances to banks	-	-	-	3,450	-	-	<b>3,450</b>
Loans and advances to customers	-	-	-	50,985	-	-	<b>50,985</b>
Financial assets available for sale	-	-	-	-	1,118	-	<b>1,118</b>
Held-to-maturity investments	-	-	17	-	-	-	<b>17</b>
<b>Total assets</b>	<b>80</b>	<b>5,894</b>	<b>17</b>	<b>68,980</b>	<b>1,118</b>	<b>-</b>	<b>76,089</b>
<b>Liabilities</b>							
Current accounts and deposits from banks	-	-	-	-	-	1,083	<b>1,083</b>
Current accounts and deposits from cus- tomers	-	-	-	-	-	58,180	<b>58,180</b>
Derivative financial liabilities	15	-	-	-	-	-	<b>15</b>
Interest-bearing borrowings	-	-	-	-	-	3,884	<b>3,884</b>
Subordinated liabilities	-	-	-	-	-	2	<b>2</b>
<b>Total liabilities</b>	<b>15</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>63,149</b>	<b>63,164</b>

**Notes to the financial statements (continued)**

**43 Fair values of financial assets and liabilities (continued)**

**c) Classification of financial assets and financial liabilities (continued)**

(in HRK million)

<b>Bank</b>						
<b>As at 31 December 2016</b>	Trading	Designated at fair value	Loans and receivables	Available- for-sale	Other amortised cost	Total
<b>Assets</b>						
Cash and current accounts with banks	-	-	12,338	-	-	<b>12,338</b>
Balances with the Croatian National Bank	-	-	3,916	-	-	<b>3,916</b>
Financial assets at fair value through profit or loss	518	5,457	-	-	-	<b>5,975</b>
Derivative financial assets	19	-	-	-	-	<b>19</b>
Loans and advances to banks	-	-	1,731	-	-	<b>1,731</b>
Loans and advances to customers	-	-	45,667	-	-	<b>45,667</b>
Financial assets available for sale	-	-	-	370	-	<b>370</b>
<b>Total assets</b>	<b>537</b>	<b>5,457</b>	<b>63,652</b>	<b>370</b>	<b>-</b>	<b>70,016</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	-	-	-	-	1,376	<b>1,376</b>
Current accounts and deposits from customers	-	-	-	-	54,108	<b>54,108</b>
Derivative financial liabilities	5	-	-	-	-	<b>5</b>
Interest-bearing borrowings	-	-	-	-	2,747	<b>2,747</b>
<b>Total liabilities</b>	<b>5</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>58,231</b>	<b>58,236</b>

**Notes to the financial statements (continued)**

**43 Fair values of financial assets and liabilities (continued)**

**c) Classification of financial assets and financial liabilities (continued)**

(in HRK million)

<b>Bank</b>						
<b>As at 31 December 2015</b>	Trading	Designated at fair value	Loans and receivables	Available- for-sale	Other amortised cost	Total
<b>Assets</b>						
Cash and current accounts with banks	-	-	9,143	-	-	9,143
Balances with the Croatian National Bank	-	-	4,550	-	-	4,550
Financial assets at fair value through profit or loss	75	5,743	-	-	-	5,818
Derivative financial assets	4	-	-	-	-	4
Loans and advances to banks	-	-	2,966	-	-	2,966
Loans and advances to customers	-	-	44,186	-	-	44,186
Financial assets available for sale	-	-	-	293	-	293
<b>Total assets</b>	<b>79</b>	<b>5,743</b>	<b>60,845</b>	<b>293</b>	<b>-</b>	<b>66,960</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	-	-	-	-	1,373	1,373
Current accounts and deposits from customers	-	-	-	-	52,815	52,815
Derivative financial liabilities	15	-	-	-	-	15
Interest-bearing borrowings	-	-	-	-	2,838	2,838
<b>Total liabilities</b>	<b>15</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>57,026</b>	<b>57,041</b>

**Notes to the financial statements (continued)****43 Fair values of financial assets and liabilities (continued)****d) Reclassification of financial assets**

Following a reduction in the level of market activity for many assets and inability to sell assets other than at substantially lower prices, in 2009 the Group decided to reclassify Croatian Government bonds and commercial papers from the portfolio of financial instruments at fair value through profit or loss (held for trading) and the available-for-sale portfolio to the loans and receivables portfolio. For the reclassified assets the Group has the intention and ability to hold the reclassified financial instruments for the foreseeable future or until maturity. Following reclassification, the carrying values of those assets are derived using the model as described below.

Upon reclassification of financial assets to the loans and receivables category, the fair value of the financial assets immediately prior to the reclassification became the new amortised cost. Following reclassification of a financial asset available for sale with a fixed maturity, any gain or loss previously recognised in other comprehensive income, and the difference between the newly established cost and the maturity amount are both amortised over the remaining term of the financial asset using the effective interest method. For a financial asset available for sale with no stated maturity, any gain or loss previously recognised in other comprehensive income is reclassified from other comprehensive income to profit or loss when the financial asset is disposed of or impaired.

The following tables present the carrying amount and fair value of financial assets reclassified from “Held-for-Trading” and from “Available-for-Sale” to the “Loans and Receivables” category, at the reporting date.

All transfers occurred on 30 April 2009. There were no other reclassifications prior to or after 30 April 2009.

	(in HRK million)					
	GROUP			BANK		
	Amounts re-classified	Carrying amount	Fair value	Amounts re-classified	Carrying amount	Fair value
<b>31 December 2016</b>						
Financial assets reclassified from held for trading to loans and receivables	1,903	616	622	1,903	616	622
Financial assets reclassified from available for sale to loans and receivables	1,418	74	76	381	16	13
<b>31 December 2015</b>						
Financial assets reclassified from held for trading to loans and receivables	1,903	607	634	1,903	607	634
Financial assets reclassified from available for sale to loans and receivables	1,418	83	90	381	23	27



## Notes to the financial statements (continued)

### 43 Fair values of financial assets and liabilities (continued)

#### d) Reclassification of financial assets (continued)

The following table presents gains and losses recognised in the income statement in 2016 and 2015 on assets reclassified to the loans and receivables category:

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Financial assets reclassified from held for trading to loans and receivables</b>				
Interest income	34	35	34	35
Amortisation of discount	10	10	10	10
<b>Financial assets reclassified from available for sale to loans and receivables</b>				
Interest income	3	11	1	2
Amortisation of discount	6	6	4	4
Amortisation of fair value reserve	(2)	(4)	(1)	(1)

The following table presents the fair value gains or losses that would have been recognised in the income statement or in other comprehensive income during the year if the Group had not reclassified financial assets from "Held-for-Trading" and "Available-for-Sale" to the "Loans and Receivables" category.

This disclosure is provided for information purposes only and does not reflect what has actually been recorded in the financial statements of the Group.

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Financial assets reclassified from held for trading to loans and receivables</b>				
Fair value gains/(losses) which would have been recognised in net trading income and net gains and losses on translation of monetary assets and liabilities	(7)	(7)	(13)	(7)
<b>Financial assets reclassified from available for sale to loans and receivables</b>				
Fair value losses which would have been recognised in other comprehensive income	(11)	(14)	(14)	(11)

## Notes to the financial statements (continued)

### 44 Financial information by segment

The following tables present information on the Group's result of each reportable business segment.

The segment reporting format is based on business segments as the Group's risks and rates of return are affected predominantly by differences in the products and services produced.

The operating businesses are organised and managed separately according to the nature of the products and services provided, with each segment representing a strategic segment unit that offers different products and serve different markets. Intersegment income and expenses are based on current market prices.

For management purposes, the Bank is organised into 3 operating segments based on products and services accompanied with a central supporting structure. This segmentation follows the organisational structure as reflected in internal management reporting systems, which are the basis for assessing the financial performance of the business segments and for allocating resources to the business segments.

<i>Retail banking:</i>	Individual customers' savings and deposits, current accounts and overdrafts, all types of consumer loans, credit cards facilities and other facilities to individual customers
<i>Corporate banking:</i>	Loans and other credit facilities as well as deposit and current accounts for corporate and institutional customers including medium-term funding, public sector, government agencies and municipalities as well as small and medium sized enterprises
<i>Finance banking:</i>	Treasury operations as well as investment banking services including corporate finance, merger and acquisition services and trading
<i>Central structure:</i>	All other residual activities, including fund management activities

Furthermore, the management of the Bank monitors performance of its subsidiaries on an individual basis. However, for the purpose of presentation of the operating segments, with the exception of PBZ Card and ISP BH, subsidiaries have been grouped into one segment. In that context, the following tables present overall financial information for the Bank and the Group by segment.

Items of the income statement in the presented tables on segment information for the Bank and the Group are generally in the format and of classification criteria suited for management reporting purposes. Therefore, the disclosed segments have been reconciled to the financial statements prepared in accordance with IFRS. This reconciliation also includes consolidation adjustments in the Group segment report. Segment assets and segment liabilities for management reporting purpose are stated gross of provisions and other allowances unlike the disclosure criteria in the financial statements where assets and liabilities are presented net of provisions, deferred fees and other tax and non-tax allowances. In that context, reconciliation to the financial statements has reflected such offsetting.

**Notes to the financial statements (continued)**

**44 Financial information by segment (continued)**

**a) Information about business segments**

Group As of and for the year ended 31 December 2016	(in HRK million)								
	Corporate banking	Retail banking	Finance banking	Central Structure	PBZ Card	Other subsidiaries	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	795	1,475	373	(68)	25	24	2,624	-	2,624
Net commission income/(expense)	319	381	(1)	(0)	534	13	1,246	-	1,246
Net profit/(loss) from trading and dividend and other operating income	21	(30)	49	129	(29)	94	234	414	648
<b>Operating income</b>	<b>1,135</b>	<b>1,826</b>	<b>421</b>	<b>61</b>	<b>530</b>	<b>131</b>	<b>4,104</b>	<b>414</b>	<b>4,518</b>
Operating expenses	(399)	(967)	(50)	(7)	(153)	(66)	(1,642)	(454)	(2,096)
<b>Operating profit</b>	<b>736</b>	<b>859</b>	<b>371</b>	<b>54</b>	<b>377</b>	<b>65</b>	<b>2,462</b>	<b>(40)</b>	<b>2,422</b>
Impairments and provisions	(326)	(32)	-	(9)	(52)	(11)	(430)	40	(390)
<b>Profit before tax</b>	<b>410</b>	<b>827</b>	<b>371</b>	<b>45</b>	<b>325</b>	<b>54</b>	<b>2,032</b>	<b>-</b>	<b>2,032</b>
Income tax expense	-	-	-	(392)	(46)	(7)	(445)	-	(445)
<b>Profit after tax</b>	<b>410</b>	<b>827</b>	<b>371</b>	<b>(347)</b>	<b>279</b>	<b>47</b>	<b>1,587</b>	<b>-</b>	<b>1,587</b>
Segment assets	28,402	25,715	26,469	3,982	2,774	3,085	90,427	(8,366)	82,061
Investments in associates	-	-	-	67	-	-	67	-	67
<b>Total segment assets</b>	<b>28,402</b>	<b>25,715</b>	<b>26,469</b>	<b>4,049</b>	<b>2,774</b>	<b>3,085</b>	<b>90,494</b>	<b>(8,366)</b>	<b>82,128</b>
<b>Total segment liabilities</b>	<b>23,064</b>	<b>42,042</b>	<b>1,877</b>	<b>3,820</b>	<b>1,553</b>	<b>2,646</b>	<b>75,002</b>	<b>(7,433)</b>	<b>67,569</b>
Capital expenditure	2	21	-	83	2	-	108	-	108

**Notes to the financial statements (continued)**

**44 Financial information by segment (continued)**

**a) Information about business segments (continued)**

Group As of and for the year ended 31 December 2015	(in HRK million)								
	Corporate banking	Retail banking	Finance banking	Central Structure	PBZ Card	Other subsidiaries	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	783	1,377	(98)	366	47	40	2,515	-	2,515
Net commission income/(expense)	346	363	1	-	507	11	1,228	-	1,228
Net profit/(loss) from trading and dividend and other operating income	10	(38)	(6)	(53)	(174)	113	(148)	404	256
<b>Operating income</b>	<b>1,139</b>	<b>1,702</b>	<b>(103)</b>	<b>313</b>	<b>380</b>	<b>164</b>	<b>3,595</b>	<b>404</b>	<b>3,999</b>
Operating expenses	(400)	(957)	(46)	-	(166)	(97)	(1,666)	(404)	(2,070)
<b>Operating profit</b>	<b>739</b>	<b>745</b>	<b>(149)</b>	<b>313</b>	<b>214</b>	<b>67</b>	<b>1,929</b>	<b>-</b>	<b>1,929</b>
Impairments and provisions	(6)	(177)	(26)	(1,293)	41	(1)	(1,462)	-	(1,462)
<b>Profit before tax</b>	<b>733</b>	<b>568</b>	<b>(175)</b>	<b>(980)</b>	<b>255</b>	<b>66</b>	<b>467</b>	<b>-</b>	<b>467</b>
Income tax expense	-	-	-	(29)	(60)	(8)	(97)	-	(97)
<b>Profit after tax</b>	<b>733</b>	<b>568</b>	<b>(175)</b>	<b>(1,009)</b>	<b>195</b>	<b>58</b>	<b>370</b>	<b>-</b>	<b>370</b>
Segment assets	32,243	25,852	19,754	3,899	2,676	2,995	87,419	(9,146)	78,273
Investments in associates	-	-	-	150	-	-	150	-	150
<b>Total segment assets</b>	<b>32,243</b>	<b>25,852</b>	<b>19,754</b>	<b>4,049</b>	<b>2,676</b>	<b>2,995</b>	<b>87,569</b>	<b>(9,146)</b>	<b>78,423</b>
<b>Total segment liabilities</b>	<b>23,279</b>	<b>42,589</b>	<b>1,375</b>	<b>2,183</b>	<b>1,404</b>	<b>2,581</b>	<b>73,411</b>	<b>(8,212)</b>	<b>65,199</b>
Capital expenditure	1	14	-	82	2	-	99	-	99

**Notes to the financial statements (continued)****44 Financial information by segment (continued)****a) Information about business segments (continued)**

(in HRK million)

Bank As of and for the year ended 31 December 2016	Corporate banking	Retail banking	Finance banking	Central Structure	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	704	1,327	372	(68)	2,335	-	2,335
Net commission income	303	333	(2)	-	634	-	634
Net profit/(loss) from trading and dividend and other operating income	62	196	50	350	658	212	870
<b>Operating income</b>	<b>1,069</b>	<b>1,856</b>	<b>420</b>	<b>282</b>	<b>3,627</b>	<b>212</b>	<b>3,839</b>
Operating expenses	(400)	(855)	(45)	(7)	(1,307)	(212)	(1,519)
<b>Operating profit</b>	<b>669</b>	<b>1,001</b>	<b>375</b>	<b>275</b>	<b>2,320</b>	<b>-</b>	<b>2,320</b>
Impairments and provisions	(323)	(4)	-	(8)	(335)	-	(335)
<b>Profit before tax</b>	<b>346</b>	<b>997</b>	<b>375</b>	<b>267</b>	<b>1,985</b>	<b>-</b>	<b>1,985</b>
Income tax expense	-	-	-	(380)	(380)	-	(380)
<b>Profit after tax</b>	<b>346</b>	<b>997</b>	<b>375</b>	<b>(113)</b>	<b>1,605</b>	<b>-</b>	<b>1,605</b>
<b>Total segment assets</b>	<b>25,712</b>	<b>23,456</b>	<b>24,434</b>	<b>3,641</b>	<b>77,243</b>	<b>(5,193)</b>	<b>72,050</b>
<b>Total segment liabilities</b>	<b>20,151</b>	<b>39,724</b>	<b>979</b>	<b>3,617</b>	<b>64,471</b>	<b>(5,190)</b>	<b>59,281</b>
Capital expenditure	2	21	-	79	102	-	102

**Notes to the financial statements (continued)****44 Financial information by segment (continued)****a) Information about business segments (continued)**

(in HRK million)

Bank As of and for the year ended 31 December 2015	Corporate banking	Retail banking	Finance banking	Central Structure	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	678	1,249	(99)	365	2,193	-	2,193
Net commission income	323	326	-	-	649	-	649
Net profit/(loss) from trading and dividend and other operating income	47	138	(7)	(53)	125	194	319
<b>Operating income</b>	<b>1,048</b>	<b>1,713</b>	<b>(106)</b>	<b>312</b>	<b>2,967</b>	<b>194</b>	<b>3,161</b>
Operating expenses	(408)	(851)	(42)	-	(1,301)	(194)	(1,495)
<b>Operating profit</b>	<b>640</b>	<b>862</b>	<b>(148)</b>	<b>312</b>	<b>1,666</b>	<b>-</b>	<b>1,666</b>
Impairments and provisions	21	(159)	(26)	(1,293)	(1,457)	-	(1,457)
<b>Profit before tax</b>	<b>661</b>	<b>703</b>	<b>(174)</b>	<b>(981)</b>	<b>209</b>	<b>-</b>	<b>209</b>
Income tax expense	-	-	-	(17)	(17)	-	(17)
<b>Profit after tax</b>	<b>661</b>	<b>703</b>	<b>(174)</b>	<b>(998)</b>	<b>192</b>	<b>-</b>	<b>192</b>
<b>Total segment assets</b>	<b>29,610</b>	<b>23,709</b>	<b>18,375</b>	<b>3,570</b>	<b>75,264</b>	<b>(6,050)</b>	<b>69,214</b>
<b>Total segment liabilities</b>	<b>20,962</b>	<b>40,369</b>	<b>465</b>	<b>2,044</b>	<b>63,840</b>	<b>(6,050)</b>	<b>57,790</b>
Capital expenditure	1	14	-	75	90	-	90

## Notes to the financial statements (continued)

### 44 Financial information by segment (continued)

#### b) Geographical segment information

	(in HRK million)	
	GROUP	
	2016	2015
Operating income	4,518	3,975
<i>Croatia</i>	4,194	3,668
<i>Bosnia and Herzegovina</i>	324	307
Non-current assets*	1,250	1,337
<i>Croatia</i>	1,174	1,270
<i>Bosnia and Herzegovina</i>	76	67
Capital expenditure	108	99
<i>Croatia</i>	104	90
<i>Bosnia and Herzegovina</i>	4	9

\* Includes property and equipment, intangible assets and investment property.

Geographical segmentation is based on the domicile of Group subsidiaries.

## Notes to the financial statements (continued)

### 45 Financial risk management policies

This section provides details of the Group's exposure to risks and describes the methods used by the management to identify, measure and manage risks. The most important types of financial risk to which the Group is exposed are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk and equity price risk.

An integrated system of risk management has been established at the Group level by introducing a set of policies and procedures, determining the limits of risk levels acceptable to the Group and monitoring their implementation. With particular reference to risk taking preferences, the Group defines its risk appetite through Risk Appetite Framework (RAF), i.e. set of strategic key limits ensuring stability of the Group in the upcoming period and beyond.

Accepted management principles of risk management have been implemented in all subsidiaries.

#### a) Credit risk

The Group is subject to credit risk through its trading, lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees. The risk that counterparties to both derivative and other instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Group deals with counterparties of good credit standing, and when appropriate, obtains collateral.

The Group's primary exposure to credit risk arises through its loans and advances to customers. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the statement of financial position. In addition, the Group is exposed to off-balance-sheet credit risk through commitments to extend credit and guarantees issued – as disclosed in Note 35.

Lending commitments including those based on guarantees issued by the Group that are contingent upon customers maintaining specific standards (including the solvency position of customers not worsening) represent liabilities that can be revoked. Irrevocable liabilities are based on undrawn but approved loans and approved overdrafts because these liabilities are the result of terms determined by loan contracts.

Guarantees and approved letters of credit that commit the Group to make payments on behalf of customers in the event of a specific act carry the same credit risk as loans. Standby letters of credit, which represent written guarantees of the Group in a client's name such that a third party can withdraw funds up to the preapproved limit, are covered by collateral, being the goods for which they were issued. The credit risk for this type of product is significantly lower than for direct loans.

Exposure to credit risk has been managed in accordance with the Group's policies and with the regulatory requirements of the Croatian National Bank. Credit exposures to portfolios and individual group exposures are reviewed on a regular basis against the limits set. Breaches are reported to the appropriate bodies and personnel within the Bank authorised to approve them. Any substantial increases in credit exposure are authorised by the Credit Committee. The Asset Quality Committee monitors changes in the credit-worthiness of credit exposures and reviews them for any proposed impairment losses. Credit risk assessment is continuously monitored and reported, thus enabling an early identification of impairment in the credit portfolio. The Group continually applies prudent methods and models used in the process of credit risk assessment.

The Group is also continuously developing internal models compliant with an internal ratings-based approach ("IRB"), as prescribed by the Capital Requirement Regulation (EU Regulation no. 575/2013) and supplementing legislation, in order to quantify:

- default risk expressed in terms of internal rating which is periodically assigned to corporate and retail customers and quantified as probability of default (PD models);
- loss given default as an estimate of potential losses in the event of default, given the characteristics of the transaction and present collateral (LGD models).

Internal models are deeply embedded into credit processes and underwriting policies where they determine characteristics of the transaction such as lending limit, required collateral and price as well as an appropriate decision level within an internal scheme of delegation of powers. Furthermore, internal models are also used for calculation of an adequate level of internal capital (ICAAP) and within the stress testing framework.



**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****a) Credit risk (continued)****Maximum exposure to credit risk**

The table below presents the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is presented net of impairment allowance before the effect of mitigation through collateral agreements.

		(in HRK million)			
		GROUP		BANK	
Notes		2016	2015	2016	2015
Cash and current accounts with banks (excluding cash in hand)	15	10,956	8,013	10,818	7,713
Balances with the Croatian National bank	16	3,916	4,550	3,916	4,550
Financial assets at fair value through profit or loss (excluding equity securities and units in investment funds)	17	5,983	5,851	5,949	5,792
Derivative financial assets	18	25	4	19	4
Loans and advances to banks	19	2,806	3,450	1,731	2,966
Loans and advances to customers	20	52,885	50,985	45,667	44,186
Financial assets available for sale (excluding equity securities)	21	1,310	900	276	76
Held-to-maturity investments	22	17	17	-	-
Other assets (excluding foreclosed assets, prepaid expenses and leaseholds improvements)	27	348	328	159	196
Tax prepayments		22	157	-	145
<b>Total</b>		<b>78,268</b>	<b>74,255</b>	<b>68,535</b>	<b>65,628</b>
Contingent liabilities and commitments	35	14,483	13,068	13,341	12,023
<b>Total credit risk exposure</b>		<b>92,751</b>	<b>87,323</b>	<b>81,876</b>	<b>77,651</b>

Where financial instruments are recorded at fair value, the amounts shown above represent the credit risk exposure at the reporting date but not the maximum risk exposure that could arise in the future as a result of changes in fair values.

**Collateral held and other credit enhancements**

In terms of credit risk mitigation the Group's policy is to require suitable collateral to be provided by certain customers prior to the disbursement of approved loans. As a rule, the Group approves a facility if there are two independent and viable repayment sources – cash flows generated by the borrower's activity and security instruments/collateral. The main types of collateral obtained are as follows:

- cash deposit for which the agreement stipulates that the Bank shall have the right to use the cash deposit for debt recovery and that the depositor may not use this deposit until the final settlement of all obligations under the approved facility;
- guarantee of the Government of the Republic of Croatia;
- pledge of securities issued by the Republic of Croatia or the Croatian National Bank;
- irrevocable guarantee or super guarantee issued by a domestic or foreign bank with adequate credit rating with the conditions of "payable on first demand" or "without objections" or similar;
- credit insurance policy issued by the Croatian Bank for Reconstruction and Development;
- credit insurance policy issued by an appropriate insurance company in accordance with the internal regulations of the Bank;
- pledge of units in investment funds managed by PBZ Invest;
- mortgage/lien/fiduciary transfer of ownership of property, movable property or securities of other issuers.

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### a) Credit risk (continued)

##### Collateral held and other credit enhancements (continued)

In general, a quality security instrument is an instrument with characteristics that provide a reasonable estimate of the Bank's ability to recover its receivables secured by that instrument (in case of its activation), through market or court mechanisms, within a reasonable period of time. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its regular review of the adequacy of the allowance for impairment losses.

The majority of housing loans are secured by mortgages over residential property. A significant part of the corporate portfolio is secured by mortgages over different types of commercial property

##### Refinanced loans

Loan refinancing is done for clients where the focus of the business relationship has shifted from making profit to mitigating losses on lending exposure at a stage when legal action for mitigating losses is not yet needed. The goal is timely identification of clients where refinancing would enable them to continue in business and to mitigate or prevent further losses for the Group.

Refinancing activities are based on cooperation with other organisational parts of the Group, which identify clients/exposures that are the subject of refinancing and include: supporting of sales staff in defining the appropriate refinancing strategy, analysing refinancing applications, suggesting measures and making recommendations for refinancing, monitoring progress, monitoring the portfolio, assessing the level of impairment and the Group's proposing measures that would improve collateral coverage in order to strengthen its position in the collection of receivables.

All restructurings and reschedulings have been marked with forbearance flag in line with relevant regulation. Compared to the end of 2015, forbore portfolio exposure of the Group has declined in volume by 0.5% in 2016, amounting to HRK 3,650 million (2015: HRK 3,667 million). Provisions coverage of forbore portfolio as of 31 December 2016 was 22.7% (2015: 27,8%). Forborne performing portfolio exposure has grown in volume by 33.5% (amounting to HRK 1,529 million, 2015: HRK 1,145 million), while forbore NPL portfolio exposure has declined in volume by 15.9% (amounting to HRK 2,121 million, 2015: HRK 2,522 million) primarily driven by the execution of dedicated NPL management strategies through sale of receivables and successful refinancing with sufficiently high cure rates.

The Group is also continuously improving collection and workout processes (problem loan management framework) by introducing new application support boosting process efficiency and developing novel collection strategies in the form of tailor-made products and offers to retail customers, refinancing standards and support for corporate clients, and finally sale of assets where further collection is deemed immaterial and therefore not appropriate/efficient to be executed within the Group.

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### a) Credit risk (continued)

##### *Loans and advances to customers: analysis by performance*

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Loans and advances to customers</b>				
Neither past due nor impaired	48,809	46,242	42,267	40,508
Past due but not impaired	2,360	2,783	1,929	2,020
Impaired	5,403	6,647	4,568	5,746
<b>Gross</b>	<b>56,572</b>	<b>55,672</b>	<b>48,764</b>	<b>48,274</b>
Specific impairment allowance	(2,885)	(3,510)	(2,369)	(2,985)
IBNR	(549)	(593)	(508)	(549)
<b>Net of impairment allowance</b>	<b>53,138</b>	<b>51,569</b>	<b>45,887</b>	<b>44,740</b>

##### *Loans and advances to customers that are neither past due nor impaired*

For loans and advances to corporate customers that are neither past due nor impaired the Group and the Bank adopts special monitoring for clients with occasional defaults in repayment of loan. Special monitoring graded clients are analysed in detail within Proactive Credit Exposure Management (PCEM) team where individual client's strategies have been defined, implemented and their execution is closely monitored. In cases where the PCEM strategies fail, the Bank classifies the clients to individually impaired category.

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Loans and advances to corporate customers</b>				
Standard monitoring	23,197	21,780	21,313	20,015
Special monitoring	890	962	826	875
<b>Loans and advances to retail customers</b>				
Standard monitoring	24,722	23,500	20,128	19,618
<b>Total</b>	<b>48,809</b>	<b>46,242</b>	<b>42,267</b>	<b>40,508</b>

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### a) Credit risk (continued)

##### *Loans and advances to customers past due but not impaired*

Past due but not impaired loans and advances to customers are those for which contractual interest or principal payments are past due, but the Group believes that impairment is not appropriate based on the level of security, collateral available and/or the stage of collection of amounts owed to the Group.

An ageing analysis of loans and advances to customers past due but not impaired is shown below. The exposures below include both due and not due portions of the loan.

Group 2016	(in HRK million)					
	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	164	1	1	-	-	166
Enterprises	150	92	158	-	-	400
<i>of which:</i>						
Micro enterprises	3	3	36	-	-	42
Small enterprises	21	21	36	-	-	78
Mid enterprises	96	68	86	-	-	250
Large corporate	30	-	-	-	-	30
Others	218	-	16	-	-	234
<b>Loans and advances to corporate customers</b>	<b>532</b>	<b>93</b>	<b>175</b>	<b>-</b>	<b>-</b>	<b>800</b>
Housing loans	109	107	257	40	-	513
Mortgage loans	9	35	27	3	-	74
Car loans	-	-	1	-	-	1
Non-purpose loans	134	154	140	14	-	442
Quick loans	27	7	29	1	-	64
Overdrafts	11	4	7	1	-	23
Refinancing	38	43	70	19	-	170
Others	96	109	51	-	-	256
Craftsmen	1	3	13	-	-	17
<b>Loans and advances to retail customers</b>	<b>425</b>	<b>462</b>	<b>595</b>	<b>78</b>	<b>-</b>	<b>1,560</b>
<b>Total</b>	<b>957</b>	<b>555</b>	<b>770</b>	<b>78</b>	<b>-</b>	<b>2,360</b>

**Notes to the financial statements (continued)**

**45 Financial risk management policies (continued)**

**a) Credit risk (continued)**

*Loans and advances to customers past due but not impaired (continued)*

<b>Group 2015</b>	(in HRK million)					
	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	-	1	11	-	-	12
Enterprises	141	53	210	-	-	404
<i>of which:</i>						
Micro enterprises	2	3	19	-	-	24
Small enterprises	77	3	65	-	-	145
Mid enterprises	62	47	91	-	-	200
Large corporate	-	-	35	-	-	35
Others	-	-	231	-	-	231
<b>Loans and advances to corporate customers</b>	<b>141</b>	<b>54</b>	<b>452</b>	<b>-</b>	<b>-</b>	<b>647</b>
Housing loans	143	138	329	111	51	772
Mortgage loans	13	21	45	6	1	86
Car loans	-	-	1	-	-	1
Non-purpose loans	126	143	184	15	1	469
Quick loans	27	6	29	2	-	64
Overdrafts	13	4	8	2	2	29
Refinancing	36	48	94	25	11	214
Others	302	94	58	16	13	483
Craftsmen	1	2	15	-	-	18
<b>Loans and advances to retail customers</b>	<b>661</b>	<b>456</b>	<b>763</b>	<b>177</b>	<b>79</b>	<b>2,136</b>
<b>Total</b>	<b>802</b>	<b>510</b>	<b>1,215</b>	<b>177</b>	<b>79</b>	<b>2,783</b>

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****a) Credit risk (continued)***Loans and advances to customers past due but not impaired (continued)*

	(in HRK million)					
<b>Bank 2016</b>	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	164	1	1	-	-	166
Enterprises	136	33	127	-	-	296
<i>of which:</i>						
Micro enterprises	1	-	36	-	-	37
Small enterprises	21	16	31	-	-	68
Mid enterprises	84	17	60	-	-	161
Large corporate	30	-	-	-	-	30
Others	218	-	16	-	-	234
<b>Loans and advances to corporate customers</b>	<b>518</b>	<b>34</b>	<b>144</b>	<b>-</b>	<b>-</b>	<b>696</b>
Housing loans	103	97	254	40	-	494
Mortgage loans	5	21	23	3	-	52
Car loans	-	-	1	-	-	1
Non-purpose loans	131	113	133	14	-	391
Quick loans	27	7	29	1	-	64
Overdrafts	11	4	6	1	-	22
Refinancing	38	43	70	19	-	170
Others	7	11	7	-	-	25
Craftsmen	-	2	12	-	-	14
<b>Loans and advances to retail customers</b>	<b>322</b>	<b>298</b>	<b>535</b>	<b>78</b>	<b>-</b>	<b>1,233</b>
<b>Total</b>	<b>840</b>	<b>332</b>	<b>679</b>	<b>78</b>	<b>-</b>	<b>1,929</b>

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****a) Credit risk (continued)***Loans and advances to customers past due but not impaired (continued)*

	(in HRK million)					
<b>Bank 2015</b>	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	-	1	11	-	-	12
Enterprises	45	4	148	-	-	197
<i>of which:</i>						
Micro enterprises	2	1	19	-	-	22
Small enterprises	14	3	56	-	-	73
Mid enterprises	29	-	38	-	-	67
Large corporate	-	-	35	-	-	35
Others	-	-	231	-	-	231
<b>Loans and advances to corporate customers</b>	<b>45</b>	<b>5</b>	<b>390</b>	<b>-</b>	<b>-</b>	<b>440</b>
Housing loans	136	127	328	111	51	753
Mortgage loans	5	8	41	6	1	61
Car loans	-	-	1	-	-	1
Non-purpose loans	119	104	177	15	1	416
Quick loans	27	6	29	2	-	64
Overdrafts	13	4	7	2	2	28
Refinancing	36	48	94	25	11	214
Others	7	12	7	1	-	27
Craftsmen	1	1	14	-	-	16
<b>Loans and advances to retail customers</b>	<b>344</b>	<b>310</b>	<b>698</b>	<b>162</b>	<b>66</b>	<b>1,580</b>
<b>Total</b>	<b>389</b>	<b>315</b>	<b>1,088</b>	<b>162</b>	<b>66</b>	<b>2,020</b>

The exposure is presented before the effect of mitigation through collateral agreements.

The delinquencies up to 30 days are of a technical nature and are frequently of low value and represent an insignificant part of the aggregate outstanding amount of the borrower. The management believes that these exposures are fully recoverable.

Loans to retail customers which are past due more than 90 days relate to those loans whose due instalments are below materiality threshold set by the Group. A significant part of this effect relates to housing loans which have relatively low instalments compared to total debt.

**Notes to the financial statements (continued)**
**45 Financial risk management policies (continued)**
**a) Credit risk (continued)**
*Loans and advances to customers that are impaired*

The Group determines that loans and advances to customers are impaired when there is objective evidence that a loss event has occurred since initial recognition and such loss event has an impact on future estimated cash flows from the asset. Impaired loans and advances to customers are set out below:

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Loans and advances to corporate customers</b>				
Government and municipalities	6	10	6	10
Enterprises	2,115	3,164	1,574	2,557
<i>of which:</i>				
Micro enterprises	497	571	352	393
Small enterprises	469	652	385	581
Mid enterprises	701	1,017	399	673
Large corporate	448	924	438	910
Others	365	231	364	231
<b>Total gross amount</b>	<b>2,486</b>	<b>3,405</b>	<b>1,944</b>	<b>2,798</b>
Specific impairment allowance	(1,441)	(1,919)	(1,137)	(1,605)
<b>Net amount</b>	<b>1,045</b>	<b>1,486</b>	<b>807</b>	<b>1,193</b>
<b>Loans and advances to retail customers</b>				
Housing loans	665	795	655	786
Mortgage loans	126	168	105	146
Car loans	14	19	11	15
Non-purpose loans	306	373	225	302
Quick loans	42	53	42	53
Overdrafts	72	89	67	83
Refinancing	1,369	1,387	1,369	1,387
Others	190	203	23	27
Craftsmen	133	155	127	149
<b>Total gross amount</b>	<b>2,917</b>	<b>3,242</b>	<b>2,624</b>	<b>2,948</b>
Specific impairment allowance	(1,444)	(1,591)	(1,232)	(1,380)
<b>Net amount</b>	<b>1,473</b>	<b>1,651</b>	<b>1,392</b>	<b>1,568</b>
<b>Total gross amount</b>	<b>5,403</b>	<b>6,647</b>	<b>4,568</b>	<b>5,746</b>
Specific impairment allowance	(2,885)	(3,510)	(2,369)	(2,985)
<b>Net amount</b>	<b>2,518</b>	<b>3,137</b>	<b>2,199</b>	<b>2,761</b>

The fair value of collateral that the Group and the Bank hold in respect of loans determined to be impaired as of 31 December 2016 amounts to HRK 5,700 million (31 December 2015: HRK 7,100 million).



**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****a) Credit risk (continued)***Analysis of performance of other financial assets*

The table below sets out the credit quality of other financial assets.

(in HRK million)

<b>Group</b>	Financial assets at fair value through profit or loss	Loans and ad- vances to banks	Financial assets available for sale	Held-to-maturity investments
<b>As at 31 December 2016</b>				
Neither past due nor impaired	5,983	2,839	1,310	17
Past due but not impaired	-	-	-	-
Impaired	-	8	-	-
<b>Gross</b>	<b>5,983</b>	<b>2,847</b>	<b>1,310</b>	<b>17</b>
Specific impairment allowance	-	(8)	-	-
IBNR	-	(33)	-	-
<b>Net of impairment allowance</b>	<b>5,983</b>	<b>2,806</b>	<b>1,310</b>	<b>17</b>
<b>As at 31 December 2015</b>				
Neither past due nor impaired	5,851	3,498	900	17
Past due but not impaired	-	-	-	-
Impaired	6	8	-	-
<b>Gross</b>	<b>5,857</b>	<b>3,506</b>	<b>900</b>	<b>17</b>
Specific impairment allowance	(6)	(8)	-	-
IBNR	-	(48)	-	-
<b>Net of impairment allowance</b>	<b>5,851</b>	<b>3,450</b>	<b>900</b>	<b>17</b>

**Notes to the financial statements (continued)**

**45 Financial risk management policies (continued)**

**a) Credit risk (continued)**

*Analysis of performance of other financial assets (continued)*

(in HRK million)

<b>Bank</b>	Financial assets at fair value through profit or loss	Loans and ad- vances to banks	Financial assets available for sale	Held-to-maturity investments
<b>As at 31 December 2016</b>				
Neither past due nor impaired	5,949	1,764	276	-
Past due but not impaired	-	-	-	-
Impaired	-	8	-	-
<b>Gross</b>	<b>5,949</b>	<b>1,772</b>	<b>276</b>	<b>-</b>
Specific impairment allowance	-	(8)	-	-
IBNR	-	(33)	-	-
<b>Net of impairment allowance</b>	<b>5,949</b>	<b>1,731</b>	<b>276</b>	<b>-</b>
<b>As at 31 December 2015</b>				
Neither past due nor impaired	5,792	3,014	76	-
Past due but not impaired	-	-	-	-
Impaired	6	8	-	-
<b>Gross</b>	<b>5,798</b>	<b>3,022</b>	<b>76</b>	<b>-</b>
Specific impairment allowance	(6)	(8)	-	-
IBNR	-	(48)	-	-
<b>Net of impairment allowance</b>	<b>5,792</b>	<b>2,966</b>	<b>76</b>	<b>-</b>

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### a) Credit risk (continued)

##### *Loans and advances to customers per internal risk classification*

Credit risk of loans and advances to customers is monitored using internal classifications for the credit risk.

The Group internally classifies the loan exposures into the following risk categories:

- Performing: the client is timely servicing its liabilities and there is no objective evidence of impairment;
- Doubtful: exposures to borrowers being effectively insolvent (although not yet legally) or in comparable status, regardless of any loss forecasts made by the bank;
- Unlikely to pay: exposures to borrowers which are experiencing financial or economic difficulties that are expected to be overcome in a reasonable period of time;
- Past due impaired: exposures other than those classified as unlikely to pay or doubtful that are past due for more than 90 days on a continuous basis above the established threshold.

The tables below present exposures to loans and advances to customers broken down by internal risk grades for management reporting purposes as at 31 December 2016 and 31 December 2015. The amounts provided are gross of specific or collective provisions.

(in HRK million)

Group	2016		2015	
	Loans and advances to customers	Impairment allowance	Loans and advances to customers	Impairment allowance
Performing loans	51,169	549	49,025	593
Non-performing loans	5,403	2,885	6,647	3,510
<i>Doubtful loans</i>	<i>2,741</i>	<i>1,985</i>	<i>3,646</i>	<i>2,415</i>
<i>Unlikely to pay</i>	<i>2,584</i>	<i>872</i>	<i>2,909</i>	<i>1,065</i>
<i>Past due impaired</i>	<i>78</i>	<i>28</i>	<i>92</i>	<i>30</i>
	<b>56,572</b>	<b>3,434</b>	<b>55,672</b>	<b>4,103</b>

(in HRK million)

Bank	2016		2015	
	Loans and advances to customers	Impairment allowance	Loans and advances to customers	Impairment allowance
Performing loans	44,196	508	42,528	549
Non-performing loans	4,568	2,369	5,746	2,985
<i>Doubtful loans</i>	<i>2,140</i>	<i>1,545</i>	<i>3,007</i>	<i>1,940</i>
<i>Unlikely to pay</i>	<i>2,374</i>	<i>807</i>	<i>2,673</i>	<i>1,026</i>
<i>Past due impaired</i>	<i>54</i>	<i>17</i>	<i>66</i>	<i>19</i>
	<b>48,764</b>	<b>2,877</b>	<b>48,274</b>	<b>3,534</b>

**Notes to the financial statements (continued)**

**45 Financial risk management policies (continued)**

**a) Credit risk (continued)**

*Financial assets at fair value through profit or loss per external risk classification*

The table below provides information of the credit quality of financial assets at fair value through profit or loss (excluding equity securities and units in investment funds); using external ratings of Fitch Ratings or Standard & Poor's if Fitch Ratings was not available:

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Government bonds and treasury bills</b>	<b>5,972</b>	<b>5,763</b>	<b>5,938</b>	<b>5,704</b>
BB+	4,418	3,146	4,409	3,101
B	244	1,383	219	1,383
no rating	1,310	1,234	1,310	1,220
<b>Domestic corporate bonds</b>	<b>6</b>	<b>61</b>	<b>6</b>	<b>61</b>
BB-	-	11	-	11
B+	-	49	-	49
no rating	6	1	6	1
<b>Municipal bonds</b>	<b>5</b>	<b>27</b>	<b>5</b>	<b>27</b>
no rating	5	27	5	27
<b>Total</b>	<b>5,983</b>	<b>5,851</b>	<b>5,949</b>	<b>5,792</b>

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### a) Credit risk (continued)

##### *Offsetting financial assets and financial liabilities*

The disclosures set out in the table on the next page include financial assets and financial liabilities that are offset in the Group's statement of financial position; or are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments, irrespective of whether they are offset in the statement of financial position.

The similar agreements include derivative clearing agreements, global master repurchase agreements, and global master securities lending agreements. Similar financial instruments include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and lending agreements. Financial instruments such as loans and deposits are not disclosed in the tables unless they are offset in the statement of financial position.

The Group receives and gives collateral in the form of cash and marketable securities in respect of the following transactions:

- derivatives;
- sale and repurchase, and reverse sale and repurchase agreements; and
- securities lending and borrowing.

The disclosures set out in the table on the next page include financial assets and financial liabilities that are subject to offsetting, irrespective of whether they are offset in the statement of financial position. These include derivative clearing agreements, sale and repurchase agreements and reverse sale and repurchase agreements.

##### *Derivative financial instruments*

Derivative financial instruments include foreign exchange forward contracts, foreign exchange swaps and embedded derivatives in contracts with a single-sided currency clause. All derivatives are classified as held for trading and carried as assets when their fair value is positive and as liabilities when negative.

At 31 December 2016 derivative financial instruments with positive fair value amounted to HRK 25 million (31 December 2015: HRK 4 million) for the Group and HRK 19 million (31 December 2015: HRK 4 million) for the Bank, while derivative financial instruments with negative fair value amounted to HRK 11 million (31 December 2015: HRK 15 million) for the Group and HRK 5 million (31 December 2015: HRK 15 million) for the Bank.

##### *Sale and repurchase agreement, and reverse sale and repurchase transaction*

Sale and repurchase agreements are transactions in which the Group sells a security and simultaneously agrees to repurchase it at a fixed price on a future date. The Group continues to recognise the securities in their entirety in the statement of financial position because it retains substantially all the risks and rewards of ownership. The cash consideration received is recognised as a financial asset and a financial liability is recognised for the obligation to repay at the repurchase price, classified as interest-bearing borrowings.

Reverse sale and repurchase agreements are transactions in which the Group purchases a security and simultaneously agrees to sell it at a fixed price on a future date. The Group holds collateral in the form of marketable securities in respect of loans given.

Sale and repurchase agreements as well as reverse sale and repurchase agreements give the Group possibility for offsetting on a net basis, in case of default of any counterparty.

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****a) Credit risk (continued)***Offsetting financial assets and financial liabilities (continued)*

*Sale and repurchase agreement, and reverse sale and repurchase transaction (continued)*

The table below shows the amount of collateral accepted in respect of reverse sale and repurchase agreements and given in respect of sale and repurchase agreements. Collateral accepted and given includes government issued T-bills and Bonds.

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Receivables from reverse sale and repurchase agreements related to:</b>	<b>314</b>	<b>182</b>	<b>351</b>	<b>182</b>
- loans and advances to banks	165	20	202	20
- loans and advances to customers	149	162	149	162
Fair value of collateral accepted in respect of the above	342	205	382	205
<b>Payables under sale and repurchase agreements</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
- interest-bearing borrowings	-	-	-	-
Carrying amount of collateral provided in respect of the above relating to:	-	-	-	-
- financial assets at fair value through profit and loss	-	-	-	-
- debt securities classified as loans and receivables	-	-	-	-

**b) Liquidity risk**

Liquidity risk arises in the general funding of the Group's activities and in the management of positions. It includes both the risk of being unable to fund assets at the appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Group has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, interest-bearing borrowings and share capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funding. The Group continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall Group strategy. In addition, the Group holds a portfolio of liquid assets as part of its liquidity risk management.

The Group adjusts its business activities to manage liquidity risk according to regulatory and internal policies for the maintenance of liquidity reserves, matching of liabilities and assets, control of limits, preferred liquidity ratios and contingency planning procedures. Needs for short-term liquidity are planned every month for a period of one month and are controlled and maintained daily. The Treasury department manages liquidity reserves daily, ensuring also the fulfilment of all customer needs.

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****b) Liquidity risk (continued)**

Apart from external requirements that include regulatory limits prescribed by the CNB (obligatory reserve with the CNB, minimum required amount of foreign currency claims, minimum liquidity coefficient and others), the Bank has defined a set of internal limits for measuring and monitoring liquidity risk exposure. Thus, the process of liquidity monitoring and control is defined through the following activities and indicators:

- monitoring of liquidity reserve levels;
- short-term mismatches (Liquidity coverage ratio and Short term Gap);
- stressed short-term mismatches;
- monitoring and control of the Bank's structural liquidity ratios (Net stable funding ratio and Medium and long-term "MLT" structural indicator) and analysis of the Bank's funding structure (core deposits modelling, MLT funding projection);
- money market debt exposure towards the overall deposit base and other funding concentration ratios;
- cash flow projections;
- liquidity contingency plan indicators.

For the purpose of the Group's liquidity risk exposure reporting, the following three types of signals are defined:

- *Hard limit* - breach of a prescribed limit demands action in accordance with the Bank's liquidity risk management guidelines;
- *Threshold of attention* - breach of a threshold acts as an early warning signal, demanding additional attention and action if decided by responsible persons;
- *Information on various measures and indicators* - serving as information to the relevant decision-making bodies.

In accordance with the CNB Decision on minimum foreign currency claims, the Bank is obliged to maintain a minimum of 17% (2015: 17%) of foreign currency liabilities in short-term assets. The actual figures were as follows:

2016	%	2015	%
"17% ratio" (at year end)	28.6	"17% ratio" (at year end)	24.10
Average	26.6	Average	21.35
Maximum	36.6	Maximum	26.75
Minimum	19.1	Minimum	17.57

A maturity analysis of financial liabilities according to the remaining contractual maturity as well as an analysis of financial assets and financial liabilities according to their expected maturities are presented in Note 49 to these financial statements.

As part of the management of liquidity risk arising from financial liabilities, the Group holds liquid assets comprising cash and cash equivalents and debt securities for which there is an active and liquid market so that they can be readily sold to meet liquidity requirements. In addition, the Group maintains agreed lines of credit with banks and holds unencumbered assets eligible for use as collateral.

## Notes to the financial statements (continued)

### 45 Financial risk management policies (continued)

#### c) Market risk

All trading instruments are subject to market risk, which is the risk that changes in market prices, such as interest rates, equity securities prices, foreign exchange rates and credit spreads (not relating to changes in the obligator's/issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments. The Group manages and controls market risk exposures within acceptable parameters to ensure the Group's solvency while optimising the return on risk.

Market risk limits are defined based on the Group strategy and requirements, in accordance with senior management risk policy indicators.

#### *Market risk measurement techniques*

Exposure to market risk is formally managed by risk limits which are approved by senior management and revised at least annually. The Group applies the following market risk management techniques: VaR ("Value at Risk"), issuer limits, positional (nominal) exposure, PV01 (the present value of the impact of a 1 bps movement in interest rate) and stop loss limits. The exposure figures and limit utilisations are delivered daily to the senior management and lower management levels within the Treasury Division, which enables informed decision-making at all management and operational levels.

The Group follows market risk measurement and management principles set in cooperation with the Intesa Sanpaolo Group. VaR methodology is used as a basis for top management reporting on the Group's market risk exposure. The Group uses historical simulation (as the Group standard VaR methodology) and RiskWatch (as a Group wide VaR calculation engine), and other supporting activities (pricing, back-testing, stress testing) to ensure compliance with Intesa Sanpaolo Group standards.

The major elements of the market risk management framework include:

- VaR Methodology and Backtesting;
- Sensitivity;
- Fair Value Measurement;
- Level measurements (nominal amount, open position, market value etc.) ;
- Profit and loss indicators (P&L) ;
- Stress testing and scenario analysis;
- Monitoring and measurement of counterparty and delivery risk exposure.

#### *VaR*

The principal tool used to measure and control market risk exposure within the Group's trading portfolio is value-at-risk (VaR). VaR of a trading portfolio is the estimated loss that will arise on the portfolio over a specified period of time (holding period) given an adverse movement with a specified probability (confidence level). The model used by the Group is based upon a 99% confidence level, assumes a 1 day holding period and takes into account 250 historical scenarios. The use of a 99% confidence level means that losses exceeding the VaR figure should occur, on average, not more than once every one hundred days.

The Group uses VaR to measure the following market risks:

- general interest rate risk in trading book;
- equity risk in trading book;
- foreign exchange risk on the statement of financial position level (both trading and banking book).



**Notes to the financial statements (continued)**

**45 Financial risk management policies (continued)**

**c) Market risk (continued)**

**Group**

(in HRK thousand)

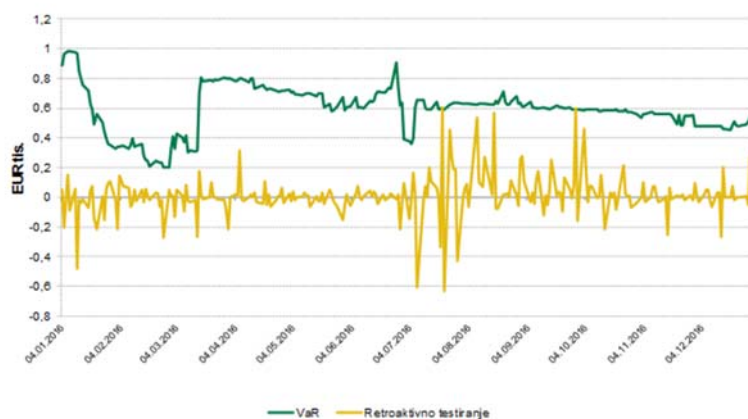
	Equity VaR	Interest rate VaR	Foreign exchange VaR	Effects of correlation	Total
2016 – 4 January	273	934	5,296	290	<b>6,793</b>
2016 – 31 December	236	3,448	1,673	(1,147)	<b>4,210</b>
2016 – Average daily	255	3,889	2,065	(1,766)	<b>4,443</b>
2016 – Lowest	213	645	203	442	<b>1,503</b>
2016 – Highest	285	6,149	7,147	(6,139)	<b>7,442</b>

Note: historical simulation used for VaR calculations

	Equity VaR	Interest rate VaR	Foreign exchange VaR	Effects of correlation	Total
2015 – 2 January	254	1,020	1,623	(1,325)	<b>1,572</b>
2015 – 31 December	241	878	5,335	210	<b>6,664</b>
2015 – Average daily	261	613	7,121	(707)	<b>7,288</b>
2015 – Lowest	215	36	49	(14)	<b>286</b>
2015 – Highest	388	2,789	31,209	(2,785)	<b>31,601</b>

Note: historical simulation used for VaR calculations

Chart below presents Bank’s Total VaR movements in 2016 and corresponding backtest values:



Due to the fact that main contributor of the Total VaR is FX Open position, in 2016 Total VaR changed in line with movement of FX Open position.

In accordance with confidence level of VaR model, in period of one year at least 2 backtest breaches are expected, while in 2016 two backtest breaches were observed, both of them due to change in interest rate.

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****c) Market risk (continued)**

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based give rise to some limitations:

- a one day holding period assumes that it is possible to hedge or dispose of positions within that period. This may not be the case for illiquid assets or in situations in which there is severe market illiquidity;
- a 99% confidence level does not reflect losses that may occur beyond this level;
- the use of historical data as a basis for determining the possible range of future outcomes may not cover all possible scenarios, especially those of an exceptional nature;
- the VaR measure is dependent upon the Group's position and the volatility of market prices.

To determine the reliability of the VaR models, actual outcomes are monitored regularly to test the validity of the assumptions and the parameters used in the VaR calculation. As part of the validation process, the potential weaknesses of the models are analysed using statistical techniques, such as back-testing.

*Currency risk*

The Group is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit-taking, investment and trading activities. It is monitored daily in accordance with regulations and internally set limits, for each currency and for the total assets and liabilities denominated in or linked to foreign currency.

The currency risk exposure is monitored at the overall statement-of-financial-position level by calculating the foreign exchange open position as prescribed by the regulatory provisions and daily through internal limits based on market risk models (foreign exchange VaR). The management of foreign exchange currency risk is supported by monitoring the sensitivity of the Group's financial assets and liabilities to fluctuation in foreign currencies exchange rates.

The tables below indicate the currencies to which the Group and the Bank had significant exposure at 31 December 2016 and 31 December 2015 and for other currencies summarized. FX open position represents net exposure in foreign currency, for both balance and off-balance sheet items, after adjustments for the effects of derivatives. The analysis calculates the effect of a reasonably possible movement of the currencies against the kuna, with all other variables held constant on the income statement. A negative amount in the table reflects a potential net reduction in the income statement, while a positive amount reflects a net potential increase.

**Group**

Currency	FX Open position 31 December 2016*	Scenario 2016		FX Open position 31 December 2015*	Scenario 2015	
		10% Move Up	10% Move Down		10% Move Up	10% Move Down
		(in HRK million)				
EUR	472	47	(47)	(151)	(15)	15
CHF	1	0.1	(0.1)	497	50	(50)
USD	4	0.4	(0.4)	3	0.3	(0.3)
Other	1,621	162	(162)	1,694	169	(169)

\* Positive amounts represent long FX position while negative amounts represent short FX Position.

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****c) Market risk (continued)****Bank**

(in HRK million)

Currency	FX Open position 31 December 2016*	Scenario 2016		FX Open position 31 December 2015*	Scenario 2015	
		10% Move Up	10% Move Down		10% Move Up	10% Move Down
EUR	<b>489</b>	49	(49)	<b>(265)</b>	(27)	27
CHF	<b>1</b>	0.1	(0.1)	<b>497</b>	50	(50)
USD	<b>4</b>	0.4	(0.4)	<b>2</b>	0.2	(0.2)
Other	<b>79</b>	8	(8)	<b>10</b>	1	(1)

\* Positive amounts represent long FX position while negative amounts represent short FX Position.

Currency risk is further analysed in Note 48.

*Interest rate risk*

Interest rate risk represents the risk of decrease in assets values caused by adverse interest rate changes. Interest rate changes affect the net present value of future cash flows and consequently net interest income.

The sources of interest rate risk are:

- repricing risk - resulting from unfavourable changes in the fair value of assets and liabilities in the remaining period until the next interest rate change;
- yield curve risk - the risk of changes in shape and slope of yield curve; and
- basis risk - the risk of different base rates of corresponding asset and liabilities (e.g. EURIBOR vs LIBOR).

Asset-liability risk management activities are conducted to manage the Group's sensitivity to interest rate changes. Exposure to interest rate risk is monitored and measured using repricing gap analysis, net interest income and the economic value of capital. Risk management activities are aimed at optimising net interest income and the economic value of capital, in accordance with the Group's business strategies and given market interest rate levels.

**Notes to the financial statements (continued)****45 Financial risk management policies (continued)****c) Market risk (continued)***Interest rate risk (continued)*

The following table demonstrates the sensitivity to a reasonable possible change in interest rates of the Group and the Bank income statements, with all other variables held constant. The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2016. Items with floating interest rate are distributed according to next repricing date, while items with fixed interest rate according to their original maturity.

	Increase in basis points	(in HRK million)					
		Change at 31 December 2016			Change at 31 December 2015		
		interest in- come	interest expenses	net interest income	interest income	interest expenses	net interest income
<b>Group</b>	+25	126.8	(84.6)	42.2	128.5	(90.9)	37.6
	+50	253.6	(169.3)	84.3	257.0	(181.7)	75.3
<b>Bank</b>	+25	116.8	(77.6)	39.2	116.0	(81.1)	34.9
	+50	233.5	(155.3)	78.2	231.8	(162.2)	69.6

A decrease in basis points would have an opposite effect on the Bank and Group's net interest income in the same amount.

Interest rate risk management is further analysed in Note 46.

*Equity price risk*

Equity price risk is the possibility that equity prices will fluctuate affecting the fair value of equity investments and other instruments that derive their value from a particular equity investment. The primary exposure to equity prices arises from equity securities held for trading and available for sale, which is not significant.

*Derivative financial instruments*

The Group enters into derivative financial instruments primarily to satisfy the needs and requirements of customers. Derivative financial instruments used by the Group include foreign exchange swaps and forwards. Derivatives are contracts which are individually negotiated over the counter.

**d) Operational risk**

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputation risk. In order to measure and manage operational risk exposure at the Group level efficiently, the Group applies an internal model for operational risk exposure management in line with the prescribed Basel II framework.

The internal model for calculation of the regulatory capital requirement for operational risk is based on the Advanced Measurement Approach (AMA) and contains the following components: *Loss Distribution Approach – LDA* based on measure of historical losses or ex-post measured exposure (backward looking) and integrated *self-diagnosis process* (scenario analysis and business environment evaluation) based on subjective estimation of possible future operational losses (forward looking measure).

The AMA model has been used only for the calculation of the capital requirement for the Bank and it applies the AMA approach since 31 March 2011. For all other Group members the Standardised Approach (TSA) has been used, which calculates capital requirement as a risk weighted indicator for all regulatory business lines.

## Notes to the financial statements (continued)

### 46 Interest rate risk

The following tables present the Group's and the Bank's assets and liabilities analysed according to repricing periods determined as the earlier of the remaining contractual maturity and the contractual repricing. Following amendments to the Customer Protection Law, which abolished the concept of administrative interest rates, for the majority loans covered by this Act interest rate is linked to one of the published index. Such loans are put in the appropriate category according to their next repricing period which depends on the period of the index revision. For part of housing loans financed from the joint program with the HBOR, according to the contract, regardless of the displayed index, the next repricing date is a fixed date in the future.

As at 1 January 2014, the Ministry of Finance amended the Consumer Lending Act which requires defining clear parameters in calculating interest rates for all existing loans. Consequently, the Bank changed its contracts with customers (which were previously agreed with administrative interest rate) and now all those clients have variable interest rate, which is linked to 6M EURIBOR and 6M NRS1 for EUR and HRK loans, and 6M LIBOR for non-housing CHF loans. CHF housing loans which in accordance with the amended Consumer Lending Act, have prescribed an interest rate which equals to weighted average of interest rates for all Croatian credit institutions decreased by 30% (i.e. 3.23%) as long as the appreciation of foreign exchange rate from initial fx rate is above 20%. Given the non-existence of the long-term forward rates for such contracts, it is not practicable for the Bank to separate and value embedded derivative related to contracts linked to CHF. Accordingly, embedded derivatives on these contracts are not separately measured and presented in these financial statements.

**Notes to the financial statements (continued)****46 Interest rate risk (continued)**

<b>Group</b>	(in HRK million)					<b>Total</b>	
	<b>As at 31 December 2016</b>	<b>Up to 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 months to 1 year</b>	<b>Over 1 year</b>		<b>Non-interest bearing</b>
<b>Assets</b>							
Cash and current accounts with banks	11,332	-	3	-	-	1,635	<b>12,970</b>
Balances with the Croatian National Bank	-	-	-	-	-	3,916	<b>3,916</b>
Financial assets at fair value through profit or loss	-	1,710	3,831	415	-	147	<b>6,103</b>
Derivative financial assets	-	-	-	-	-	25	<b>25</b>
Loans and advances to banks	2,700	95	10	-	-	1	<b>2,806</b>
Loans and advances to customers	7,255	15,487	17,141	10,702	-	2,300	<b>52,885</b>
Financial assets available for sale	1	-	305	1,004	-	95	<b>1,405</b>
Held-to-maturity investments	-	-	-	17	-	-	<b>17</b>
Investments in associates	-	-	-	-	-	67	<b>67</b>
Intangible assets	-	-	-	-	-	158	<b>158</b>
Property and equipment	-	-	-	-	-	1,030	<b>1,030</b>
Investment property	-	-	-	-	-	62	<b>62</b>
Deferred tax assets	-	-	-	-	-	130	<b>130</b>
Other assets	-	-	-	-	-	532	<b>532</b>
Tax prepayments	-	-	-	-	-	22	<b>22</b>
<b>Total assets</b>	<b>21,288</b>	<b>17,292</b>	<b>21,290</b>	<b>12,138</b>	<b>10,120</b>	<b>10,120</b>	<b>82,128</b>
<b>Liabilities</b>							
Current accounts and deposits from banks	1,081	17	18	9	-	-	<b>1,125</b>
Current accounts and deposits from customers	6,211	4,586	39,118	9,775	-	688	<b>60,378</b>
Derivative financial liabilities	-	-	-	-	-	11	<b>11</b>
Interest-bearing borrowings	862	687	895	1,122	-	5	<b>3,571</b>
Subordinated liabilities	-	-	-	1	-	-	<b>1</b>
Other liabilities	-	-	-	-	-	1,749	<b>1,749</b>
Accrued expenses and deferred income	-	-	-	-	-	264	<b>264</b>
Provisions for liabilities and charges	-	-	-	-	-	284	<b>284</b>
Deferred tax liabilities	-	-	-	-	-	21	<b>21</b>
Current tax liability	-	-	-	-	-	165	<b>165</b>
<b>Total liabilities</b>	<b>8,154</b>	<b>5,290</b>	<b>40,031</b>	<b>10,907</b>	<b>3,187</b>	<b>3,187</b>	<b>67,569</b>
<b>Interest sensitivity gap</b>	<b>13,134</b>	<b>12,002</b>	<b>(18,741)</b>	<b>1,231</b>	<b>6,933</b>	<b>6,933</b>	<b>14,559</b>

**Notes to the financial statements (continued)****46 Interest rate risk (continued)**

(in HRK million)

<b>Group</b>						
<b>As at 31 December 2015</b>	<b>Up to 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 months to 1 year</b>	<b>Over 1 year</b>	<b>Non-in- terest bearing</b>	<b>Total</b>
<b>Assets</b>						
Cash and current accounts with banks	8,800	-	-	-	1,195	<b>9,995</b>
Balances with the Croatian National Bank	-	-	-	-	4,550	<b>4,550</b>
Financial assets at fair value through profit or loss	-	2,004	3,690	101	175	<b>5,970</b>
Derivative financial assets	-	-	-	-	4	<b>4</b>
Loans and advances to banks	2,907	20	139	-	384	<b>3,450</b>
Loans and advances to customers	6,739	15,674	17,296	8,972	2,304	<b>50,985</b>
Financial assets available for sale	1	1	84	814	218	<b>1,118</b>
Held-to-maturity investments	-	-	-	17	-	<b>17</b>
Investments in associates	-	-	-	-	150	<b>150</b>
Intangible assets	-	-	-	-	182	<b>182</b>
Property and equipment	-	-	-	-	1,132	<b>1,132</b>
Investment property	-	-	-	-	23	<b>23</b>
Deferred tax assets	-	-	-	-	141	<b>141</b>
Other assets	-	-	-	-	549	<b>549</b>
Tax prepayments	-	-	-	-	157	<b>157</b>
<b>Total assets</b>	<b>18,447</b>	<b>17,699</b>	<b>21,209</b>	<b>9,904</b>	<b>11,164</b>	<b>78,423</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	1,006	7	62	8	-	<b>1,083</b>
Current accounts and deposits from customers	5,724	5,613	37,581	8,686	576	<b>58,180</b>
Derivative financial liabilities	-	-	-	-	15	<b>15</b>
Interest-bearing borrowings	342	886	1,015	1,639	2	<b>3,884</b>
Subordinated liabilities	-	-	-	2	-	<b>2</b>
Other liabilities	-	-	-	-	1,438	<b>1,438</b>
Accrued expenses and deferred income	-	-	-	-	238	<b>238</b>
Provisions for liabilities and charges	-	-	-	-	313	<b>313</b>
Deferred tax liabilities	-	-	-	-	34	<b>34</b>
Current tax liability	-	-	-	-	11	<b>11</b>
<b>Total liabilities</b>	<b>7,072</b>	<b>6,506</b>	<b>38,658</b>	<b>10,335</b>	<b>2,627</b>	<b>65,198</b>
<b>Interest sensitivity gap</b>	<b>11,375</b>	<b>11,193</b>	<b>(17,449)</b>	<b>(431)</b>	<b>8,537</b>	<b>13,225</b>

**Notes to the financial statements (continued)****46 Interest rate risk (continued)**

(in HRK million)

<b>Bank</b>	(in HRK million)					
<b>As at 31 December 2016</b>	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-in- terest bearing	Total
<b>Assets</b>						
Cash and current accounts with banks	10,818	-	3	-	1,517	<b>12,338</b>
Balances with the Croatian National Bank	-	-	-	-	3,916	<b>3,916</b>
Financial assets at fair value through profit or loss	-	1,700	3,806	416	53	<b>5,975</b>
Derivative financial assets	-	-	-	-	19	<b>19</b>
Loans and advances to banks	1,620	96	10	-	5	<b>1,731</b>
Loans and advances to customers	6,887	14,565	14,684	9,418	113	<b>45,667</b>
Financial assets available for sale				276	94	<b>370</b>
Investments in subsidiaries and associates	-	-	-	-	953	<b>953</b>
Intangible assets	-	-	-	-	124	<b>124</b>
Property and equipment	-	-	-	-	545	<b>545</b>
Investment property	-	-	-	-	50	<b>50</b>
Deferred tax assets	-	-	-	-	88	<b>88</b>
Other assets	-	-	-	-	274	<b>274</b>
<b>Total assets</b>	<b>19,325</b>	<b>16,361</b>	<b>18,503</b>	<b>10,110</b>	<b>7,751</b>	<b>72,050</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	992	57	62	265	-	<b>1,376</b>
Current accounts and deposits from customers	3,607	4,423	37,992	7,366	720	<b>54,108</b>
Derivative financial liabilities	-	-	-	-	5	<b>5</b>
Interest-bearing borrowings	772	202	612	1,158	3	<b>2,747</b>
Other liabilities	-	-	-	-	481	<b>481</b>
Accrued expenses and deferred income	-	-	-	-	137	<b>137</b>
Provisions for liabilities and charges	-	-	-	-	257	<b>257</b>
Deferred tax liabilities	-	-	-	-	5	<b>5</b>
Current tax liability	-	-	-	-	165	<b>165</b>
<b>Total liabilities</b>	<b>5,371</b>	<b>4,682</b>	<b>38,666</b>	<b>8,789</b>	<b>1,773</b>	<b>59,281</b>
<b>Interest sensitivity gap</b>	<b>13,954</b>	<b>11,679</b>	<b>(20,163)</b>	<b>1,321</b>	<b>5,978</b>	<b>12,769</b>



**Notes to the financial statements (continued)****46 Interest rate risk (continued)**

	(in HRK million)					
<b>Bank</b>						
<b>As at 31 December 2015</b>	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	Over 1 year	Non-interest bearing	Total
<b>Assets</b>						
Cash and current accounts with banks	7,712	-	-	-	1,431	9,143
Balances with the Croatian National Bank	-	-	-	-	4,550	4,550
Financial assets at fair value through profit or loss	-	1,994	3,640	101	83	5,818
Derivative financial assets	-	-	-	-	4	4
Loans and advances to banks	2,790	20	139	-	17	2,966
Loans and advances to customers	6,326	15,028	14,363	8,206	263	44,186
Financial assets available for sale	-	-	-	76	217	293
Investments in subsidiaries and associates	-	-	-	-	963	963
Intangible assets	-	-	-	-	106	106
Property and equipment	-	-	-	-	625	625
Investment property	-	-	-	-	10	10
Deferred tax assets	-	-	-	-	100	100
Other assets	-	-	-	-	305	305
Tax prepayments	-	-	-	-	145	145
<b>Total assets</b>	<b>16,828</b>	<b>17,042</b>	<b>18,142</b>	<b>8,383</b>	<b>8,819</b>	<b>69,214</b>
<b>Liabilities</b>						
Current accounts and deposits from banks						
Current accounts and deposits from customers	944	98	283	48	-	1,373
Derivative financial liabilities	3,789	5,357	36,015	6,985	669	52,815
Interest-bearing borrowings	-	-	-	-	15	15
Other liabilities	223	694	655	1,266	-	2,838
Accrued expenses and deferred income	-	-	-	-	316	316
Provisions for liabilities and charges	-	-	-	-	123	123
Deferred tax liabilities	-	-	-	-	288	288
Current tax liability	-	-	-	-	22	22
<b>Total liabilities</b>	<b>4,956</b>	<b>6,149</b>	<b>36,953</b>	<b>8,299</b>	<b>1,433</b>	<b>57,790</b>
<b>Interest sensitivity gap</b>	<b>11,872</b>	<b>10,893</b>	<b>(18,811)</b>	<b>84</b>	<b>7,386</b>	<b>11,424</b>

## Notes to the financial statements (continued)

### 47 Weighted average interest rates

The average effective interest rates for interest-earning financial assets and interest-bearing financial liabilities during the year are calculated on average balances at the end of each month for the Group and average monthly balances for the Bank.

The weighted average interest rates at the year-end are as follows:

	GROUP		BANK	
	2016	2015	2016	2015
	%	%	%	%
Current accounts with banks	(0.14)	0.00	(0.09)	0.00
Balances with the Croatian National Bank	0.00	0.00	0.00	0.00
Financial assets at fair value through profit or loss	1.44	1.70	1.48	1.75
Loans and advances to banks	0.05	0.26	0.05	0.27
Loans and advances to customers	5.60	5.81	5.72	5.90
Current accounts and deposits from customers	0.99	1.48	0.91	1.40
Current accounts and deposits from banks and interest-bearing borrowings	1.71	1.56	1.83	1.78

## Notes to the financial statements (continued)

### 48 Currency risk

The Group manages its exposure to currency risk through a variety of measures including the use of revaluation clauses, which have the same effect as denominating HRK assets in other currencies and foreign currency deals bought and sold forward.

The Group's open FX position is mitigated through the use of derivative financial instruments which are not shown in the tables below.

Group As at 31 December 2016	(in HRK million)					
	EUR and EUR linked	CHF and CHF linked	USD and USD linked	Other currencies	HRK	Total
<b>Assets</b>						
Cash and current accounts with banks	5,840	624	85	699	5,722	12,970
Balances with the Croatian National Bank	-	-	-	-	3,916	3,916
Financial assets at fair value through profit or loss	1,987	-	32	-	4,084	6,103
Derivative financial assets	6	-	-	-	19	25
Loans and advances to banks	5	-	1,553	1,194	54	2,806
Loans and advances to customers	30,121	63	758	1,833	20,110	52,885
Financial assets available for sale	646	-	34	344	381	1,405
Held-to-maturity investments	17	-	-	-	-	17
Investments in associates	-	-	-	-	67	67
Intangible assets	-	-	-	25	133	158
Property and equipment	-	-	-	50	980	1,030
Investment property	-	-	-	-	62	62
Deferred tax assets	-	-	-	1	129	130
Other assets	41	-	12	38	441	532
Tax prepayments	-	-	-	9	13	22
<b>Total assets</b>	<b>38,663</b>	<b>687</b>	<b>2,474</b>	<b>4,193</b>	<b>36,111</b>	<b>82,128</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	341	43	133	55	553	1,125
Current accounts and deposits from customers	34,173	723	2,971	2,802	19,709	60,378
Derivative financial liabilities	-	-	-	6	5	11
Interest-bearing borrowings	1,691	179	253	195	1,253	3,571
Subordinated liabilities	-	-	-	1	-	1
Other liabilities	132	2	10	63	1,542	1,749
Accrued expenses and deferred income	1	-	-	-	263	264
Provisions for liabilities and charges	29	-	14	30	211	284
Deferred tax liabilities	-	-	-	7	14	21
Current tax liability	-	-	-	-	165	165
<b>Total liabilities</b>	<b>36,367</b>	<b>947</b>	<b>3,381</b>	<b>3,159</b>	<b>23,715</b>	<b>67,569</b>
<b>Net position</b>	<b>2,296</b>	<b>(260)</b>	<b>(907)</b>	<b>1,034</b>	<b>12,396</b>	<b>14,559</b>

**Notes to the financial statements (continued)**

**48 Currency risk (continued)**

Group	(in HRK million)					
	EUR and EUR linked	CHF and CHF linked	USD and USD linked	Other currencies	HRK	Total
<b>As at 31 December 2015</b>						
<b>Assets</b>						
Cash and current accounts with banks	3,868	630	271	1,211	4,015	9,995
Balances with the Croatian National Bank	660	-	-	-	3,890	4,550
Financial assets at fair value through profit or loss	1,185	-	-	-	4,785	5,970
Derivative financial assets	-	-	-	-	4	4
Loans and advances to banks	10	-	1,756	356	1,328	3,450
Loans and advances to customers	32,695	740	591	1,347	15,612	50,985
Financial assets available for sale	725	-	-	161	232	1,118
Held-to-maturity investments	17	-	-	-	-	17
Investments in associates	-	-	-	-	150	150
Intangible assets	-	-	-	20	162	182
Property and equipment	-	-	-	47	1,085	1,132
Investment property	-	-	-	-	23	23
Deferred tax assets	-	-	-	1	140	141
Other assets	44	-	11	36	458	549
Tax prepayments	-	-	-	6	151	157
<b>Total assets</b>	<b>39,204</b>	<b>1,370</b>	<b>2,629</b>	<b>3,185</b>	<b>32,035</b>	<b>78,423</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	465	100	83	77	358	1,083
Current accounts and deposits from customers	34,036	779	3,026	2,183	18,156	58,180
Derivative financial liabilities	-	-	-	-	15	15
Interest-bearing borrowings	3,071	-	3	9	801	3,884
Subordinated liabilities	-	-	-	2	-	2
Other liabilities	84	2	9	51	1,292	1,438
Accrued expenses and deferred income	2	-	-	-	236	238
Provisions for liabilities and charges	35	-	14	17	247	313
Deferred tax liabilities	-	-	-	7	27	34
Current tax liability	-	-	-	1	10	11
<b>Total liabilities</b>	<b>37,693</b>	<b>881</b>	<b>3,135</b>	<b>2,347</b>	<b>21,142</b>	<b>65,198</b>
<b>Net position</b>	<b>1,511</b>	<b>489</b>	<b>(506)</b>	<b>838</b>	<b>10,893</b>	<b>13,225</b>

## Notes to the financial statements (continued)

## 48 Currency risk (continued)

Bank	(in HRK million)					
	EUR and EUR linked	CHF and CHF linked	USD and USD linked	Other currencies	HRK	Total
<b>As at 31 December 2016</b>						
<b>Assets</b>						
Cash and current accounts with banks	5,718	608	80	207	5,725	12,338
Balances with the Croatian National Bank	-	-	-	-	3,916	3,916
Financial assets at fair value through profit or loss	1,986	-	32	-	3,957	5,975
Derivative financial assets	-	-	-	-	19	19
Loans and advances to banks	5	-	1,421	214	91	1,731
Loans and advances to customers	26,797	63	758	81	17,968	45,667
Financial assets available for sale	14	-	34	-	322	370
Investments in subsidiaries and associates	-	-	-	-	953	953
Intangible assets	-	-	-	-	124	124
Property and equipment	-	-	-	-	545	545
Investment property	-	-	-	-	50	50
Deferred tax assets	-	-	-	-	88	88
Other assets	34	-	12	-	228	274
<b>Total assets</b>	<b>34,554</b>	<b>671</b>	<b>2,337</b>	<b>502</b>	<b>33,986</b>	<b>72,050</b>
Current accounts and deposits from banks	616	43	77	24	616	1,376
Current accounts and deposits from customers	30,373	707	2,890	354	19,784	54,108
Derivative financial liabilities	-	-	-	-	5	5
Interest-bearing borrowings	1,872	-	3	-	872	2,747
Other liabilities	95	2	9	2	373	481
Accrued expenses and deferred income	2	-	-	-	135	137
Provisions for liabilities and charges	28	-	14	12	203	257
Deferred tax liabilities	-	-	-	-	5	5
Current tax liability	-	-	-	-	165	165
<b>Total liabilities</b>	<b>32,986</b>	<b>752</b>	<b>2,993</b>	<b>392</b>	<b>22,158</b>	<b>59,281</b>
<b>Net position</b>	<b>1,568</b>	<b>(81)</b>	<b>(656)</b>	<b>110</b>	<b>11,828</b>	<b>12,769</b>

**Notes to the financial statements (continued)****48 Currency risk (continued)**

<b>Bank</b>	(in HRK million)					
	EUR and EUR linked	CHF and CHF linked	USD and USD linked	Other currencies	HRK	Total
<b>As at 31 December 2015</b>						
<b>Assets</b>						
Cash and current accounts with banks	3,787	615	267	88	4,386	9,143
Balances with the Croatian National Bank	660	-	-	-	3,890	4,550
Financial assets at fair value through profit or loss	1,184	-	-	-	4,634	5,818
Derivative financial assets	-	-	-	-	4	4
Loans and advances to banks	9	-	1,669	360	928	2,966
Loans and advances to customers	29,099	749	598	-	13,740	44,186
Financial assets available for sale	120	-	-	-	173	293
Investments in subsidiaries and associates	-	-	-	-	963	963
Intangible assets	-	-	-	-	106	106
Property and equipment	-	-	-	-	625	625
Investment property	-	-	-	-	10	10
Deferred tax assets	-	-	-	-	100	100
Other assets	36	-	11	3	255	305
Tax prepayments	-	-	-	-	145	145
<b>Total assets</b>	<b>34,895</b>	<b>1,364</b>	<b>2,545</b>	<b>451</b>	<b>29,959</b>	<b>69,214</b>
<b>Liabilities</b>						
Current accounts and deposits from banks	726	100	44	34	469	1,373
Current accounts and deposits from customers	30,429	765	2,951	394	18,276	52,815
Derivative financial liabilities	-	-	-	-	15	15
Interest-bearing borrowings	2,062	-	3	-	773	2,838
Other liabilities	43	2	9	2	260	316
Accrued expenses and deferred income	2	-	-	-	121	123
Provisions for liabilities and charges	35	-	14	-	239	288
Deferred tax liabilities	-	-	-	-	22	22
<b>Total liabilities</b>	<b>33,297</b>	<b>867</b>	<b>3,021</b>	<b>430</b>	<b>20,175</b>	<b>57,790</b>
<b>Net position</b>	<b>1,598</b>	<b>497</b>	<b>(476)</b>	<b>21</b>	<b>9,784</b>	<b>11,424</b>

**Notes to the financial statements (continued)****49 Liquidity risk****Analysis of financial liabilities by remaining undiscounted contractual maturities**

The tables below set out the remaining undiscounted contractual maturity of the Group's and Bank's financial liabilities as at 31 December 2016 and 31 December 2015.

<b>Group</b>						(in HRK million)	
	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total gross cash flows	Total carrying amount
<b>As at 31 December 2016</b>							
<b>Liabilities</b>							
Current accounts and deposits from banks	1,062	73	18	6	1	1,160	1,125
Current accounts and deposits from customers	31,044	4,671	14,310	11,082	117	61,224	60,378
Derivative financial liabilities	2	9	-	-	-	11	11
Interest-bearing borrowings	666	94	1,000	1,647	327	3,734	3,571
Other liabilities*	2,237	50	83	69	19	2,458	2,484
<b>Total undiscounted financial liabilities</b>	<b>35,011</b>	<b>4,897</b>	<b>15,411</b>	<b>12,804</b>	<b>464</b>	<b>68,587</b>	<b>67,569</b>
<b>Off-balance sheet contingent liabilities and commitments</b>							
Undrawn lending commitments	755	1,119	7,217	1,708	27	10,826	10,826
Other contingent liabilities	256	483	1,296	1,425	197	3,657	3,657
<b>Total undiscounted off-balance sheet contingent liabilities and commitments</b>	<b>1,011</b>	<b>1,602</b>	<b>8,513</b>	<b>3,133</b>	<b>224</b>	<b>14,483</b>	<b>14,483</b>
<b>As at 31 December 2015</b>							
<b>Liabilities</b>							
Current accounts and deposits from banks	1,010	6	59	7	1	1,083	1,083
Current accounts and deposits from customers	26,838	5,690	15,974	10,330	388	59,220	58,180
Derivative financial liabilities	2	1	12	-	-	15	15
Interest-bearing borrowings	42	103	726	2,357	920	4,148	3,884
Other liabilities*	1,765	33	120	63	55	2,036	2,036
<b>Total undiscounted financial liabilities</b>	<b>29,657</b>	<b>5,833</b>	<b>16,891</b>	<b>12,757</b>	<b>1,364</b>	<b>66,502</b>	<b>65,198</b>
<b>Off-balance sheet contingent liabilities and commitments</b>							
Undrawn lending commitments	944	1,015	6,292	1,113	500	9,864	9,864
Other contingent liabilities	638	372	1,261	803	130	3,204	3,204
<b>Total undiscounted off-balance sheet contingent liabilities and commitments</b>	<b>1,582</b>	<b>1,387</b>	<b>7,553</b>	<b>1,916</b>	<b>630</b>	<b>13,068</b>	<b>13,068</b>

\* Other liabilities include subordinated liabilities, other liabilities, accrued expenses and deferred income, provisions for liabilities and charges, deferred tax liabilities and current tax liability.

**Notes to the financial statements (continued)**
**49 Liquidity risk (continued)**
**Analysis of financial liabilities by remaining contractual maturities (continued)**

		(in HRK million)						
Bank								
As at 31 December 2016	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total gross cash flows	Total carrying amount	
<b>Liabilities</b>								
Current accounts and deposits from banks	991	58	63	281	1	1,394	1,376	
Current accounts and deposits from customers	28,439	4,503	13,499	8,167	116	54,724	54,108	
Derivative financial liabilities	2	3	-	-	-	5	5	
Interest-bearing borrowings	654	57	394	1,211	556	2,872	2,747	
Other liabilities*	833	28	73	59	52	1,045	1,045	
<b>Total undiscounted financial liabilities</b>	<b>30,919</b>	<b>4,649</b>	<b>14,029</b>	<b>9,718</b>	<b>725</b>	<b>60,040</b>	<b>59,281</b>	
<b>Off-balance sheet contingent liabilities and commitments</b>								
Undrawn lending commitments	698	1,026	6,761	1,582	27	10,094	10,094	
Other contingent liabilities	204	448	1,057	1,341	197	3,247	3,247	
<b>Total undiscounted off-balance sheet contingent liabilities and commitments</b>	<b>902</b>	<b>1,474</b>	<b>7,818</b>	<b>2,923</b>	<b>224</b>	<b>13,341</b>	<b>13,341</b>	
As at 31 December 2015	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total gross cash flows	Total carrying amount	
<b>Liabilities</b>								
Current accounts and deposits from banks	944	98	287	50	1	1,380	1,373	
Current accounts and deposits from customers	25,042	5,428	15,084	7,900	181	53,635	52,815	
Derivative financial liabilities	2	1	12	-	-	15	15	
Interest-bearing borrowings	32	71	364	1,910	632	3,009	2,838	
Other liabilities*	512	32	114	60	31	749	749	
<b>Total undiscounted financial liabilities</b>	<b>26,532</b>	<b>5,630</b>	<b>15,861</b>	<b>9,920</b>	<b>845</b>	<b>58,788</b>	<b>57,790</b>	
<b>Off-balance sheet contingent liabilities and commitments</b>								
Undrawn lending commitments	905	919	5,798	981	501	9,104	9,104	
Other contingent liabilities	616	371	1,070	733	129	2,919	2,919	
<b>Total undiscounted off-balance sheet contingent liabilities and commitments</b>	<b>1,521</b>	<b>1,290</b>	<b>6,868</b>	<b>1,714</b>	<b>630</b>	<b>12,023</b>	<b>12,023</b>	

\* Other liabilities include other liabilities, accrued expenses and deferred income, provisions for liabilities and charges, deferred tax liabilities and current tax liability.



**Notes to the financial statements (continued)****49 Liquidity risk (continued)****Maturity analysis of assets and liabilities**

The tables below present analyses of assets and liabilities of the Group and Bank according to their expected maturities at 31 December 2016 and 31 December 2015. The Group's expected cash flows on some financial assets and liabilities vary significantly from the contractual cash flows. For example, demand deposits from customers are expected to maintain a stable balance and are not all expected to be drawn immediately.

The Group and the Bank made certain assumptions in producing the maturity analyses set out below. The assumptions applied for loans and advances to customers were mostly based on contractual maturities, whilst overdraft, revolving and other facilities without precise amortisation plans were assumed to be recoverable within 12 months. Moreover, expected maturities for current accounts and deposits from customers and to some extent non-performing loans were based on statistical behaviour model as of past experience. All other items of the Group and the Bank were mostly based on contractual maturities.

	(in HRK million)		
Group	Less than 12 months	Over 12 months	Total
<b>As at 31 December 2016</b>			
<b>Assets</b>			
Cash and current accounts with banks	12,970	-	12,970
Balances with the Croatian National Bank	-	3,916	3,916
Financial assets at fair value through profit or loss	5,687	416	6,103
Derivative financial assets	25	-	25
Loans and advances to banks	2,806	-	2,806
Loans and advances to customers	17,847	35,038	52,885
Financial assets available for sale	402	1,003	1,405
Held-to-maturity investments	-	17	17
Investments in associates	-	67	67
Intangible assets	-	158	158
Property and equipment	-	1,030	1,030
Investment property	-	62	62
Deferred tax assets	-	130	130
Other assets	435	97	532
Tax prepayments	22	-	22
<b>Total assets</b>	<b>40,194</b>	<b>41,934</b>	<b>82,128</b>
<b>Liabilities</b>			
Current accounts and deposits from banks	1,116	9	1,125
Current accounts and deposits from customers	38,166	22,212	60,378
Derivative financial liabilities	11	-	11
Interest-bearing borrowings	1,447	2,124	3,571
Subordinated liabilities	-	1	1
Other liabilities	1,749	-	1,749
Accrued expenses and deferred income	250	14	264
Provisions for liabilities and charges	9	275	284
Deferred tax liabilities	-	21	21
Current tax liability	165	-	165
<b>Total liabilities</b>	<b>42,913</b>	<b>24,656</b>	<b>67,569</b>
<b>Net expected maturity gap</b>	<b>(2,719)</b>	<b>17,278</b>	<b>14,559</b>

**Notes to the financial statements (continued)****49 Liquidity risk (continued)****Maturity analysis of assets and liabilities (continued)**

	(in HRK million)		
<b>Group</b>	Less than 12 months	Over 12 months	Total
<b>As at 31 December 2015</b>			
<b>Assets</b>			
Cash and current accounts with banks	9,995	-	9,995
Balances with the Croatian National Bank	-	4,550	4,550
Financial assets at fair value through profit or loss	5,869	101	5,970
Derivative financial assets	4	-	4
Loans and advances to banks	3,447	3	3,450
Loans and advances to customers	15,936	35,049	50,985
Financial assets available for sale	303	815	1,118
Held-to-maturity investments	-	17	17
Investments in associates	-	150	150
Intangible assets	-	182	182
Property and equipment	-	1,132	1,132
Investment property	-	23	23
Deferred tax assets	-	141	141
Other assets	374	175	549
Tax prepayments	157	-	157
<b>Total assets</b>	<b>36,085</b>	<b>42,338</b>	<b>78,423</b>
<b>Liabilities</b>			
Current accounts and deposits from banks	1,075	8	1,083
Current accounts and deposits from customers	39,286	18,894	58,180
Derivative financial liabilities	15	-	15
Interest-bearing borrowings	869	3,015	3,884
Subordinated liabilities	1	1	2
Other liabilities	1,438	-	1,438
Accrued expenses and deferred income	225	13	238
Provisions for liabilities and charges	240	73	313
Deferred tax liabilities	-	34	34
Current tax liability	11	-	11
<b>Total liabilities</b>	<b>43,160</b>	<b>22,038</b>	<b>65,198</b>
<b>Net expected maturity gap</b>	<b>(7,075)</b>	<b>20,300</b>	<b>13,225</b>

**Notes to the financial statements (continued)****49 Liquidity risk (continued)****Maturity analysis of assets and liabilities (continued)**

(in HRK million)

<b>Bank</b>	Less than 12 months	Over 12 months	Total
<b>As at 31 December 2016</b>			
<b>Assets</b>			
Cash and current accounts with banks	12,338	-	<b>12,338</b>
Balances with the Croatian National Bank	-	3,916	<b>3,916</b>
Financial assets at fair value through profit or loss	5,560	415	<b>5,975</b>
Derivative financial assets	19	-	<b>19</b>
Loans and advances to banks	1,731	-	<b>1,731</b>
Loans and advances to customers	13,917	31,750	<b>45,667</b>
Financial assets available for sale	96	274	<b>370</b>
Investments in subsidiaries and associates	-	953	<b>953</b>
Intangible assets	-	124	<b>124</b>
Property and equipment	-	545	<b>545</b>
Investment property	-	50	<b>50</b>
Deferred tax assets	-	88	<b>88</b>
Other assets	181	93	<b>274</b>
<b>Total assets</b>	<b>33,842</b>	<b>38,208</b>	<b>72,050</b>
<b>Liabilities</b>			
Current accounts and deposits from banks	1,111	265	<b>1,376</b>
Current accounts and deposits from customers	46,410	7,698	<b>54,108</b>
Derivative financial liabilities	5	-	<b>5</b>
Interest-bearing borrowings	1,100	1,647	<b>2,747</b>
Other liabilities	481	-	<b>481</b>
Accrued expenses and deferred income	123	14	<b>137</b>
Provisions for liabilities and charges	-	257	<b>257</b>
Deferred tax liabilities	-	5	<b>5</b>
Current tax liability	165	-	<b>165</b>
<b>Total liabilities</b>	<b>49,395</b>	<b>9,886</b>	<b>59,281</b>
<b>Net expected maturity gap</b>	<b>(15,553)</b>	<b>28,322</b>	<b>12,769</b>

**Notes to the financial statements (continued)****49 Liquidity risk (continued)****Maturity analysis of assets and liabilities (continued)**

	(in HRK million)		
<b>Bank</b>	Less than 12	Over 12	
<b>As at 31 December 2015</b>	months	months	Total
<b>Assets</b>			
Cash and current accounts with banks	9,143	-	9,143
Balances with the Croatian National Bank	-	4,550	4,550
Financial assets at fair value through profit or loss	5,717	101	5,818
Derivative financial assets	4	-	4
Loans and advances to banks	2,966	-	2,966
Loans and advances to customers	12,232	31,954	44,186
Financial assets available for sale	217	76	293
Investments in subsidiaries and associates	-	963	963
Intangible assets	-	106	106
Property and equipment	-	625	625
Investment property	-	10	10
Deferred tax assets	-	100	100
Other assets	216	89	305
Tax prepayments	145	-	145
<b>Total assets</b>	<b>30,640</b>	<b>38,574</b>	<b>69,214</b>
<b>Liabilities</b>			
Current accounts and deposits from banks	1,325	48	1,373
Current accounts and deposits from customers	36,341	16,474	52,815
Derivative financial liabilities	15	-	15
Interest-bearing borrowings	462	2,376	2,838
Other liabilities	316	-	316
Accrued expenses and deferred income	110	13	123
Provisions for liabilities and charges	232	56	288
Deferred tax liabilities	-	22	22
<b>Total liabilities</b>	<b>38,801</b>	<b>18,989</b>	<b>57,790</b>
<b>Net expected maturity gap</b>	<b>(8,161)</b>	<b>19,585</b>	<b>11,424</b>

## Notes to the financial statements (continued)

### 50 Concentration of assets and liabilities

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The Bank's and the Group's assets and liabilities can be analysed by the following geographical regions and industry sector:

(in HRK million)

As at 31 December 2016	GROUP			BANK		
	Assets	Liabilities	Off balance sheet liabilities	Assets	Liabilities	Off balance sheet liabilities
<b>Geographic region</b>						
Republic of Croatia	68,147	57,491	12,230	64,906	55,077	12,260
Other European Union members	4,869	3,215	992	4,592	2,447	990
Other countries	9,112	6,863	1,261	2,552	1,757	91
	<b>82,128</b>	<b>67,569</b>	<b>14,483</b>	<b>72,050</b>	<b>59,281</b>	<b>13,341</b>
<b>Industry sector</b>						
Citizens	27,426	43,134	5,945	22,430	39,444	5,595
Finance	18,940	6,822	531	18,433	5,573	564
Government	16,555	3,591	138	15,140	1,816	136
Commerce	3,791	1,889	1,332	2,784	1,725	963
Tourism	1,817	803	225	1,551	596	196
Agriculture	810	212	92	716	196	84
Other sectors	12,789	11,118	6,220	10,996	9,931	5,803
	<b>82,128</b>	<b>67,569</b>	<b>14,483</b>	<b>72,050</b>	<b>59,281</b>	<b>13,341</b>

As at 31 December 2015	GROUP			BANK		
	Assets	Liabilities	Off balance sheet items	Assets	Liabilities	Off balance sheet items
<b>Geographic region</b>						
Republic of Croatia	64,024	55,850	11,200	60,841	53,810	11,216
Other European Union members	6,306	3,397	667	6,116	2,353	667
Other countries	8,093	5,951	1,201	2,257	1,627	140
	<b>78,423</b>	<b>65,198</b>	<b>13,068</b>	<b>69,214</b>	<b>57,790</b>	<b>12,023</b>
<b>Industry sector</b>						
Citizens	26,600	42,592	5,773	22,064	39,148	5,436
Finance	17,260	7,456	721	17,236	5,413	713
Government	15,711	2,278	299	14,503	1,549	272
Commerce	3,737	1,675	1,017	2,690	1,393	750
Tourism	1,751	492	97	1,563	368	51
Agriculture	710	160	100	629	143	95
Other sectors	12,654	10,545	5,061	10,529	9,776	4,706
	<b>78,423</b>	<b>65,198</b>	<b>13,068</b>	<b>69,214</b>	<b>57,790</b>	<b>12,023</b>

**Notes to the financial statements (continued)****51 Earnings per share**

For the purpose of calculating earnings per share, earnings represent the net profit after tax. The number of ordinary shares is the weighted average number of ordinary shares outstanding during the year after deducting the number of ordinary treasury shares. The weighted average number of ordinary shares used for basic earnings per share was 19,010,096 (2015: 19,010,096). There is no potential dilution effect from any instruments and hence the basic earnings per share are the same as diluted earnings per share.

	<b>GROUP</b>		<b>BANK</b>	
	2016	2015	2016	2015
Profit attributable to equity holders of the Bank (in HRK million)	1,582	365	1,605	193
Weighted average number of ordinary shares	19,010,096	19,010,096	19,010,096	19,010,096
Basic and diluted earnings per share (in HRK per share)	<b>83.2</b>	<b>19.2</b>	<b>84.4</b>	<b>10.2</b>

## Appendix 1 - Supplementary forms required by local regulation

Supplementary financial statements of the Group and the Bank prepared in accordance with the framework for reporting set out in the Decision of the Croatian National Bank on the Structure and Content of Annual Financial Statements (Official Gazette 62/08) are presented below:

### Form "Balance sheet"

	(in HRK million)			
	GROUP		BANK	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
<b>Assets</b>				
Cash and deposits with the Croatian National Bank	12,531	9,953	12,037	9,401
<i>Cash</i>	2,015	1,983	1,521	1,431
<i>Deposits with the Croatian National Bank</i>	10,516	7,970	10,516	7,970
Deposits with banking institutions	7,022	7,857	5,773	7,074
Ministry of Finance treasury bills and the Croatian National Bank bills	5,452	5,677	5,418	5,618
Securities and other financial instruments held for trading	515	75	513	74
Securities and other financial instruments available for sale	1,398	1,113	368	293
Securities and other financial instruments held to maturity	17	17	-	-
Securities and other financial instruments at fair value through profit or loss which are not actively traded	109	162	17	70
Derivative financial assets	25	4	19	4
Loans to financial institutions	138	183	174	183
Loans to other clients	52,801	51,261	45,600	44,481
Investments in subsidiaries, associates and joint ventures	67	150	953	963
Foreclosed assets	115	148	68	68
Tangible assets (net of depreciation)	1,030	1,132	545	625
Interest, fees and other assets	1,038	1,186	695	855
<b>Total assets</b>	<b>82,258</b>	<b>78,918</b>	<b>72,180</b>	<b>69,709</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Balance sheet" (continued)

	(in HRK million)			
	GROUP		BANK	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
<b>Liabilities</b>				
Loans from financial institutions	3,561	3,877	2,739	2,834
<i>Short-term loans</i>	154	24	154	24
<i>Long-term loans</i>	3,407	3,853	2,585	2,810
Deposits	61,174	58,794	55,188	53,754
<i>Giro account and current account deposits</i>	16,889	14,642	14,778	13,321
<i>Savings deposits</i>	13,596	11,328	11,744	9,517
<i>Term deposits</i>	30,689	32,824	28,666	30,916
Other loans	-	-	-	-
<i>Short-term loans</i>	-	-	-	-
<i>Long-term loans</i>	-	-	-	-
Derivative financial liabilities and other financial liabilities held for trading	11	15	5	15
Debt securities issued	-	-	-	-
<i>Short-term debt securities issued</i>	-	-	-	-
<i>Long-term debt securities issued</i>	-	-	-	-
Subordinated instruments issued	1	2	-	-
Hybrid instruments issued	-	-	-	-
Interest, fees and other liabilities	2,952	3,005	1,479	1,682
<b>Total liabilities</b>	<b>67,699</b>	<b>65,693</b>	<b>59,411</b>	<b>58,285</b>
<b>Equity</b>				
Share capital	1,907	1,907	1,907	1,907
Current year profit/(loss)	1,587	370	1,605	193
Retained earnings/(loss)	9,488	9,228	7,442	7,442
Legal reserves	142	141	134	134
Statutory reserves and other capital reserves	1,379	1,471	1,662	1,662
Unrealised gains/(losses) on value adjustments of financial assets available for sale	56	108	19	86
<b>Total equity</b>	<b>14,559</b>	<b>13,225</b>	<b>12,769</b>	<b>11,424</b>
<b>Total liabilities and equity</b>	<b>82,258</b>	<b>78,918</b>	<b>72,180</b>	<b>69,709</b>
<b>Total equity</b>	<b>14,559</b>	<b>13,225</b>	<b>12,769</b>	<b>11,424</b>
Equity holders of the Bank	14,509	13,180	12,769	11,424
Non-controlling interests	50	45	-	-

The balance sheet form is prepared in accordance with the CNB Decision on the Structure and Content of Annual Financial Statements for Banks.



**Appendix 1 - Supplementary forms required by local regulation (continued)**

The following tables provide reconciliation between statutory financial statements and supplementary schedules for CNB.

**Balance sheet reconciliation as at 31 December 2016****Assets****(in HRK million)**

GROUP	per IFRS															Total assets
	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets at fair value through profit or loss	Derivative financial assets	Loans and advances to banks	Loans and advances to customers	Financial assets available for sale	Held-to-maturity investments	Investments in associates	Intangible assets	Property and equipment	Investment property	Deferred tax assets	Other assets	Tax prepayments	
Cash and deposits with the Croatian National Bank	8,615	3,916	-	-	-	-	-	-	-	-	-	-	-	-	-	12,531
<i>Cash</i>	2,015	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,015
<i>Deposits with the Croatian National Bank</i>	6,600	3,916	-	-	-	-	-	-	-	-	-	-	-	-	-	10,516
Deposits with banking institutions	4,355	-	-	-	2,667	-	-	-	-	-	-	-	-	-	-	7,022
Ministry of Finance treasury bills and the Croatian National Bank bills	-	-	5,452	-	-	-	-	-	-	-	-	-	-	-	-	5,452
Securities and other financial instruments held for trading	-	-	515	-	-	-	-	-	-	-	-	-	-	-	-	515
Securities and other financial instruments available for sale	-	-	-	-	-	-	1,398	-	-	-	-	-	-	-	-	1,398
Securities and other financial instruments held to maturity	-	-	-	-	-	-	-	17	-	-	-	-	-	-	-	17

**Appendix 1 - Supplementary forms required by local regulation (continued)****Balance sheet reconciliation as at 31 December 2016 (continued)****Assets (continued)****(in HRK million)**

GROUP	per IFRS															Total assets
	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets at fair value through profit or loss	Derivative financial assets	Loans and advances to banks	Loans and advances to customers	Financial assets available for sale	Held-to-maturity investments	Investments in associates	Intangible assets	Property and equipment	Investment property	Deferred tax assets	Other assets	Tax prepayments	
Securities and other financial instruments at fair value through profit or loss which are not actively traded	-	-	109	-	-	-	-	-	-	-	-	-	-	-	-	109
Derivative financial assets	-	-	-	25	-	-	-	-	-	-	-	-	-	-	-	25
Loans to financial institutions	-	-	-	-	138	-	-	-	-	-	-	-	-	-	-	138
Loans to other clients	-	-	-	-	-	52,801	-	-	-	-	-	-	-	-	-	52,801
Investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	-	67	-	-	-	-	-	-	67
Foreclosed assets	-	-	-	-	-	-	-	-	-	-	-	-	-	115	-	115
Tangible assets (net of depreciation)	-	-	-	-	-	-	-	-	-	-	1,030	-	-	-	-	1,030
Interest, fees and other assets	-	-	27	-	1	220	7	-	-	158	-	62	130	411	22	1,038
Transfer to interest, fees and other liabilities	-	-	-	-	-	(136)	-	-	-	-	-	-	-	6	-	(130)
<b>Total assets</b>	<b>12,970</b>	<b>3,916</b>	<b>6,103</b>	<b>25</b>	<b>2,806</b>	<b>52,885</b>	<b>1,405</b>	<b>17</b>	<b>67</b>	<b>158</b>	<b>1,030</b>	<b>62</b>	<b>130</b>	<b>532</b>	<b>22</b>	<b>82,128</b>

**Appendix 1 – Supplementary forms required by local regulation (continued)**
**Balance sheet reconciliation as at 31 December 2016 (continued)**
**Liabilities**

GROUP	(in HRK million)											
	Per IFRS											Total liabilities
CNB schedules	Current accounts and deposits from banks	Current accounts and deposits from customers	Derivative financial liabilities	Interest-bearing borrowings	Subordinated liabilities	Other liabilities	Accrued expenses and deferred income	Provisions for liabilities and charges	Deferred tax liabilities	Current tax liability	Transferred from Loans and advances to customers and other assets	
Loans from financial institutions	-	-	-	3,561	-	-	-	-	-	-	-	3,561
<i>Short-term loans</i>	-	-	-	154	-	-	-	-	-	-	-	154
<i>Long-term loans</i>	-	-	-	3,407	-	-	-	-	-	-	-	3,407
Deposits	1,119	60,055	-	-	-	-	-	-	-	-	-	61,174
<i>Giro account and current account deposits</i>	945	15,944	-	-	-	-	-	-	-	-	-	16,889
<i>Savings deposits</i>	-	13,596	-	-	-	-	-	-	-	-	-	13,596
<i>Term deposits</i>	174	30,515	-	-	-	-	-	-	-	-	-	30,689
Other loans	-	-	-	-	-	-	-	-	-	-	-	-
<i>Short-term loans</i>	-	-	-	-	-	-	-	-	-	-	-	-
<i>Long-term loans</i>	-	-	-	-	-	-	-	-	-	-	-	-
Derivative financial liabilities and other financial liabilities held for trading	-	-	11	-	-	-	-	-	-	-	-	11
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-
<i>Short-term debt securities issued</i>	-	-	-	-	-	-	-	-	-	-	-	-
<i>Long-term debt securities issued</i>	-	-	-	-	-	-	-	-	-	-	-	-
Subordinated instruments issued	-	-	-	-	1	-	-	-	-	-	-	1
Hybrid instruments issued	-	-	-	-	-	-	-	-	-	-	-	-
Interest, fees and other liabilities	6	323	-	10	-	1,750	264	284	21	164	130	2,952
<b>Total liabilities</b>	<b>1,125</b>	<b>60,378</b>	<b>11</b>	<b>3,571</b>	<b>1</b>	<b>1,750</b>	<b>264</b>	<b>284</b>	<b>21</b>	<b>164</b>	<b>130</b>	<b>67,699</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Balance sheet reconciliation as at 31 December 2016 (continued)

#### Equity

(in HRK million)

GROUP	Per IFRS								Total equity
	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	Merger reserve	Non-controlling interests	
CNB schedules									
Share capital	1,907	-	-	-	-	-	-	-	1,907
Current year profit/(loss)	-	-	-	-	-	1,582	-	5	1,587
Retained earnings/(loss)	-	-	-	-	-	9,443	-	45	9,488
Legal reserves	-	-	-	142	-	-	-	-	142
Statutory reserves and other capital reserves	-	1,570	(76)	233	-	-	(348)	-	1,379
Unrealised gains/(losses) on value adjustments of financial assets available for sale	-	-	-	-	56	-	-	-	56
<b>Total equity</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>375</b>	<b>56</b>	<b>11,025</b>	<b>(348)</b>	<b>50</b>	<b>14,559</b>

**Appendix 1 - Supplementary forms required by local regulation (continued)****Balance sheet reconciliation as at 31 December 2016 (continued)****Assets****(in HRK million)**

<b>BANK</b>	<b>per IFRS</b>														<b>Total assets</b>
	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets at fair value through profit or loss	Derivative financial assets	Loans and advances to banks	Loans and advances to customers	Financial assets available for sale	Investments in subsidiaries and associates	Intangible assets	Property and equipment	Investment property	Deferred tax assets	Other assets	Tax prepayments	
Cash and deposits with the Croatian National Bank	8,121	3,916	-	-	-	-	-	-	-	-	-	-	-	-	12,037
<i>Cash</i>	1,521	-	-	-	-	-	-	-	-	-	-	-	-	-	1,521
<i>Deposits with the Croatian National Bank</i>	6,600	3,916	-	-	-	-	-	-	-	-	-	-	-	-	10,516
Deposits with banking institutions	4,217	-	-	-	1,556	-	-	-	-	-	-	-	-	-	5,773
Ministry of Finance treasury bills and the Croatian National Bank bills	-	-	5,418	-	-	-	-	-	-	-	-	-	-	-	5,418
Securities and other financial instruments held for trading	-	-	513	-	-	-	-	-	-	-	-	-	-	-	513
Securities and other financial instruments available for sale	-	-	-	-	-	-	368	-	-	-	-	-	-	-	368
Securities and other financial instruments held to maturity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

**Appendix 1 - Supplementary forms required by local regulation (continued)****Balance sheet reconciliation as at 31 December 2016 (continued)****Assets (continued)****(in HRK million)**

BANK CNB schedules	Cash and current ac- counts with banks	Balances with the Cro- atian Na- tional Bank	Financial assets at fair value through profit or loss	Deriva- tive fi- nancial assets	Loans and advances to banks	Loans and advances to customers	per IFRS							Tax prepay- ments	Total assets
							Financial assets available for sale	Investments in subsidiar- ies and asso- ciates	Intan- gible assets	Property and equip- ment	Invest- ment property	De- ferred tax as- sets	Other assets		
Securities and other financial instruments at fair value through profit or loss which are not actively traded	-	-	17	-	-	-	-	-	-	-	-	-	-	-	17
Derivative finan- cial assets	-	-	-	19	-	-	-	-	-	-	-	-	-	-	19
Loans to financial institutions	-	-	-	-	174	-	-	-	-	-	-	-	-	-	174
Loans to other cli- ents	-	-	-	-	-	45,600	-	-	-	-	-	-	-	-	45,600
Investments in subsidiaries, as- sociates and joint ventures	-	-	-	-	-	-	-	953	-	-	-	-	-	-	953
Foreclosed assets	-	-	-	-	-	-	-	-	-	-	-	-	68	-	68
Tangible assets (net of deprecia- tion)	-	-	-	-	-	-	-	-	-	545	-	-	-	-	545
Interest, fees and other assets	-	-	27	-	1	203	2	-	124	-	50	88	200	-	695
Transfer to inter- est, fees and other liabilities	-	-	-	-	-	(136)	-	-	-	-	-	-	6	-	(130)
<b>Total assets</b>	<b>12,338</b>	<b>3,916</b>	<b>5,975</b>	<b>19</b>	<b>1,731</b>	<b>45,667</b>	<b>370</b>	<b>953</b>	<b>124</b>	<b>545</b>	<b>50</b>	<b>88</b>	<b>274</b>	<b>-</b>	<b>72,050</b>

## Appendix 1 – Supplementary forms required by local regulation (continued)

### Balance sheet reconciliation as at 31 December 2016 (continued)

#### Liabilities

BANK CNB schedules	Current ac- counts and de- posits from banks	Current ac- counts and deposits from customers	Derivative finan- cial liabilities	Interest-bear- ing borrow- ings	Other lia- bilities	Accrued ex- penses and de- ferred income	Provisions for liabilities and charges	Per IFRS		Transferred from Loans and ad- vances to customers and other assets	Total lia- bilities
								Deferred tax liabili- ties	Current tax liability		
Loans from financial institutions	-	-	-	2,739	-	-	-	-	-	-	2,739
<i>Short-term loans</i>	-	-	-	154	-	-	-	-	-	-	154
<i>Long-term loans</i>	-	-	-	2,585	-	-	-	-	-	-	2,585
Deposits	1,370	53,818	-	-	-	-	-	-	-	-	55,188
<i>Giro account and current account deposits</i>	904	13,874	-	-	-	-	-	-	-	-	14,778
<i>Savings deposits</i>	-	11,744	-	-	-	-	-	-	-	-	11,744
<i>Term deposits</i>	466	28,200	-	-	-	-	-	-	-	-	28,666
Other loans	-	-	-	-	-	-	-	-	-	-	-
<i>Short-term loans</i>	-	-	-	-	-	-	-	-	-	-	-
<i>Long-term loans</i>	-	-	-	-	-	-	-	-	-	-	-
Derivative financial liabilities and other fi- nancial liabilities held for trading	-	-	5	-	-	-	-	-	-	-	5
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-
<i>Short-term debt securities issued</i>	-	-	-	-	-	-	-	-	-	-	-
<i>Long-term debt securities issued</i>	-	-	-	-	-	-	-	-	-	-	-
Subordinated instruments issued	-	-	-	-	-	-	-	-	-	-	-
Hybrid instruments issued	-	-	-	-	-	-	-	-	-	-	-
Interest, fees and other liabilities	6	290	-	8	481	137	257	5	165	130	1,479
<b>Total liabilities</b>	<b>1,376</b>	<b>54,108</b>	<b>5</b>	<b>2,747</b>	<b>481</b>	<b>137</b>	<b>257</b>	<b>5</b>	<b>165</b>	<b>130</b>	<b>59,411</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Balance sheet reconciliation as at 31 December 2016 (continued)

#### Equity

(in HRK million)

BANK CNB schedules	Per IFRS						Total equity
	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	
Share capital	1,907	-	-	-	-	-	1,907
Current year profit/(loss)	-	-	-	-	-	1,605	1,605
Retained earnings/(loss)	-	-	-	-	-	7,442	7,442
Legal reserves	-	-	-	134	-	-	134
Statutory reserves and other capital reserves	-	1,570	(76)	168	-	-	1,662
Unrealised gains/(losses) on value adjustments of financial assets available for sale	-	-	-	-	19	-	19
<b>Total equity</b>	<b>1,907</b>	<b>1,570</b>	<b>(76)</b>	<b>302</b>	<b>19</b>	<b>9,047</b>	<b>12,769</b>



## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Income statement"

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
Interest income	3,279	3,432	2,888	2,997
(Interest expenses)	(676)	(930)	(573)	(817)
<b>Net interest income</b>	<b>2,603</b>	<b>2,502</b>	<b>2,315</b>	<b>2,180</b>
Income from fees and commissions	1,491	1,521	754	758
(Expenses on fees and commissions)	(245)	(293)	(120)	(109)
<b>Net income from fees and commissions</b>	<b>1,246</b>	<b>1,228</b>	<b>634</b>	<b>649</b>
Gains/(losses) from investments in subsidiaries, associates and joint ventures	24	24	-	-
Gains/(losses) from trading activities	22	(23)	22	(23)
Gains/(losses) from embedded derivatives	-	-	-	-
Gains/(losses) from financial assets at fair value through profit or loss and not traded	(8)	4	(8)	3
Gains/(losses) from activities related to assets available for sale	125	1	125	1
Gains/(losses) from activities related to assets held to maturity	-	-	-	-
Gains/(losses) from hedging transactions	-	-	-	-
Income from equity investments in subsidiaries, associates and joint ventures	-	-	218	165
Income from other equity investments	9	5	9	5
Gains/(losses) from exchange differences	213	101	199	92
Other income	287	144	305	76
Other expenses	(581)	(576)	(322)	(327)
General administrative expenses and depreciation	(1,539)	(1,494)	(1,197)	(1,168)
<b>Net operating income before value adjustments and loss provisions</b>	<b>2,401</b>	<b>1,916</b>	<b>2,300</b>	<b>1,653</b>
Impairment expenses	(369)	(1,449)	(315)	(1,443)
<b>Profit/(loss) before taxes</b>	<b>2,032</b>	<b>467</b>	<b>1,985</b>	<b>210</b>
Income tax	(445)	(97)	(380)	(17)
<b>Current year profit/(loss)</b>	<b>1,587</b>	<b>370</b>	<b>1,605</b>	<b>193</b>
Attributable to:				
Equity holders of the Bank	1,582	365	1,605	193
Non-controlling interests	5	5	-	-
	<b>1,587</b>	<b>370</b>	<b>1,605</b>	<b>193</b>

The income statement form is prepared in accordance with the CNB Decision on the Structure and Content of Annual Financial Statements for Banks.

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Income statement reconciliation for the year ended 31 December 2016

(in HRK million)

GROUP CNB schedules	Per IFRS															
	Interest income	Interest expense	Fee and commission income	Fee and commission expense	Dividend income	Net trading income/(expense) and net gains/(losses) on translation of monetary assets and liabilities	Other operating income	Personnel expenses	Impairment losses on loans and advances to customers	Release/(loss) recognized on CHF conversion	Other impairment losses and provisions	Depreciation and amortisation	Other operating expenses	Share of profits from associates	Income tax expense	Profit for the year
Interest income	3,279	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,279
(Interest expenses)	-	(676)	-	-	-	-	-	-	-	-	-	-	-	-	-	(676)
Income from fees and commissions	-	-	1,491	-	-	-	-	-	-	-	-	-	-	-	-	1,491
(Expenses on fees and commissions)	-	-	-	(245)	-	-	-	-	-	-	-	-	-	-	-	(245)
Gains/(losses) from investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	-	24	-	24
Gains/(losses) from trading activities	-	-	-	-	-	22	-	-	-	-	-	-	-	-	-	22
Gains/(losses) from embedded derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gains/(losses) from financial assets at fair value through profit or loss and not traded	-	-	-	-	-	(8)	-	-	-	-	-	-	-	-	-	(8)
Gains/(losses) from activities related to assets available for sale	-	-	-	-	-	-	125	-	-	-	-	-	-	-	-	125
Gains/(losses) from activities related to assets held to maturity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Income statement reconciliation for the year ended 31 December 2016 (continued)

(in HRK million)

GROUP	Per IFRS															
	Interest income	Interest expense	Fee and commission income	Fee and commission expense	Dividend income	Net trading income/(expense) and net gains/(losses) on translation of monetary assets and liabilities	Other operating income	Personnel expenses	Impairment losses on loans and advances to customers	Re-lease/(loss) recognised on CHF conversion	Other impairment losses and provisions	Depreciation and amortisation	Other operating expenses	Share of profits from associates	Income tax expense	Profit for the year
Gains/(losses) from hedging transactions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income from equity investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income from other equity investments	-	-	-	-	9	-	-	-	-	-	-	-	-	-	-	9
Gains/(losses) from exchange differences	-	-	-	-	-	213	-	-	-	-	-	-	-	-	-	213
Other income	-	-	-	-	-	-	287	-	-	-	-	-	-	-	-	287
Other expenses	-	-	-	-	-	-	-	-	-	-	-	-	(581)	-	-	(581)
General administrative expenses and depreciation	-	-	-	-	-	-	-	(872)	-	-	-	(205)	(462)	-	-	(1,539)
Impairment expenses	21	-	-	-	-	-	-	-	(436)	30	16	-	-	-	-	(369)
Income tax	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(445)	(445)
<b>Current year profit/(loss)</b>	<b>3,300</b>	<b>(676)</b>	<b>1,491</b>	<b>(245)</b>	<b>9</b>	<b>227</b>	<b>412</b>	<b>(872)</b>	<b>(436)</b>	<b>30</b>	<b>16</b>	<b>(205)</b>	<b>(1,043)</b>	<b>24</b>	<b>(445)</b>	<b>1,587</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Income statement reconciliation for the year ended 31 December 2016 (continued)

(in HRK million)

BANK CNB schedules	Per IFRS														Profit for the year	
	Interest income	Interest expense	Fee and commis- sion in- come	Fee and commis- sion ex- pense	Divi- dend in- come	Net trading income/(ex- pense) and net gains/(losses) on translation of monetary assets and li- abilities	Other operat- ing in- come	Personnel expenses	Impair- ment losses on loans and advances to custom- ers	Re- lease/(loss ) recog- nised on CHF con- version	Other impair- ment losses and pro- visions	Deprecia- tion and amortisa- tion	Other operat- ing ex- penses	Income tax ex- pense		
Interest income	2,888	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,888
(Interest expenses)	-	(573)	-	-	-	-	-	-	-	-	-	-	-	-	-	(573)
Income from fees and commis- sions	-	-	754	-	-	-	-	-	-	-	-	-	-	-	-	754
(Expenses on fees and commis- sions)	-	-	-	(120)	-	-	-	-	-	-	-	-	-	-	-	(120)
Gains/(losses) from invest- ments in subsidiaries, associ- ates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gains/(losses) from trading ac- tivities	-	-	-	-	-	22	-	-	-	-	-	-	-	-	-	22
Gains/(losses) from embedded derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gains/(losses) from financial assets at fair value through profit or loss and not traded	-	-	-	-	-	(8)	-	-	-	-	-	-	-	-	-	(8)
Gains/(losses) from activities related to assets available for sale	-	-	-	-	-	-	125	-	-	-	-	-	-	-	-	125
Gains/(losses) from activities related to assets held to ma- turity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

**Appendix 1 - Supplementary forms required by local regulation (continued)****Income statement reconciliation for the year ended 31 December 2016 (continued)**

(in HRK million)

BANK CNB schedules	Per IFRS														Profit for the year
	Interest income	Interest expense	Fee and commis- sion in- come	Fee and commis- sion ex- pense	Divi- dend in- come	Net trading income/(ex- pense) and net gains/(losses) on transla- tion of mone- tary assets and liabilities	Other operat- ing in- come	Personnel expenses	Impair- ment losses on loans and advances to custom- ers	Re- lease/(loss) recognised on CHF conversion	Other impair- ment losses and pro- visions	Deprecia- tion and amortisa- tion	Other operat- ing ex- penses	Income tax ex- pense	
Gains/(losses) from hedging transactions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income from equity investments in subsidiaries, associates and joint ventures	-	-	-	-	218	-	-	-	-	-	-	-	-	-	218
Income from other equity investments	-	-	-	-	9	-	-	-	-	-	-	-	-	-	9
Gains/(losses) from exchange differences	-	-	-	-	-	199	-	-	-	-	-	-	-	-	199
Other income	-	-	-	-	-	-	305	-	-	-	-	-	-	-	305
Other expenses	-	-	-	-	-	-	-	-	-	-	-	-	(322)	-	(322)
General administrative expenses and depreciation	-	-	-	-	-	-	-	(718)	-	-	-	(113)	(366)	-	(1,197)
Impairment expenses	20	-	-	-	-	-	-	-	(389)	30	24	-	-	-	(315)
Income tax	-	-	-	-	-	-	-	-	-	-	-	-	-	(380)	(380)
<b>Current year profit/(loss)</b>	<b>2,908</b>	<b>(573)</b>	<b>754</b>	<b>(120)</b>	<b>227</b>	<b>213</b>	<b>430</b>	<b>(718)</b>	<b>(389)</b>	<b>30</b>	<b>24</b>	<b>(113)</b>	<b>(688)</b>	<b>(380)</b>	<b>1,605</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Cash flow statement"

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Cash flow from operating activities</b>				
Profit/(loss) before tax	2,032	467	1,985	210
Impairment losses	370	1,449	315	1,443
Depreciation and amortization	204	174	113	117
(Gains)/losses from sale of tangible assets	(22)	(13)	(5)	(4)
Unrealised (gains)/losses on securities at fair value through profit or loss	(14)	19	(14)	20
Other (gains)/losses	162	-	(241)	-
<b>Cash flow from operating activities before changes in operating assets</b>	<b>2,732</b>	<b>2,096</b>	<b>2,153</b>	<b>1,786</b>
<b>(Increase)/decrease in operating assets</b>				
Deposits with the Croatian National Bank	634	198	634	198
Ministry of Finance treasury bills and Croatian National Bank bills	224	125	200	125
Deposits with banking institutions and loans to financial institutions	(557)	30	46	77
Loans to other clients	(2,193)	(1,414)	(1,726)	(1,251)
Securities and other financial instruments held for trading	(419)	(18)	(418)	(18)
Securities and other financial instruments available for sale	(347)	(433)	(151)	(92)
Securities and other financial instruments at fair value through profit or loss which are not actively traded	46	49	46	39
Other operating assets	(167)	34	(79)	(207)
<b>Net (increase)/decrease in operating assets</b>	<b>(2,779)</b>	<b>(1,429)</b>	<b>(1,448)</b>	<b>(1,129)</b>
<b>Increase/(decrease) in operating liabilities</b>				
Demand deposits	2,247	1,481	1,458	1,374
Savings and term deposits	133	1,145	(24)	968
Derivative financial liabilities and other liabilities held for trading	(4)	14	(10)	14
Other liabilities	(219)	17	(285)	78
<b>Net increase/(decrease) in operating liabilities</b>	<b>2,157</b>	<b>2,657</b>	<b>1,139</b>	<b>2,434</b>
<b>Net cash flow from operating activities</b>	<b>2,110</b>	<b>3,324</b>	<b>1,844</b>	<b>3,091</b>
(Income tax paid)	(146)	(257)	(58)	(178)
<b>Net inflow/(outflow) of cash from operating activities</b>	<b>1,964</b>	<b>3,067</b>	<b>1,786</b>	<b>2,913</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Cash flow statement" (continued)

	(in HRK million)			
	GROUP		BANK	
	2016	2015	2016	2015
<b>Investing activities</b>				
Cash receipts from/(payments to acquire) tangible and intangible assets	41	(26)	15	(19)
Cash receipts from the disposal of/(payments for the investment in) subsidiaries, associates and joint ventures	251	(748)	251	(748)
Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity	-	157	-	-
Dividends received	9	5	227	170
Other receipts from/(payments for) investments	-	-	-	-
<b>Net cash flow from investing activities</b>	<b>301</b>	<b>(612)</b>	<b>493</b>	<b>(597)</b>
<b>Financing activities</b>				
Net increase/(decrease) in received loans	(314)	(1,679)	(94)	(1,694)
Net increase/(decrease) in issued debt securities	-	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-	-
Proceeds from issue of share capital	-	-	-	-
(Dividends paid)	(193)	(513)	(193)	(513)
Other proceeds/(payments) from financing activities	-	-	-	-
<b>Net cash flow from financing activities</b>	<b>(507)</b>	<b>(2,192)</b>	<b>(287)</b>	<b>(2,207)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,758</b>	<b>263</b>	<b>1,992</b>	<b>109</b>
Effect of foreign exchange differences on cash and cash equivalents	5	(7)	5	(7)
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,763</b>	<b>256</b>	<b>1,997</b>	<b>102</b>
<b>Cash and cash equivalents at the beginning of the year</b>	<b>12,989</b>	<b>12,733</b>	<b>12,019</b>	<b>11,917</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>14,752</b>	<b>12,989</b>	<b>14,016</b>	<b>12,019</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Cash flow statement reconciliation for the year ended 31 December 2016

(in HRK million)

	GROUP			BANK		
	CNB sched- ules	per IFRS	Differ- ences	CNB sched- ules	per IFRS	Differ- ences
<b>Cash flow from operating activities</b>						
Profit (loss) before tax	2,032	2,032	-	1,985	1,985	-
Impairment losses	370	-	370	315	-	315
Impairment losses on loans and advances to customers	-	436	(436)	-	389	(389)
Other impairment losses and provisions	-	(16)	16	-	(24)	24
Depreciation and amortization	205	205	-	113	113	-
Loss recognised on CHF conversion		(30)	30		(30)	30
(Gains)/losses from sale of tangible assets	(22)	(22)	-	(5)	(5)	-
Unrealised (gains)/losses on securities at fair value through profit or loss	(14)	(14)	-	(14)	(14)	-
Other (gains)/losses	162	-	162	(241)	-	(241)
Share of profit from associates	-	(24)	24	-	-	-
Net interest income	-	(2,624)	2,624	-	(2,335)	2,335
Gain on disposal of associate	-	(162)	162	-	(241)	241
Net gain from disposal of available-for-sale securities	-	(125)	125	-	(125)	125
Dividend income	-	(9)	9	-	(227)	227
<b>Cash flow from operating activities before changes in operating assets</b>	<b>2,733</b>	<b>(353)</b>	<b>3,086</b>	<b>2,153</b>	<b>(514)</b>	<b>2,667</b>
<b>(Increase)/decrease in operating assets</b>						
Deposits with the Croatian National Bank	634	634	-	634	634	-
Ministry of Finance treasury bills and Croatian National Bank bills	224	-	224	200	-	200
Deposits with banking institutions and loans to financial institutions	(557)	-	(557)	46	-	46
Loans and advances to banks	-	(557)	557	-	48	(48)
Loans to other clients	(2,193)	(2,307)	114	(1,725)	(1,837)	112
Securities and other financial instruments held for trading	(419)	-	(419)	(418)	-	(418)
Securities and other financial instruments available for sale	(347)	-	(347)	(151)	-	(151)
Securities and other financial instruments at fair value through profit or loss which are not actively traded	46	-	46	46	-	46
Financial assets held for trading and financial assets available for sale	-	(390)	390	-	(215)	215
Other operating assets	(168)	-	(168)	(80)	-	(80)
Other assets	-	(17)	17	-	7	(7)
<b>Net (increase)/decrease in operating assets</b>	<b>(2,780)</b>	<b>(2,637)</b>	<b>(143)</b>	<b>(1,448)</b>	<b>(1,363)</b>	<b>(85)</b>
<b>Increase/(decrease) in operating liabilities</b>						
Demand deposits	2,247	-	2,247	1,458	-	1,458
Savings and time deposits	133	-	133	(24)	-	(24)
Current accounts and deposits from banks	-	36	(36)	-	(3)	3
Current accounts and deposits from customers	-	2,343	(2,343)	-	1,436	(1,436)
Derivative financial liabilities and other liabilities held for trading	(4)	-	(4)	(10)	-	(10)
Other liabilities	(219)	328	(547)	(285)	165	(450)



## Appendix 1 - Supplementary forms required by local regulation (continued)

### Cash flow statement reconciliation for the year ended 31 December 2016 (continued)

	(in HRK million)					
	GROUP			BANK		
	CNB sched- ules	per IFRS	Differ- ences	CNB sched- ules	per IFRS	Differ- ences
<b>Net increase/(decrease) in operating liabilities</b>	<b>2,157</b>	<b>2,707</b>	<b>(550)</b>	<b>1,139</b>	<b>1,598</b>	<b>(459)</b>
Interest received	-	3,327	(3,327)	-	2,931	(2,931)
Interest paid	-	(812)	812	-	(706)	706
Dividends received	-	27	(27)	-	227	(227)
<b>Net cash flow from operating activities</b>	<b>2,110</b>	<b>2,259</b>	<b>(149)</b>	<b>1,844</b>	<b>2,173</b>	<b>(329)</b>
(Income tax paid)	(146)	(146)	-	(58)	(58)	-
<b>Net inflow/(outflow) of cash from operating activities</b>	<b>1,964</b>	<b>2,113</b>	<b>(149)</b>	<b>1,786</b>	<b>2,115</b>	<b>(329)</b>
<b>Investing activities</b>						
Cash receipts from/(payments to acquire) tangible and intangible assets	41	-	41	15	-	15
Purchase of property and equipment and intangible assets	-	(160)	160	-	(98)	98
Cash receipts from the disposal of/ (payments for the investment in) subsidiaries, associates and joint ventures	251	251	-	251	251	-
Disposal of property and equipment and intangible assets	-	64	(64)	-	12	(12)
Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity	-	-	-	-	-	-
Dividends received	9	-	9	227	-	227
Other receipts from/(payments for) investments	-	-	-	-	-	-
<b>Net cash flow from investing activities</b>	<b>301</b>	<b>155</b>	<b>146</b>	<b>493</b>	<b>165</b>	<b>328</b>
<b>Financing activities</b>						
Net increase/(decrease) in received loans	(314)	(317)	3	(94)	(95)	1
Net increase/(decrease) in issued debt securities	-	-	-	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-	-	-	-
Proceeds from issue of share capital	-	-	-	-	-	-
(Dividends paid)	(193)	(193)	-	(193)	(193)	-
Other proceeds/(payments) from financing activities	-	-	-	-	-	-
<b>Net cash flow from financing activities</b>	<b>(507)</b>	<b>(510)</b>	<b>3</b>	<b>(287)</b>	<b>(288)</b>	<b>1</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,758</b>	<b>1,758</b>	<b>-</b>	<b>1,992</b>	<b>1,992</b>	<b>-</b>
Effect of foreign exchange differences on cash and cash equivalents	5	5	-	5	5	-
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,763</b>	<b>1,763</b>	<b>-</b>	<b>1,997</b>	<b>1,997</b>	<b>-</b>
<b>Cash and cash equivalents at the beginning of the year</b>	<b>12,989</b>	<b>12,989</b>	<b>-</b>	<b>12,019</b>	<b>12,019</b>	<b>-</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>14,752</b>	<b>14,752</b>	<b>-</b>	<b>14,016</b>	<b>14,016</b>	<b>-</b>

## **Appendix 1 - Supplementary forms required by local regulation (continued)**

### **Cash flow statement reconciliation for the year ended 31 December 2016 (continued)**

Differences between the cash flows positions disclosed in the statutory financial statements, and those prescribed by the CNB Decision relate to the following categories:

Net interest income, interest received and interest paid are disclosed separately in the statutory financial statements while in the CNB schedule they are included as part of the increase/decrease in operating assets and liabilities.

Dividends received are treated as cash flow from Operating activities in the statutory financial statements, while in the CNB schedule they are included within Investing activities.

Impairment losses on loans and advances to customers and Other impairment losses and provisions are disclosed separately in the statutory financial statements while in the CNB schedule they are presented as one category Impairment losses.

Other (gains)/losses in the CNB schedule include Net (gains)/losses from securities initially designated at fair value through profit or loss and Dividend income which are disclosed separately in the statutory financial statements.

Share of profit from associates is presented separately in the statutory financial statements while in the CNB schedule it is included within Other operating assets.

Net change in Ministry of Finance treasury bills and Croatian National Bank bills, Securities and other financial instruments held for trading, Securities and other financial instruments available for sale and Securities and other financial instruments at fair value in profit or loss and not traded are presented separately in the CNB schedule while in the statutory financial statements they are included within the position Financial assets held for trading and Financial assets available for sale.

Cash receipts from/(payments to acquire) tangible and intangible assets in the CNB schedule include net proceeds from purchase/sale of tangible and intangible assets and foreclosed assets. In the statutory financial statements purchase and disposal of property and equipment and intangible assets are disclosed separately within cash flows from investing activities and net proceeds from foreclosed assets are shown within Other assets.

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Statement of changes in equity"

(in HRK million)

	Share capital	Treasury shares	Legal, statutory and other reserves	Retained earnings/ (loss)	Current year profit/(loss)	Unrealised gains/ (losses) on value adjustments of financial assets available for sale	Minority interest	Total equity
<b>Group</b>								
<b>Balance as at 1 January 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,688</b>	<b>9,188</b>	<b>365</b>	<b>108</b>	<b>45</b>	<b>13,225</b>
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-	-
<b>Closing balance as at 1 January 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,688</b>	<b>9,188</b>	<b>365</b>	<b>108</b>	<b>45</b>	<b>13,225</b>
Sale of available-for-sale financial assets	-	-	-	-	-	(94)	-	(94)
Changes in fair value of the portfolio of available-for sale financial assets	-	-	-	-	-	29	-	29
Tax on items recognised directly or transferred from equity	-	-	-	-	-	13	-	13
Other gains and losses recognised directly in equity	-	-	(8)	-	-	-	-	(8)
<b>Net gains/losses recognised directly in equity</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>-</b>	<b>-</b>	<b>(52)</b>	<b>-</b>	<b>(60)</b>
Current year profit/(loss)	-	-	-	-	1,582	-	5	1,587
<b>Total current year income and expenses</b>	<b>-</b>	<b>-</b>	<b>(8)</b>	<b>-</b>	<b>1,582</b>	<b>(52)</b>	<b>5</b>	<b>1,527</b>
Increase/(decrease) of share capital	-	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-	-
Other changes	-	-	-	-	-	-	-	-
Transfer to reserves	-	-	(83)	255	(172)	-	-	-
Dividend payments	-	-	-	-	(193)	-	-	(193)
<b>Profit distribution</b>	<b>-</b>	<b>-</b>	<b>(83)</b>	<b>255</b>	<b>(365)</b>	<b>-</b>	<b>-</b>	<b>(193)</b>
<b>Closing balance as at 31 December 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,597</b>	<b>9,443</b>	<b>1,582</b>	<b>56</b>	<b>50</b>	<b>14,559</b>

**Appendix 1 - Supplementary forms required by local regulation (continued)****Form "Statement of changes in equity" (continued)**

(in HRK million)

	Share capital	Treasury shares	Legal, statutory and other reserves	Retained earnings/(loss)	Current year profit/(loss)	Unrealised gains/ (losses) on value adjustments of financial assets available for sale	Minority interest	Total equity
<b>Group</b>								
<b>Balance as at 1 January 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>2,436</b>	<b>8,716</b>	<b>985</b>	<b>15</b>	<b>40</b>	<b>14,023</b>
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-	-
<b>Closing balance as at 1 January 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>2,436</b>	<b>8,716</b>	<b>985</b>	<b>15</b>	<b>40</b>	<b>14,023</b>
Sale of available-for-sale financial assets	-	-	-	-	-	(1)	-	(1)
Changes in fair value of the portfolio of available-for-sale financial assets	-	-	-	-	-	113	-	113
Tax on items recognised directly or transferred from equity	-	-	-	-	-	(23)	-	(23)
Other gains and losses recognised directly in equity	-	-	-	-	-	4	-	4
<b>Net gains/losses recognised directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>93</b>	<b>-</b>	<b>93</b>
Current year profit/(loss)	-	-	-	-	365	-	5	370
<b>Total current year income and expenses</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>365</b>	<b>93</b>	<b>5</b>	<b>463</b>
Increase/(decrease) of share capital	-	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-	-
Other changes	-	-	(748)	-	-	-	-	(748)
Transfer to reserves	-	-	-	472	(472)	-	-	-
Dividend payments	-	-	-	-	(513)	-	-	(513)
<b>Profit distribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>472</b>	<b>(985)</b>	<b>-</b>	<b>-</b>	<b>(513)</b>
<b>Closing balance as at 31 December 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>1,688</b>	<b>9,188</b>	<b>365</b>	<b>108</b>	<b>45</b>	<b>13,225</b>

## Appendix 1 - Supplementary forms required by local regulation (continued)

### Form "Statement of changes in equity" (continued)

(in HRK million)

	Share capital	Treasury shares	Legal, statutory and other re- serves	Retained earn- ings/ (loss)	Current year profit/(loss)	Unrealised gains/ (losses) on value adjust- ments of finan- cial assets avail- able for sale	Total equity
<b>Bank</b>							
<b>Balance as at 1 January 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,442</b>	<b>193</b>	<b>86</b>	<b>11,424</b>
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-
<b>Closing balance as at 1 January 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,442</b>	<b>193</b>	<b>86</b>	<b>11,424</b>
Sale of available-for-sale financial assets	-	-	-	-	-	(95)	(95)
Changes in fair value of the portfolio of available-for sale financial assets	-	-	-	-	-	11	11
Tax on items recognised directly or transferred from equity	-	-	-	-	-	17	17
Other gains and losses recognised directly in equity	-	-	-	-	-	-	-
<b>Net gains/losses recognised directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(67)</b>	<b>(67)</b>
Current year profit/(loss)	-	-	-	-	1,605	-	1,605
<b>Total current year income and expenses</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,605</b>	<b>(67)</b>	<b>1,538</b>
Increase/(decrease) of share capital	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-
Other changes	-	-	-	-	-	-	-
Transfer to reserves	-	-	-	-	-	-	-
Dividend payments	-	-	-	-	(193)	-	(193)
<b>Profit distribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(193)</b>	<b>-</b>	<b>(193)</b>
<b>Closing balance as at 31 December 2016</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,442</b>	<b>1,605</b>	<b>19</b>	<b>12,769</b>

**Appendix 1 - Supplementary forms required by local regulation (continued)****Form "Statement of changes in equity" (continued)**

(in HRK million)

	Share capital	Treasury shares	Legal, statutory and other re- serves	Retained earn- ings/ (loss)	Current year profit/(loss)	Unrealised gains/ (losses) on value adjust- ments of finan- cial assets avail- able for sale	Total equity
<b>Bank</b>							
<b>Balance as at 1 January 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,312</b>	<b>643</b>	<b>2</b>	<b>11,660</b>
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-
<b>Closing balance as at 1 January 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,312</b>	<b>643</b>	<b>2</b>	<b>11,660</b>
Sale of available-for-sale financial assets	-	-	-	-	-	(1)	(1)
Changes in fair value of the portfolio of available-for sale financial assets	-	-	-	-	-	106	106
Tax on items recognised directly or transferred from equity	-	-	-	-	-	(21)	(21)
Other gains and losses recognised directly in equity	-	-	-	-	-	-	-
<b>Net gains/losses recognised directly in equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>84</b>	<b>84</b>
Current year profit/(loss)	-	-	-	-	193	-	193
<b>Total current year income and expenses</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>193</b>	<b>84</b>	<b>277</b>
Increase/(decrease) of share capital	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-
Other changes	-	-	-	-	-	-	-
Transfer to reserves	-	-	-	130	(130)	-	-
Dividend payments	-	-	-	-	(513)	-	(513)
<b>Profit distribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>130</b>	<b>(643)</b>	<b>-</b>	<b>(513)</b>
<b>Closing balance as at 31 December 2015</b>	<b>1,907</b>	<b>(76)</b>	<b>1,872</b>	<b>7,442</b>	<b>193</b>	<b>86</b>	<b>11,424</b>

## **Appendix 1 - Supplementary forms required by local regulation (continued)**

### **Statement of changes in equity reconciliation**

The statement of changes in equity form is prepared in accordance with the CNB Decision on the Structure and Content of Annual Financial Statements for Banks.

Legal, statutory and other reserves in the CNB schedule include Share premium and Other reserves which are presented separately in the statutory financial statements.

Retained earnings and Profit for the year are presented separately in the CNB schedule while in the statutory financial statements they are included within Retained earnings.

Sale of available-for-sale financial assets and Other gains and losses recognised directly in equity and reserves are shown separately in the CNB schedule while in the statutory financial statements they are shown within Net amount transferred to the income statement.

**Appendix 2 - Supplementary financial statements in EUR (unaudited)****Income statement**

	(in EUR million)			
	GROUP		BANK	
	2016	2015	2016	2015
Interest income	439	453	386	395
Interest expense	(90)	(122)	(76)	(107)
<b>Net interest income</b>	<b>349</b>	<b>331</b>	<b>310</b>	<b>288</b>
Fee and commission income	198	200	100	99
Fee and commission expense	(33)	(39)	(16)	(14)
<b>Net fee and commission income</b>	<b>165</b>	<b>161</b>	<b>84</b>	<b>85</b>
Dividend income	1	1	30	22
Net trading income and net loss on translation of monetary assets and liabilities	30	11	28	9
Other operating income	55	18	57	10
<b>Total operating income</b>	<b>600</b>	<b>522</b>	<b>509</b>	<b>414</b>
Impairment losses on loans and advances to customers	(58)	(19)	(52)	(20)
Losses recognized in CHF conversion	4	(172)	4	(172)
Other impairment losses and provisions	2	-	3	1
Personnel expenses	(115)	(112)	(95)	(91)
Depreciation and amortisation	(26)	(23)	(15)	(15)
Other operating expenses	(140)	(137)	(91)	(90)
Share of profits from associates	3	3	-	-
<b>Profit before income tax</b>	<b>270</b>	<b>62</b>	<b>263</b>	<b>27</b>
Income tax expense	(59)	(13)	(50)	(2)
<b>Profit for the year</b>	<b>211</b>	<b>49</b>	<b>213</b>	<b>25</b>
Attributable to:				
Equity holders of the Bank	210	48	213	25
Non-controlling interests	1	1	-	-
	<b>211</b>	<b>49</b>	<b>213</b>	<b>25</b>

The income statement items were translated from the measurement currency (HRK) to the Euro at the average exchange rate in 2016 (1 EUR = 7.529383 HRK) and in 2015 (1 EUR = 7.609601 HRK).



## Appendix 2 - Supplementary financial statements in EUR (unaudited) (continued)

### Statement of financial position

As at 31 December

(in EUR million)

	GROUP		BANK	
	2016	2015	2016	2015
<b>Assets</b>				
Cash and current accounts with banks	1,716	1,308	1,632	1,198
Balances with the Croatian National Bank	518	596	518	596
Financial assets at fair value through profit or loss	808	782	791	762
Derivative financial assets	3	1	3	1
Loans and advances to banks	371	452	229	388
Loans and advances to customers	6,997	6,678	6,042	5,787
Financial assets available for sale	186	146	49	38
Held-to-maturity investments	2	2	-	-
Investments in subsidiaries and associates	9	20	126	126
Intangible assets	21	24	16	14
Property and equipment	136	148	72	82
Investment property	8	3	7	1
Deferred tax assets	17	18	12	13
Other assets	72	72	37	40
Tax prepayments	3	21	-	19
<b>Total assets</b>	<b>10,867</b>	<b>10,271</b>	<b>9,534</b>	<b>9,065</b>

The items of the statement of financial position were translated from the measurement currency (HRK) to the Euro at the closing exchange rates as at 31 December 2016 (1 EUR = 7.557787 HRK) and as at 31 December 2015 (1 EUR = 7.635047 HRK).

## Appendix 2 - Supplementary financial statements in EUR (unaudited) (continued)

### Statement of financial position (continued)

As at 31 December

(in EUR million)

	GROUP		BANK	
	2016	2015	2016	2015
<b>Liabilities</b>				
Current accounts and deposits from banks	149	142	182	180
Current accounts and deposits from customers	7,989	7,621	7,159	6,917
Derivative financial liabilities	1	2	1	2
Interest-bearing borrowings	473	509	363	372
Subordinated liabilities	-	-	-	-
Other liabilities	230	188	64	41
Accrued expenses and deferred income	35	31	18	16
Provisions for liabilities and charges	38	41	34	38
Deferred tax liabilities	3	4	1	3
Current tax liability	22	1	22	-
<b>Total liabilities</b>	<b>8,940</b>	<b>8,539</b>	<b>7,844</b>	<b>7,569</b>
<b>Equity attributable to equity holders of the parent</b>				
Share capital	250	250	250	250
Share premium	208	206	208	206
Treasury shares	(10)	(10)	(10)	(10)
Other reserves	50	61	40	40
Fair value reserve	7	14	3	11
Retained earnings	1,461	1,251	1,199	999
Merger reserve	(46)	(46)	-	-
<b>Total equity attributable to equity holders of the Bank</b>	<b>1,920</b>	<b>1,726</b>	<b>1,690</b>	<b>1,496</b>
<b>Non-controlling interests</b>	<b>7</b>	<b>6</b>	<b>-</b>	<b>-</b>
<b>Total equity</b>	<b>1,927</b>	<b>1,732</b>	<b>1,690</b>	<b>1,496</b>
<b>Total liabilities and equity</b>	<b>10,867</b>	<b>10,271</b>	<b>9,534</b>	<b>9,065</b>

The items of the statement of financial position were translated from the measurement currency (HRK) to the Euro at the closing exchange rates as at 31 December 2016 (1 EUR = 7.557787 HRK) and as at 31 December 2015 (1 EUR = 7.635047 HRK).