Privredna banka Zagreb dd

Annual report

31 December 2017

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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 2017 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 2017 have been used to translate balances in foreign currency on that date:

CHF 1	=	6.432 HRK
USD 1	=	6.270 HRK
EUR 1	=	7.514 HRK
BAM 1	=	3.842 HRK

Introduction (continued)

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, Slovenia 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.

2,020 thousand TOTAL CUSTOMERS 1,078 thousand CURRENT ACCOUNTS	HRK 103.8 billion TOTAL CUSTOMERS' FUNDS* HRK 14 billion ASSETS UNDER CUSTODY	668,882 INTERNET BANKING USERS 301 TOTAL BRANCHES
962 ATM MACHINES 1,215 DAY AND NIGHT VAULTS	HRK 71 billion TOTAL GROSS LOANS HRK 13.8 billion TOTAL HOUSING LOANS	2,823 thousand TOTAL CARDS ISSUED 41,719 EFT POS

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

Introduction (continued)

Five year summary and financial highlights

(in HRK million)

	2017	2016	2015	2014*	2013*
Group					
Income statement and statement of financial position					
Total gross revenue	5,782	6,294	6,047	5,355	5,234
Net interest income	2,974	2,950	2,895	2,454	2,257
Net operating income	4,908	5,224	4,625	3,938	3,726
Net profit for the year	1,346	1,739	461	989	821
Total assets	102,912	99,708	95,791	78,328	70,117
Loans and advances to customers	64,900	65,177	62,305	51,187	48,557
Due to customers	78,157	74,284	71,745	55,346	47,729
Shareholders’ equity attributable to equity holders of the Bank	15,549	15,626	14,292	13,983	12,772
Other data (as per management accounts)					
Return on average equity	8.10%	10.83%	2.90%	7.19%	6.44%
Return on average assets	1.20%	1.68%	0.44%	1.17%	1.07%
Assets per employee	20.4	20.1	20.4	18.9	17.2
Cost income ratio	42.70%	38.66%	43.79%	46.72%	45.41%

** Presented information does not include Intesa Sanpaolo Banka dd Bosnia and Herzegovina (subsidiary acquired in 2015) and Banka Intesa Sanpaolo dd Slovenia (subsidiary acquired in 2017) in a common control transaction.*

(in HRK million)

	2017	2016	2015	2014	2013
Bank					
Income statement and statement of financial position					
Total gross revenue	4,315	4,532	4,087	4,052	4,351
Net interest income	2,374	2,335	2,193	2,132	2,145
Net operating income	3,815	3,839	3,161	2,944	3,039
Net profit for the year	1,443	1,605	193	643	615
Total assets	75,497	72,050	69,214	68,876	65,617
Loans and advances to customers	44,562	45,667	44,186	44,543	45,106
Due to customers	57,173	54,108	52,815	50,387	46,427
Shareholders’ equity attributable to equity holders of the Bank	13,755	12,769	11,424	11,660	11,499
Other data (as per management accounts)					
Return on average equity	11.10%	13.44%	1.67%	5.57%	5.30%
Return on average assets	1.80%	2.13%	0.26%	0.88%	0.86%
Assets per employee	21.8	21.3	21.7	20.4	17.7
Cost income ratio	35.30%	38.36%	43.73%	48.01%	46.95%

Report from the President of the Supervisory Board

On behalf of the Supervisory Board of Privredna banka Zagreb dd., I am honoured to present you the business results of the Bank and Group for the year 2017.

Positive macroeconomic trends continued in 2017, resulting in a 3 percent growth of domestic economy. However, the economy was shaken and is still at risk due to major issues of the largest private food and retail concern. Most of the said risks were successfully mitigated in 2017 by applying the Damage Control Measures conducted through the adoption of the so-called lex Agrokor, but negative impacts are expected to emerge in 2018 when Agrokor will remain the largest negative risk to achieving the expected economic growth.

Although we anticipate a continuation of positive movements in 2018, the absence of effect of the tax reform from early 2017 will somewhat slow down the dynamics of wage growth and consequently private consumption, whereas a positive contribution of exports (goods and services) might be nullified by a stronger growth of imports.

As in the previous year, foreign economic environment was encouraging due to the expansionary monetary policy of the European Central Bank, as well as the loose monetary policy conducted by the Croatian National Bank which generated a 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.

In line with the positive trends in the economy, fiscal metrics continued to improve as both public deficit and debt declined leading to rating improvement in first days of 2018. However, negative demographics and still deep structural macroeconomic imbalances seek for more tangible structural reforms in order to strengthen domestic economy in front of inevitable challenges that monetary policy normalisation will bring.

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 5.8 billion. Consolidated net operating income equaled HRK 4.9 billion, whereas net profit recorded HRK 1.346 billion. Our cost/income ratio, an efficiency key measure, closed once again significantly below 50 (42.7) percent, while the return on average equity reached 8.1 percent. These are all very satisfactory figures consistently representing strong performance throughout the years.

In 2017, 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. Both revenues and profitability in PBZ Group are well balanced in all market segment thus successfully mitigating any burdens that concentration risk might impose.

Looking ahead, the present economic climate suggests that the respective environment in 2018 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 2017

In 2017 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 2017 the Supervisory Board held four 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 2017, the Audit Committee held six 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 2017, Report on the Operation of the Bank and its Subsidiaries and Draft Decision on the Allocation of the Bank's Profit Earned in 2017, 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., Croatia, the company that had audited the financial statements for 2017. Since the Supervisory Board has given its consent regarding the Annual Financial Statements and Consolidated Annual Financial Statements of the Bank for 2017, 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 288,763,965.84 of the Bank's net profit totaling HRK 1,443,444,287.42, earned in the year that ended on 31 December 2017, should be distributed by pay-out of dividends (or HRK 15.19 per share) whereas the remaining amount should be allocated to retained earnings.

Yours faithfully

15 February 2018

Giovanni Boccolini

Management Board report of the Status of 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 2017.

After extensively prolonged period of gloomy economic conditions of the past decade, last year's positive macroeconomic upturn was not shadowed by the enormous difficulties that our largest privately owned agriculture-retailer Agrokor was facing. Quite the opposite, the local economy managed to experience the growth of 3 percent. Eagerly awaiting such positive developments, we had well prepared ourselves to grasp this opportunity making our operations resilient and sound on the one hand and swift and agile on the other. 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 were able to accomplish such achievement by continuing to execute our predetermined business strategy built around customer relations and well-diversified source of income, thus keeping a steady course and reflecting the resilience of our earnings power in these challenging conditions. All our business segments managed to cope extremely well with the surrounding conditions. Furthermore, 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. The commitment to do so enabled us to increase the sale of the non-performing part of the portfolio, its collection and restructuring and, by applying this mix of activities, to bear fruits in the form of both significantly decreased non-performing loans share and provisions costs, fully compensating the negative impact of Agrokor.

Outlook

The economic growth in 2017 was mainly based on two positive impulses, the first coming from the surroundings and the second from domestic economic policy. In fact, the positive impulse of stronger economic growth in the European Union countries spilled over to domestic economy through two channels: exports of goods and tourism. The other positive impulse was the tax relief on wages, which aided in a mild increase in employment, boosted a recovery of private consumption. The favourable environment of low interest rates and the achieved economic growth resulted in an improvement in the fiscal policy indicators, moreover, a surplus in the general government budget was recorded for the first time since independence. All of the above contributed to the decline of the public debt level, causing an improvement in the Croatian sovereign rating.

Thus, the economic environment was particularly favourable from the aspect of continuation of the expansive monetary policy of both the European Central Bank and the Croatian National Bank, which was manifested in the continued drop in the price of loans and strengthened credit activity, particularly in the household sector. The increase in demand for kuna loans is still present, therefore their share in total loans to the private sector rose. The clients still tend to display currency risk aversion related to deposits, making banks' liabilities dominantly funded by foreign currency deposits, although kuna deposits are on the rise.

In line with the positive trends in the economy, fiscal metrics continued to improve as both deficit and public debt, thus leading to the improved rating in first days of 2018. However, negative demographics and still deep structural macroeconomic imbalances require more tangible structural reforms in order to strengthen domestic economy facing inevitable challenges that monetary policy normalisation will bring.

In terms of growth, 2018 will be more challenging as both external and domestic tailwinds start to lose pace while headwinds, in terms of Agrokor restructuring impact on the labour market and business community, gain importance. The normalisation of the euro-zone monetary policy, a further increase in FED's rates accompanied by the unpredictable US economic policy and a tense geopolitical situation will impose new challenges, but also require stable and sustainable economic policies supported by improved competitiveness in order to achieve a potential rise in growth rates and secure fiscal viability for future crisis. Needless to say, the recently launched euro introduction strategy has thus become an even more important tool for further implementation of necessary structural reforms aimed at strengthening of the domestic economy.

Management Board report of the Status of the Bank (continued)

Consolidated financial results

The consolidated net profits for 2017 amounted to HRK 1,346 million, representing only a slight decrease compared to 2016, but without any notable gains from extraordinary events as in 2016, i.e. the sale of ISP Card and Visa Europe Ltd. shares. This encouraging result has come from carefully planned and perennially executed business strategy that encompasses a conservative and systematic approach to all risks arising from business transactions, commitment to client orientation and diversification of income sources.

Supported by the present positive macroeconomic signals and in spite of a direct and indirect negative impact of the situation around Agrokor, that may eventually reflect on the banking industry, we managed to control risks arising from our operations in a much better manner than our peers. This achievement is a result of our commitment to manage the non-performing part of our portfolio in a flexible, prudent and swift manner, allowing us to sell significant parts of the non-performing portfolio, increase collection and improve the restructuring process. The above has resulted in a decrease in the non-performing loan ratio from 9.7 to 8.9 percent, compared to the previous year. Additionally, we managed to substantially control the cost of risk, simultaneously increasing the coverage of the non-performing portfolio, thus making us well-fitted to meet all future challenges.

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 the free available capital in stress scenarios. It is my pleasure to report that the PBZ Group is one of the leading, well-capitalized banking groups in the country, with more than sufficient capital buffer 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 to HRK 70. Based on the methodology used for management reporting, the Group's return on average equity in 2017 was 8.1 percent, while return on average assets stood at 1.2 percent. Assets per employee equalled 20.4 million, whereas the cost to income ratio, according to the consolidated financial statements, remained at 42.7 percent.

As a reflection of these events, the positive effect of our in-built-long-lasting client orientation, aided by positive economic signals, has profoundly affected net interest income and net fee and commission income. Equally important, despite the still risky macroeconomic surroundings in which we have found ourselves, 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 have resulted in upgrading our products and services.

In line with the above mentioned and in more details, our net interest income rose by 0.8 percent compared to 2016, however, although affected by a decrease in interest income, it was over-compensated by a stronger decrease in interest expense. The mentioned effects were caused by high liquidity on the market and by the remaining shy and defensive nature of the economic community towards consumption and investments. Net fee and commission income increased by 4.2 percent. The level of provisions and impairment, although higher compared to the previous year, is a direct proof of the quality of our non-performing loans management.

The balance sheet of the PBZ Group increased notably by 3.2 percent, amounting to HRK 102.9 billion. The most significant portion of our assets consists of loans and advances to customers which we managed to keep stable although facing the negative impact of Agrokor, notable sale of NPL portfolio and the still prevailing absence of demand for loans, due to the erratic economic situation that affected our clients, both corporate and retail. We continue conducting a well-diversified loan portfolio policy, having a remotely higher volume of placements to retail customers on the one side than placements to the public and corporate clients on the other. As we are well aware that the excellence in customer orientation can only be accomplished if we stand by our clients during difficult times, we have embedded this approach in all our business processes. Therefore, we continue developing comprehensive initiatives aimed at helping our customers during crises. From the liabilities' perspective, our balance sheet is mostly funded by customer deposits, where the retail segment plays the most significant role. In 2017, we experienced an upsurge in customer deposits by 5.2 percent, owing to both high liquidity on the market and our reputation as one of the most stable and client oriented financial group on the market. The capital adequacy ratio remained stable and it is by far exceeding the prescribed threshold.

Management Board report of the Status of the Bank (continued)

Unconsolidated financial results of the Bank

The Bank's net result in 2017 was HRK 1,443 million, representing a slight decrease compared to the preceding year. Again, this favourable result was achieved without any gains from extraordinary events, thus stemming only from careful planning and enduring execution of our business strategy. Defying the fact that some significant risks are present in the economy (although in its upward phase), net interest income rose by considerable 1.7 percent. It is noticeable that interest income slightly declined, caused solely by excess liquidity pushing downwards reference market rates. On the other hand, despite a rise in deposit volume, interest expense contracted considerably, proving that we are widely recognized as steady and low-risk partner to all our clients, thus affirming our further commitment to the fulfilment of overall client requirements. This strategy was accompanied by efficient and omnipresent cost management enterprise carried within all organizational units, which enabled our successful control of the expense side of our business. Hence, we were able to maintain our cost to income ratio at 35.3 percent.

The overall Bank’s balance sheet has significantly increased by 4.8 percent, reaching a level of HRK 75.5 billion. Although the market shows a tendency of a notable decrease in demand for loans, loans and advances to customers shrank by mere 2.4 percent, amounting to HRK 44.6 billion. Current accounts and deposits from customers increased considerably by 5.7 percent, reaching the level of HRK 57.2 billion. Having regard to the total structure of the balance sheet, the relative portion of customer deposits amounts to 75.7 percent. The total loan to deposit ratio of the Bank equals 77.9 percent, emphasizing the stability and conservative nature of our ventures.

Business segments

Despite the still prevailing absence of demand for loans on the market, I'm proud to report that we have managed to increase our portfolio in the Retail business segment where, among other initiatives, we have ventured into becoming an important provider in the affluent sub-segment of the market. Additionally, the SME business segment has managed to increase not only their size of its portfolio, but also earnings stemming from net interest income. The corporate business segment has faced harsh market conditions, due to the fact that large clients are offered more financing possibilities than ever, outside banking industry and/or local markets. However, our commitment to successfully participate in this portion of the market encouraged us to seek new opportunities. Therefore, we have successfully managed to offset negative trends in this sub-segment by significantly increasing our market share in the multinational companies' niche.

Extraordinary business events

Following the successful strategy of the ISP's regional repositioning in 2015, when PBZ Group was extended by adding Intesa Sanpaolo Banka dd Bosna i Hercegovina, as of July 2017 PBZ Group was further enriched by a new member – Intesa Sanpaolo Bank in Slovenia. Its valid contribution was already felt throughout 2017 so based on this fact and on the characteristics of our business models, we fully expect benefit from positive synergic effects in the near future.

Briefly on the Bank's subsidiaries

In 2017, 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 185.8 million, PBZ Leasing HRK 15.7 million, PBZ Stambena štedionica HRK 8.9 million, whereas PBZ Croatia osiguranje, our jointly owned pension fund management company, earned a profit of HRK 28 million.

Intesa Sanpaolo Banka dd Bosna i Hercegovina, our subsidiary established in Bosnia and Herzegovina, earned HRK 95.1 million attributable to PBZ Group. Intesa Sanpaolo Bank, our subsidiary in Slovenia, earned HRK 16 million attributable to PBZ Group. Our foreign subsidiaries' 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.

Management Board report of the Status of the Bank (continued)

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.

I would like to take this opportunity to express gratefulness to all my colleagues and all employees of the PBZ Group for their commitment and true professionalism that enabled us to safely sail through these restless times. Furthermore, I would like to thank all our distinguished 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.

In the end, having spent 20 years as Chief Executive Officer of Privredna banka Zagreb dd and at the helm of the PBZ Group I had decided to retire from that position. I will be succeeded by Mr. Dinko Lucić, a successful banker and manager, especially experienced in Retail segment, to whom I wish the best of luck in facing all future challenges. My time spent in this organization was coloured by dedication and commitment of all of us who have been contributing to our joint success story. Therefore, it is with great joy that I am extending my personal gratitude to all my co-workers, partners and clients.

Božo Prka, M.S.

President of the Management Board *(until 10 February 2018)*

8 February 2018

Management Board report for the Group

Financial Highlights of the Group

In July 2017 PBZ Group became richer for another member, Intesa Sanpaolo bank from Slovenia. Together with the new member, the consolidated net profits for 2017 amounted to HRK 1,346 million, representing a decrease of 22.6 percent compared to 2016 where Group experienced notable gains from extraordinary events, i.e. sell of ISP Card and Visa Europe Ltd. shares. 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.

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 9.7 to 8.9 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.

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 70.0. Based on the methodology used for management reporting, the Group's return on average equity in 2017 was 8.1 percent, while return on average assets was 1.2 percent. Assets per employee equalled 20.4 million, whereas the cost to income ratio, according to the consolidated financial statements, was 42.7 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 0.8 percent compared to 2016, 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 4.2 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 3.2 percent, amounting to HRK 102.9 billion. The most significant portion of our assets are loans and advances to customers which experienced a decrease in the outstanding amount by 0.4 percent in spite of still prevailing lack of demand for loans caused by the unstable economic situation that affected our clients, especially corporate. Retail recorded a rise in placement before impairment by 5.1 percent. 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 2017, we experienced an upsurge in customer deposits by 5.2 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 2017, PBZ Card's results show a continuation of a stable and growing business and therefore serve as the confirmation of the leading position on the domestic card products market.

The total net operating income of the Company in 2017 amount to HRK 595.7 million, which is by 1.9 percent higher compared to the result recorded for the year 2016. Net fee and commission based income amounts to HRK 546.4 million or by 2.3 percent higher compared to the data recorded for the last year.

In the structure of net operating income, interest income amount to HRK 22.2 million, which is by 11.1 percent lower compared to the data recorded for the last year. The aforementioned trend is expected due to the measures taken as the part of the receivables collection during 2017, including the sale of a part of the receivables. The decline in default interest based income was additionally influenced by the continued decrease in the highest possible statutory default interest rate over the past periods.

The Company's profit before tax amounts to HRK 230.4 million, and after taxation it is HRK 185.8 million, which is by 39.1 percent higher compared to the last year. The financial result for 2016 was significantly affected by Goodwill value adjustment of amounting to HRK 40 million.

The total operating costs for 2017 amount to HRK 340.2 million, which indicates a decrease of 3.9 percent compared to the year 2016. This decrease is largely due to the reduction in other operating costs, especially in the part of material costs and services. Another significant factor in lower operating costs in 2017 is the decrease in the cost of the Membership Rewards program compared to the previous year.

PBZ Card's total assets at December 31, 2017 amount to HRK 2,800 million, which indicates an increase of 9.6 percent compared to the end of 2016.

The above mentioned results make PBZ Card the segment most profitable segment of PBZ Group, thus fulfilling all the Company's goals. PBZ Card shall therefore continue its revenue-driven business by further promotion of card-based spending, both physical and virtual, focusing on innovative, contemporary digital technologies, and investing in value-added services for card holders and merchant, thus maintaining a leading position on the market, which shall further strengthen PBZ Group's position in the card business.

Intesa Sanpaolo banka Bosna i Hercegovina

The 2017's net profit of HRK 95 million shows an 8.7 percent decrease compared to the previous year.

Net Interest Margin is lower by 2.1 percent compared to last year due to decrease of lending rates, which effect is partially offset by increase of loans volumes and through further compression of cost of funding from customers, banks and international financial organizations. Total operating income increased 1.4 percent year on year due to extraordinary increase of commission income which represent increase of 12.7 percent compared to the previous year.

Total operating costs recorded a yearly increase by 1.6 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 (18.6 percent) lower net impairment costs on portfolio exposed to credit risk is the result of additional impairments in accordance with assets quality review imposed by local regulator. Due to collection, sales and write-off of non-performing positions and increase of high quality portfolio compared to previous year resulted in decrease of the NPL ratio, reaching a level of 5.7 percent, which is significantly lower than the banking sector average, while maintaining a prudent coverage ratio for defaulted exposures (74 percent).

Total assets increased by 4.2 percent at HRK 7,174 million with net loans in the amount of HRK 4,913 million and customer deposits in the amount of HRK 4,890 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 8.4 percent. Positive performance was confirmed also by improvement in collection of retail deposits (3.3 percent) and corporate deposits (6.3 percent). The Bank's position in terms of available liquidity remains comfortable and safe, even if we were to assume worsening macroeconomic scenarios, thus ready to sustain expected further expansion of credit.

Management Board report for the Group (continued)

Financial Highlights of the Group (continued)

Intesa Sanpaolo banka Bosna i Hercegovina (continued)

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

Strategic objectives of the Bank for 2018 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.

Intesa Sanpaolo Bank Slovenia

In 2017, Intesa Sanpaolo Bank's results indicate the continuation of stable business operations with net profit of HRK 31.4 million.

Lending activity in Slovenian economy has continued to show a stagnating dynamic with abundant liquidity and very low interest rates. The banks had to face fierce price-competition for the granting of loans and for the attraction of new customers which had a significant effect on profitability.

Still, Intesa Sanpaolo Bank managed to accomplish a successful performance, posting a growth of customer lending volumes. Those achievements are seen also as a result of the new marketing and strategic actions with aim to strengthen the Bank's presence and image in the Slovene banking industry, especially in the corporate finance and the wealth management segments.

Due to continuous decrease of lending interest rates, net interest income amounted to HRK 304.5 million (2.2 percent yearly decrease). On the other hand, The Bank recorded lower cost of risk which ensued from the improvement of the quality of its credit portfolio.

Total operating costs recorded a yearly decrease of 1.4 percent. Net impairment costs on loans portfolio were 10.1 percent lower compared to the previous year. It is the result of effective mastering of non-performing loans and advanced risk monitoring processes. The non-performing to total loans ratio decreased from 10.2 percent in 2016 to 9.4 percent in 2017.

Total net assets increased by 3.1 percent to HRK 18,026 million with net loans in the amount of HRK 12,586 million and customer deposits in the amount of HRK 14,813 million. The Bank's position in terms of available liquidity remains safe and ready to sustain planned further expansion of lending activity.

The Intesa Sanpaolo Bank in Slovenia, a member of the international banking group Intesa Sanpaolo, has started a re-launching initiative and business expansion, which stem from the positive performance and achievements attained by the Bank in Slovenia over the last 15 years, since the Bank became part of the Intesa Sanpaolo Group.

One of the main pillars of this growth-propelling initiative, started last year, is based on the transfer of 51 percent of the Bank's shares from Intesa Sanpaolo to Privredna banka Zagreb, a subsidiary bank of the Group in Croatia. The new ownership structure is a part of the Group's regional strategy aiming to increase synergies between its subsidiaries in the planned re-launch and business expansion in the Slovenian market.

PBZ Leasing

PBZ Leasing had a successful business year, earning net profit of HRK 15.7 million. In 2017, the Company signed new lease contracts in the total value of HRK 283 million, thus retaining positions in the Croatian leasing industry in terms of the number of realized placements.

At the end of 2017, the Company's total portfolio included net fixed assets under operating leases in the amount of HRK 387 million (2016: HRK 374 million) and net receivables under finance leases in the amount of HRK 643 million (2016: HRK 586 million).

In 2018 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.

Management Board report for the Group (continued)

Financial Highlights of the Group (continued)

PBZ Stambena Štedionica

In 2017 profit before tax of PBZ Stambena Štedionica amounted to HRK 10.9 million and net profit to HRK 8.9 million. Thanks to the synergy effect of cooperation with Privredna banka Zagreb as the parent bank and the main sales channel, PBZ Stambena Štedionica managed to increase the market share in deposits and loans in a strong competitive environment. In 2017, PBZ Stambena Štedionica has concluded 22,381 new housing savings contracts and increased the deposit balance by HRK 85 million, so that now they amount to HRK 1,532.5 million, and housing loans increased by HRK 110 million, currently amounting to HRK 698.5 million.

As at 31 December 2017, total assets of PBZ Stambena Štedionica amounted to HRK 1,819 million.

In 2018 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

The Company had a successful business year and achieved a net profit in the amount of HRK 2.5 million. The total assets at 31 December 2017 was HRK 112,3 million. The business of PBZ Nekretnina in 2017 was also directly influenced by economic situation in Croatia, especially from the real estate market. PBZ Nekretnine continued their activities on the real estate market and carried out more than 7 thousand property market value appraisals.

During 2018 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 d.d. continues to achieve positive financial results. In 2017 the Company reached net profit of HRK 28.7 million. At the same time, the cost income ratio stands at 49.4 percent. Total assets as of 31 December 2017 was HRK 145.5 million.

Net profit was influenced by the statutory change of management fee from 0.419 percent in 2016 to 0.390 percent in 2017. PBZ Croatia osiguranje d.d. is a well-recognised and highly respectable pension fund management company in Croatia. Development strategy for 2018 will be oriented at maintaining its status within the general public in the country as well as successfully managing the funds' assets.

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

Dinko Lucić

President of the Management Board

15 February 2018

Macroeconomic developments in Croatia in 2017

Continuation of recovery in the shadow of Agrokor

Although shaken by major issues of the largest private food and retail concern, domestic economy grew approximately 3.0 percent in 2017. Damage control measures conducted through the adoption of the so-called lex Agrokor at the beginning of 2017, eliminated negative impacts very likely to be reflected on the economy at that time, carrying them forward to 2018, the year in which Agrokor will remain the largest negative risk to achieving the expected economic growth.

Thus, the economic growth in 2017 was mainly based on two positive impulses, the first coming from the surroundings and the second from domestic economic policy. In fact, the positive impulse of stronger economic growth in the countries of the European Union spilled over to domestic economy through two channels: exports of goods and tourism, where Croatia has benefited for the third consecutive year of the so-called "safety dividend" and the fact that the Mediterranean markets, our competitors, still represent a safety risk for tourists. The other positive impulse was the tax relief on wages that entered into force in early 2017, which, together with a mild increase in employment, boosted a recovery of private consumption through a 5 percent growth in the average net earnings. The favourable environment of low interest rates and the achieved economic growth resulted in an improvement in the fiscal policy indicators, moreover, according to the estimate of the Ministry of Finance, a surplus in the general government budget has been recorded for the first time since independence, also, the public debt level simultaneously declined to around 78 percent of the gross domestic product, due to which rating agencies improved the outlook in 2017, but also upgraded the rating in 2018, therefore the Fitch Agency raised Croatia's rating from BB to BB+.

Thus, the economic environment was particularly favourable from the aspect of continuation of the expansive monetary policy of both the European Central Bank and the Croatian National Bank, which was manifested in the continued drop in the price of loans and strengthening of credit activity, particularly in the household sector. Data on transactions show that claims over the first eleven months cumulatively rose by 2.7 percent, with a stronger increase in the claims on households (3.4 percent) versus the claims on corporations (2.5 percent). The increase in demand for kuna loans is still present, therefore their share in total loans to the private sector rose to approximately 43 percent compared with 39.5 percent recorded at the end of 2016, which is still disproportionate to the inclination of deponents to FX savings.

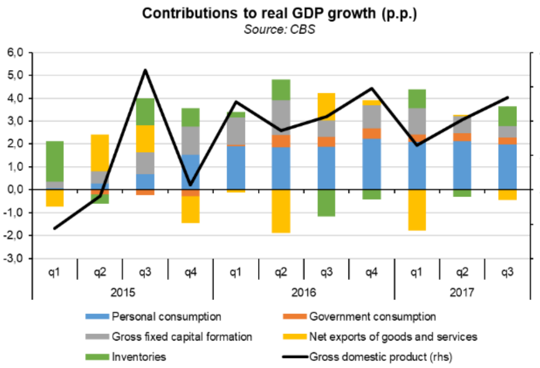
Although we anticipate a continuation of positive movements in 2018, the absence of effect of the tax reform from early 2017 will somewhat slow down the dynamics of wage growth, consequently, private consumption and, finally, economic growth (the current estimate of the growth rate in 2018 is 2.8 percent), whereas a positive contribution of exports (goods and services) might be nullified by a stronger growth of imports and, if everything goes well, because of the strengthening of investment activity as well (particularly investments financed by EU funds). The largest negative risk remains the restructuring of Agrokor, considering the large number of economic subjects involved and the amount of claims.

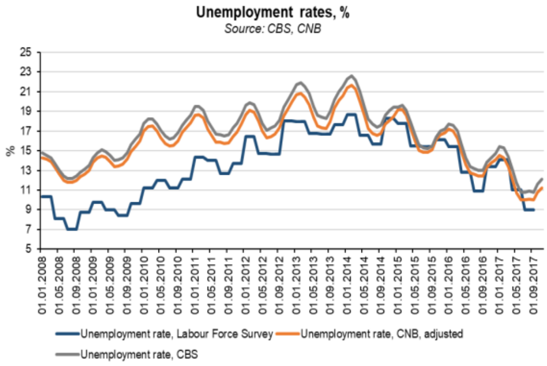
Macroeconomic developments in Croatia in 2017 (continued)

2017 in review

According to our estimate, the gross domestic product in 2017 increased by 3.0 percent yoy, representing a slightly lower growth rate of the economy compared with 2016 (+3.2 percent), where the largest contribution to the growth came from exports of goods and services (due to stronger foreign demand) and personal consumption, among other, owing to the positive effect of the tax reform.

Over the first three months of 2017, total exports rose at the rate of 6.8 percent, mainly supported by a double-digit increase in exports of goods, indicating an enhanced inclusion into global economic flows and a slightly higher demand from the countries which are Croatia's main foreign trade partners. Thus, one of the most significant contribution to higher exports of goods in 2017 came from the elimination of tariffs on the export of food products to the Bosnia and Hercegovina market, due to which the value of exports of goods to this fourth largest export market rose even by 22 percent yoy. Exports of services over the first nine months of 2017 was 4.1 percent higher yoy, i.e. slightly less versus the year before. The imports of goods and services advanced 8.8 percent, as a result of recovering domestic demand, but also because of high import dependence on the exports. The contribution of net foreign demand to the total growth last year was negative, amounting to -0.8 p.p. The industrial production, under the influence of stronger foreign demand and recovery of domestic demand, recorded a yoy increase of 2.3 percent over the first eleven months of 2017, a substantially poorer result compared with 2016 (+5.0 percent), which is a result of a notable slowdown of production in Manufacturing (from +5.4 percent in 2016 to +3.2 percent in 2017), due to a double-digit drop in particular activities (manufacture of chemicals and chemical products -12.9 percent, manufacture of fabricated metal products, except machinery and equipment -11.1 percent).

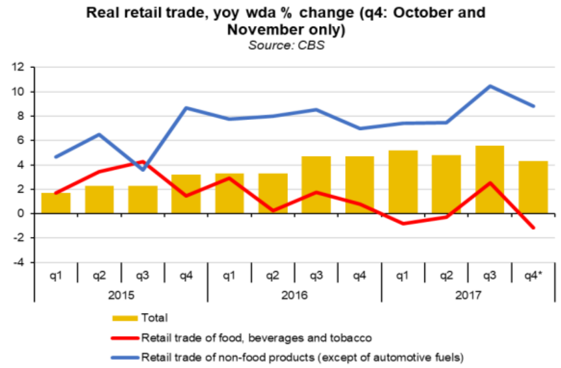


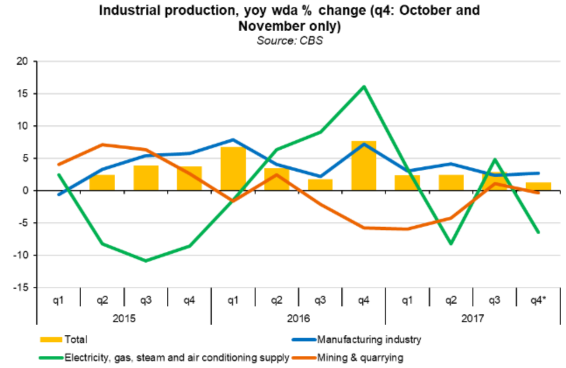


Over the first nine months of 2017, personal consumption increased by 3.6 percent compared with the same period of 2016, due to an average growth in net wages of 5.4 percent (over the first ten months), which is a result of positive effects of the tax reform, higher base salary for public sector employees, increase in minimum wages and a continuation of favourable movements in the labour market. In 2017, the registered number of unemployed persons fell by 19.8 percent on average yoy, i.e. 48 thousand persons, decreasing to an average of 194 thousand of unemployed persons, the lowest level since 1990, when 161 thousand of unemployed persons on average were recorded. The registered unemployment rate in 2017 amounted to 12.5 percent on average (-2.4 p.p. yoy), partly owing to the economic recovery, but also to a simultaneous remaining trend of more people moving abroad. The data of the Croatian Pension Insurance Institute on the number of employed persons show an increase of 1.9 percent, slightly more than 27 thousand (to 1.49 million), of which mostly in Manufacturing (+5,740), Accommodation and food service activities (+4,656) and Construction (+3,096), while the largest fall in the number of employed persons was recorded in the Public administration and defence (-2,126). Despite promising indicators in the labour market (2017 being the fourth consecutive year of a decrease in the number of unemployed persons), Croatia is still among the worst EU member states in terms of indicators of (un)employment and activity rates. Based on the previously mentioned increase in wages and employment, but also due to the improved consumer confidence and another record breaking tourism season (according to physical and financial indicators), the annual growth in retail trade turnover over the first eleven months of 2017 amounted to 7.3 percent in nominal terms, or 5.1 percent in real terms, which is the highest growth rate registered over the last ten years, where the increase in retail trade of predominantly food products moderately amounted to 0.4 percent and in retail trade of non-food products to the high 8.6 percent.

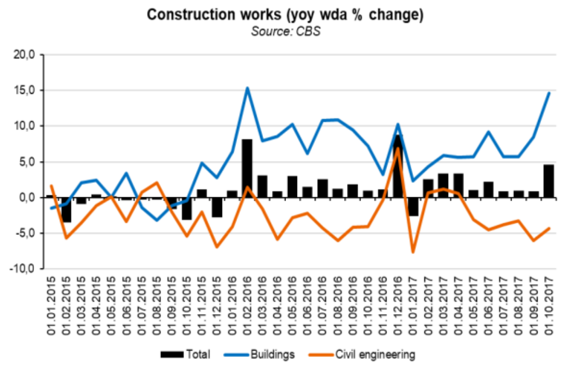
Macroeconomic developments in Croatia in 2017 (continued)

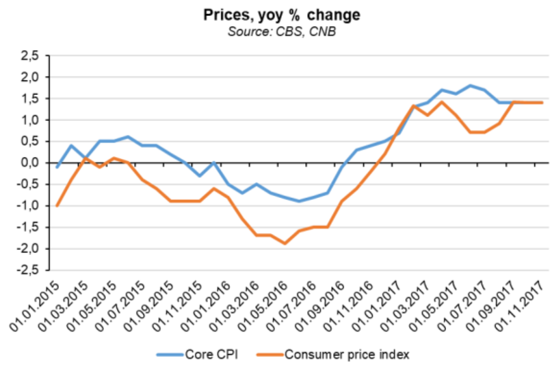
2017 in review (continued)





Gross investments in the fixed capital over the first three quarters of 2017 recorded an average growth of 4.0 percent yoy, mainly under the influence of a larger number of private sector investments (particularly in the tourism sector), which is confirmed by the data on the 6 percent growth in the volume of construction works on buildings, while civil engineering works (infrastructural projects) simultaneously decreased by 3.4 percent, which was partly affected by the absence of larger public infrastructural projects.



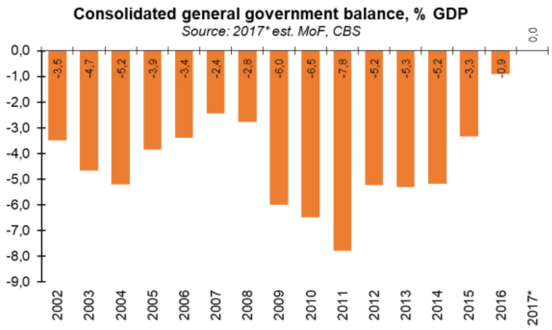


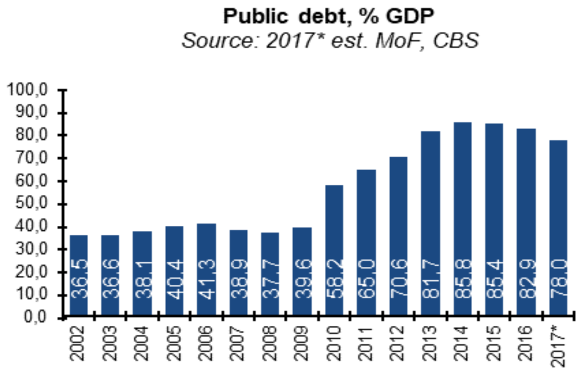
After three consecutive deflationary years, 2017 saw a 1.2 percent growth of consumer prices on average, mainly owing to higher prices of food (particularly vegetables, which may mostly be contributed to bad weather conditions) and energy (the Brent crude oil price rose from 45 dollars per barrel in 2016 to 55 dollars per barrel in 2017, i.e. approximately 22 percent yoy). A significant contribution to the growth of consumer prices in 2017 came also from higher prices in Restaurants and Hotels, which was affected by the increase in VAT rate, while the largest negative contribution came from lower prices in the category of Housing, due to a lower VAT rate on the supply of electricity, and a lower price of gas for households.

According to the estimate of the Ministry of Finance, positive economic movements and a successful control of the expenditure side of the budget led in 2017 to the balance of the general government budget and a rapid reduction in the public debt level (to around 78 percent GDP). The continuation of a fiscal adjustment enabled exiting from the Excessive Deficit Procedure in mid-2017 and the Fitch Agency's raising of credit rating by one level at the beginning of 2018 (from BB to BB+).

Macroeconomic developments in Croatia in 2017 (continued)

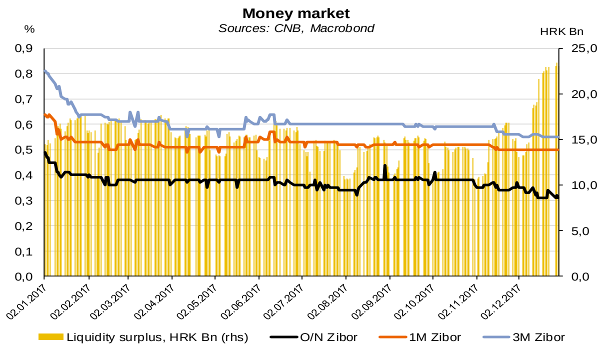
2017 in review (continued)

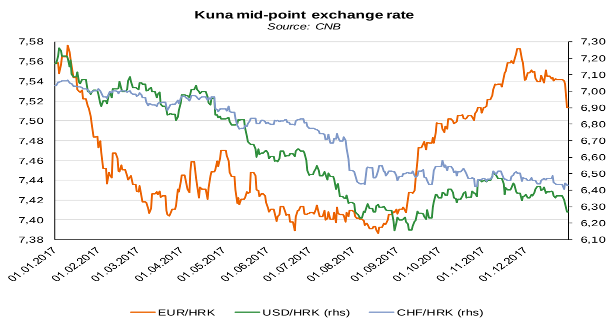




Deposit growth and modest credit activity amid the accommodative monetary policy supported by abundant FX transactions of the central bank brought about a strong rise in domestic financial sector liquidity in 2017 and a consequential further drop in the money market interest rates. The average excess liquidity doubled versus the year before, moving around 15 billion kuna, and then reached the high 23.1 billion kuna at the end of the year. The overnight Zibor fell to 0.4 percent on average, -10 b.p. yoy (year-end: 0.3 percent, -20 b.p.), 1M to 0.5 percent, -20 b.p. yoy (year-end: 0,5 percent, -20 b.p.), 3M to 0.6 percent, -30 b.p. yoy (year-end: 0.6 percent, -30 b.p.), and 12M to 0.8 percent, -50 b.p. yoy (year-end: 0.7 percent, -50 b.p.). Therefore, interest rates on T-bills decreased as well, from 0.30 percent at the end of 2016 to 0.25 percent at the end of 2017 on six-month kuna T-bills, from 0.65 percent to 0.14 percent on one-year kuna T-bills and from 0.05 percent to 0.01 percent on one-year kuna T-bills with a currency clause. The central bank has continued to hold regular reverse repo operations where it placed short-term lendings at the interest rate of 0.3 percent, however, demand was weak due to ample liquidity. In September, CNB adopted a decision, according to which banks may use the pool of eligible assets as collateral for all credit operations of CNB, thereby extending the scope of securities used as collateral, thus enabling banks to manage the pool of eligible assets. Regardless of these advantages and the fact that the maturity of structural operations has been extended from four to five years and the fixed interest rate lowered by 20 b.p. to 1.2 percent, amid generous liquidity, only one structural repo operation was held, in November, where barely 530 million kuna was injected to the banks.

The exchange rate of the kuna against the euro in 2017 was under the influence of greater FX inflows from exports of goods, an exceptionally successful tourism season and growing inflow of funds from the European Union, also, a record high net foreign position of banks and improved fiscal position. Driven by stronger appreciation pressures, the central bank conducted FX interventions through which 0.9 billion euro was purchased from banks in 2017, whereas from the beginning of the year to half-December, CNB purchased a total net worth of 1.6 billion euro through FX transactions with banks and the Ministry of Finance, thus creating 12.0 billion kuna. The exchange rate of the kuna against the euro dropped to an average of 7.46 kuna to the euro in 2017 (2016: 7.53), down by 0.9 percent yoy. The kuna against the US dollar and the Swiss franc strengthened by an average of 2.7 percent, therefore the exchange rate decreased to 6.62 kuna to the dollar, i.e. 6.72 kuna to the franc (2016: 6.80 kuna to the dollar, 6.91 kuna to the franc).





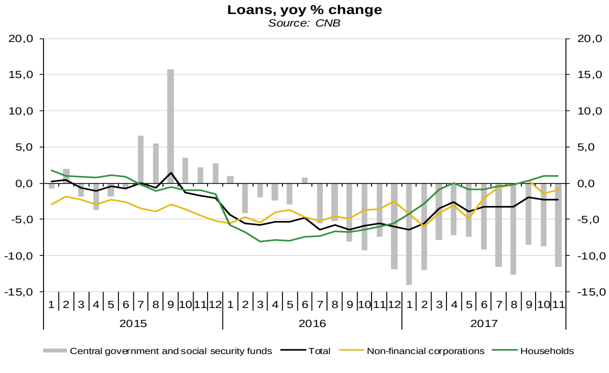
In 2017, the banking sector was characterised by a fall in assets due to a further credit portfolio clean-up, gradual recovery of private sector demand followed by a strong decline in the central government debt to banks, moderate deposit growth rates and deleveraging of banks abroad.

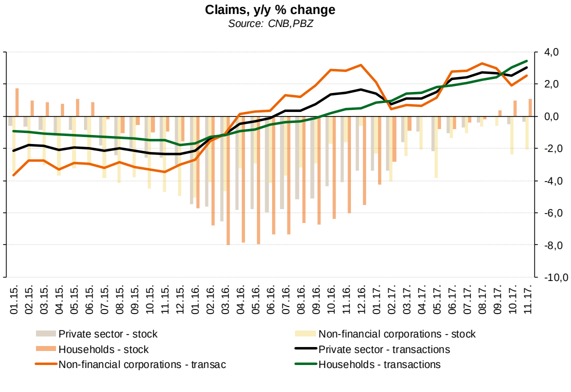
Macroeconomic developments in Croatia in 2017 (continued)

2017 in review (continued)

The total assets of other MFIs decreased by 1.1 percent at the end of November yoy, where total claims were down by 1.9 percent. A decrease in claims is mostly a result of a drop in loans, which were 2.3 percent lower at the end of November, mostly due to a 11.6 percent drop in loans to the central government and the social security funds, which is a result of the recovery of the country's fiscal position due to the growth of economic activity and refinancing at lower interest rates. In 2017, loans to the private sector continued their negative or slightly positive rates, increasing by 0.2 percent at the end of November, due to a rise in loans to households of 1.1 percent yoy, while corporate loan movements were volatile, under the impact of the sale and crisis in Agrokor, therefore the mentioned loans recorded a 1.0 percent lower level yoy at the end of November. Housing loans, after a continuous drop from October 2015 throughout October 2017, recorded a yoy growth of 0.9 percent in November. Owing to high volumes of sold claims, data on the credit portfolio movements have not given much optimism, however, data on transactions have indicated substantially more favourable trends, specifically, the acceleration of the private sector demand, from +1.6 percent yoy at the end of 2016 to +3.0 percent in November 2017. The currency structure of loans shows a continuation of higher inclination of both citizens and corporations to kuna loans, leading to an increase in the share of kuna loans in total loans from 35 percent recorded at the end of 2016 to 38 percent in November 2017. Banks responded to the growing private sector demand by lowering interest rates, so the comparison with 2016 shows that the average interest rate on kuna loans to households and non-financial corporations declined over the first eleven months of 2017 by 30 b.p. to 7.0 percent, while for kuna loans with a currency clause by 90 b.p. to 4.3 percent. The increase in deposits in 2017 was moderate, in the range 2-3 percent (2.6 percent in November), where the strengthening of economic activity and particularly higher FX inflows brought about to a robust growth in deposits of non-financial corporations (7.7 percent yoy). The growth of household deposits was limited by low interest rates, kuna appreciation and the outflow of euro savings from banks into investment funds and other types of investments with higher yields, therefore the yoy growth rate in November amounted to the low 1.0 percent. The average interest rate on term-deposits of households and non-financial corporations over the first eleven months of 2017 decreased by 40 b.p. versus the average of 2016, moving around 0.4 percent for FX and 0.8 percent on kuna savings.

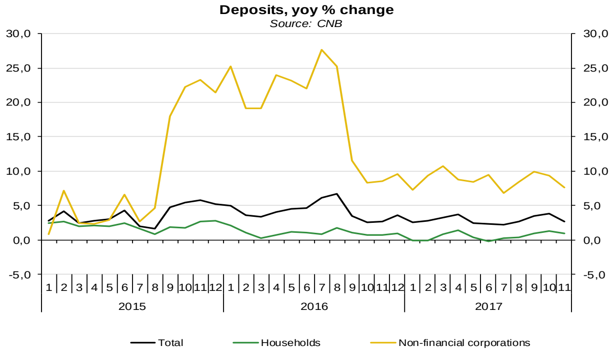
The positive trend of improvement in the credit portfolio quality continued over the first nine months of 2017, owing to the sale of claims in the gross amount of 5.3 billion kuna (citizens 1.3 billion kuna, non-financial corporations 3.9 billion kuna), growth of new loans and economic recovery and, by a lesser part, due to introduction of tax relief in terms of partial recognising of write-off as tax deductible expenditure. At the end of September of 2017, the share of partly recoverable and fully irrecoverable loans in total loans amounted to 12.5 percent, down by 1.3 p.p. versus December 2016, where the share of loans to households decreased to 8.8 percent (-1.6 p.p.), while the share of loans to non-financial corporations to 25.9 percent (-2.4 p.p.). Breaking down loans to households by purpose shows that the share of housing loans dropped by 1,.7 p.p. to 6.5 percent, of cash loans by 1.2 p.p. to 6.3 percent, of overdrafts by 3.5 p.p. to 6.5 percent, and of other loans by 0.3 p.p. to 33.4 percent. The largest contribution to the reduction in the share of non-performing loans in the loans to non-financial corporations came from the construction activity which decreased by 2.7 p.p. to a still extremely high 63.0 percent, followed by trade with a decrease of 2.9 p.p. to 25.5 percent. The share of manufacturing dropped by 2.2 p.p. to 22.9 percent, and of accommodation and food service activities by 2.5 p.p. to 13.1 percent, while in the category of other activities (Agrokor holding) the share rose by 10.4 p.p. to 20.3 percent. The total capital ratio of credit institutions fell moderately, from 22.9 percent recorded at the end of 2016 to 22.7 percent in September 2017.

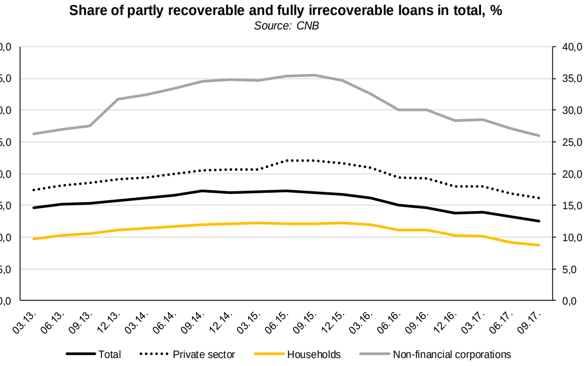


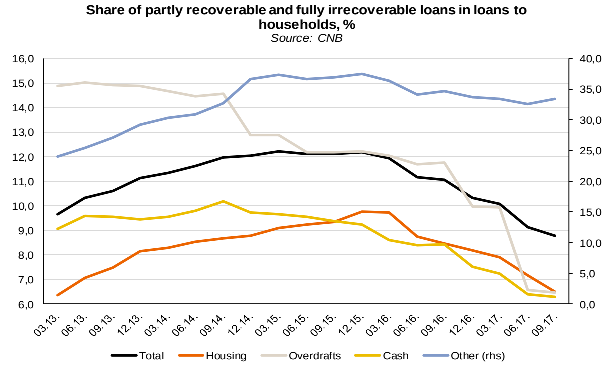


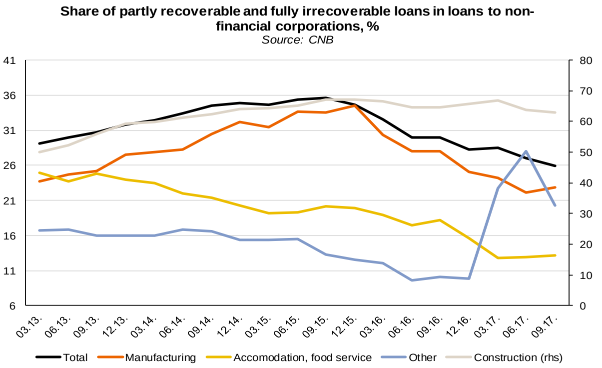
Macroeconomic developments in Croatia in 2017 (continued)

2017 in review (continued)









Global economic growth accelerated in 2017 and, according to the projections of the International Monetary Fund (World Economic Outlook, October 2017), might amount to 3,6 percent, while in 2016 it amounted to 3.2 percent. The growth in developed countries in 2017 is expected to have speeded up to 2.2 percent (versus 1.7 percent in 2016), where a rapid growth in the euro area countries (to 2.1 percent in 2017) is particularly noticeable, while a simultaneous growth in developing economies and emerging markets has accelerated to the strong 4.6 percent (4.3 percent in 2016).

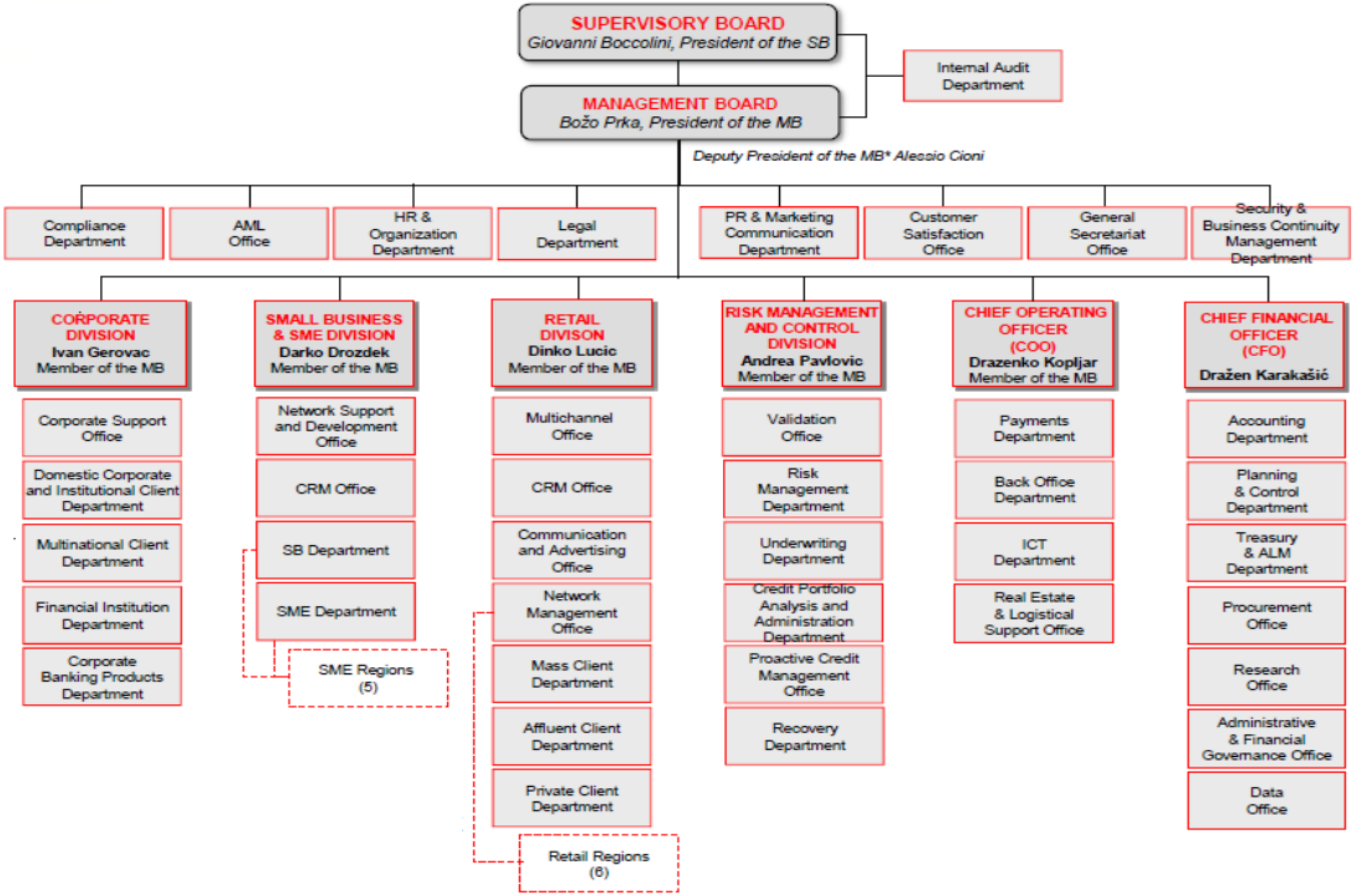
In 2017, financial markets were characterised by a further normalisation of the US monetary policy and the signals of the European Central Bank (ECB) announcing gradual reduction in quantitative easing. In fact, after the US Fed raised its interest rate by 25 b.p. in late 2016 (to 0.50-0.75 percent), there were three more corrections of interest rates in 2017, specifically in March, June and December when the interest rate in the range 1.25-1.50 percent was defined, while a further three corrections are expected in 2018. Simultaneously, in 2017 ECB moved towards a gradual decrease in the quantitative easing scope, keeping the key interest rate at 0.0 percent but also reducing the asset purchase programme from April to the end of December 2017 to 60 billion euro per month (80 billion by that time), but also from January to the end of September 2018 (or longer if necessary) to 30 billion euro.

In 2017, the currency markets saw the strengthening of the euro against the US dollar, therefore, the exchange rate jumped from 1.03 dollar at the beginning of the year to 1.20 dollar (+17 percent) in August, remaining at around 1.17 dollar to the euro by the end of the year, while in the upcoming period, in accordance with normalisation of the euro area monetary policy, its further gradual strengthening is expected.

The financing conditions for the emerging markets in Europe, including Croatia, have improved substantially over the year, which may be seen from a strong decline in the risk premium. The economic movements in Croatia's major foreign trade partners were exceptionally favourable in 2017 and all the countries recorded a rapid economic growth versus 2016.

Business description of the Bank

Organisational chart



Business description of the Bank (continued)

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 2017, PBZ is the second bank in terms of total assets in Croatia and the fifth bank in terms of subscribed share capital. PBZ is also one of the largest Fixed Income and Foreign Exchange dealers in Croatia as well as a leading player on the domestic syndicated loan market. With an outstanding reputation for innovative financial solutions, the Bank has been consistently recognised as the leading Arranger of equity, debt and commercial papers issues in the Republic of Croatia. The Bank is strongly focused on customer satisfaction and a high quality customer experience. Aware of its role and influence on society, PBZ's corporate values integrated in daily operations include not only business success, but also care for people, the sustainable development of its business and the overall improvement of quality of life in the community where it operates. 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, 2015 and 2016. During 2006 PBZ received The Best Debt House in Croatia award by Euromoney. In 2012 PBZ won award for the Best Private Banking Survey in Croatia. PBZ also received The Banker's Award for the Croatian Bank of the Year in 2005, 2011 and 2017. Additionally, PBZ's quality was confirmed by Global Finance's magazine in years from 2003 to 2011 and 2017 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 years from 2003 to 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, 2010 and 2017 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 3,675 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 740 ATMs). PBZ is expanding the ATM network and generating new revenue in cooperation with Croatian and foreign companies with an independent ATM network. Together with the partners, the ATM network should grow by several hundred ATMs. The number of EFT POS's (point of sale) has reached 33,416.

As a leader in modern technologies, PBZ has expanded its distribution channels and products using the most advanced technology in implementing its services of PBZ digital banking. The latest digital trends are part of the clients' daily routines, and PBZ wants the clients to have such an experience when doing business with the Bank. Therefore, it has developed a unique PBZ digital banking service, which is the concept of a new PBZ Internet and mobile banking with new functionalities with the option to personalize the app according to the needs and wishes of the clients. The new interface provides unique user experience and functionalities, regardless of which device or app the clients are using (computer, tablet or mobile phone). In the new service, the clients have a graphic representation of their assets with the option to manage them according to their own preferences.

With the improvement of existing functionalities, numerous new options and functionalities are available, such as app login using fingerprints or face identification, quick overview of the balance without logging into the app, new daily savings concept, new payment concept between the service users using a mobile phone number, new mobile token integrated into the mobile banking app that provides easier access to Internet banking, the option to receive automated notifications to the mobile device on account and product changes according to the user's selection, contractual documentation and confirmations of completed transactions all in one place, the option to transfer funds between user accounts without additional authorization, defining their favourite recipients and transfers of small amounts without additional authorization, an advanced electronic signature that allows a user to complete all banking transactions without having to go to the PBZ branch office, the option that allows payment to other PBZ users without entering IBAN, Scan and Pay – the option to pay payment slips which may or may not have a 2D bar code.

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. PBZ has also introduced 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 one of the market leaders in retail loans with 21.4 percent share in the loan market on the Group level. In the area of savings, the PBZ Group has significantly increased its deposits, keeping 21.1 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.

Business description of the Bank (continued)

Retail Division (continued)

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.

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.

Business description of the Bank (continued)

Retail Division (continued)

Private Client Department

The "Private" Client Department is responsible for defining and implementing business and commercials 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.

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 it 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: 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 concerned 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, various models of deposit transactions, granting all types and forms of short-term and long-term financing, including loans from external sources, club loans and syndicated loans, purchase of receivables, project financing, factoring, letters of guarantees, letters of credit, cash handling services (organization, collection and transportation of cash, cash pooling), as well as services in card operations, leasing, investments in funds, 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.

Business description of the Bank (continued)

Corporate Division (continued)

Multinational Client Department

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

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, 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.

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.

Business description of the Bank (continued)

Corporate Division (continued)

Financial Institutions Department (continued)

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 supranationals, 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.

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 Depositary 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.

Business description of the Bank (continued)

Corporate Division (continued)

Corporate Banking Products Department (continued)

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.

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).

Business description of the Bank (continued)

Corporate Division (continued)

Corporate Banking Products Department (continued)

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.

Corporate Support Office

The task of this organizational unit is to provide support to sales organization units within Corporate Division in the area of project activities, applications development, business analysis and preparation of reports and information for internal and external users, preparation of business plans and monitoring of their realization, providing professional and expert support to sales employees.

Business description of the Bank (continued)

Small Business & SME Division

In 2006, as one of the leading corporate banks, Privredna banka Zagreb d.d. founded Small Business and SME Division (SME Group) with strong emphasis on small and medium businesses. SME Group was organized into four business functions at the Bank’s central office (SB Department, SME Department, Network Support and Development Office, and CRM Office) and a business network.

To develop strong business relationships with the clients, SME Group has a large business network for work in five regions, 16 Business Centres and 50 Sinergo desks with approximately 260 employees.

The Group is focused on the development of new products and the improvement of existing ones, implementation of innovative business applications, process optimization and organization, and enabling more efficient services for over 60,000 clients – joint stock companies, trades and companies.

Clients can use the largest network of Branch Offices, ATMs (Cash-In/Cash-Out), day-night vaults and POS terminals.

PBZ leads in technology, and that has been reaffirmed with the launch of Online Loans, the first product of its kind on our market in the SB segment. It is a type of a loan which is approved and contracted extremely fast through an online procedure. This is the first type of loan with a digital signature which protects document content with prominent security and court validity. We believe that digital signatures will replace physical signatures and that they will undoubtedly be used daily in the near banking future.

This is one of the main reasons why there is continuous work on Internet and mobile banking progress and safety, as well as connected services available under PBZCOM@NET, mPBZ, eplaće (e-salaries). The biggest indicator of PBZ's quality service is the increasing number of users, as well as the more frequent use of direct distribution channels. The use of VISA Electron debit cards linked to transaction accounts, American Express business cards and the largest EFT POS terminals network is available with the support of PBZ CARD as a PBZ Group member.

In cooperation with local and EU partners (HBOR, HAMAG, EIB, EBRD and EIF), we provide small and medium businesses easier access to financing based on developed business models and long-term development loans for financing production, export and other development projects.

The SME Group consists out of four business offices: SB Department, SME Department, Network Support and Development Office, and CRM Office.

SB Department & SME Department

SB Department & SME Department are primarily responsible for the organization, portfolio management and sales monitoring, coordination and sales support, service model improvement, processes and products.

Network Support and Development Office

Network Support and Development Office is responsible for providing support to the SME network, development and maintenance of business applications and processes, support for the development of new products and services that are developed together with other business functions and IT, and help for SME customers who use Bank products and services. To perform the tasks properly, Network Support and Development Office has a sub-office: Customer Call Centre.

CRM Office

CRM Office oversees establishing, developing and monitoring business relationships with SME clients. It is also responsible for the business definition of product and distribution channels, revenue tracking, cost and profitability of clients and business centres, planning and calculating key business performance indicators and employee reward system. CRM’s role is defining business segments and managing all types of marketing campaigns by using the Customer Relationship Management and DWH tools through available media and communication channels of the Bank.

SME Regions

SME Group is organized into 5 regional centres: Zagreb, Central Croatia, Dalmatia, Istria-Rijeka-Lika and Slavonia, where 16 Business Centres and 50 Sinergo Desks.

The activities and responsibilities of centres and desks are the sale of products and services to SME clients (crediting, issuing of guarantees, letters of credit, factoring, deposit collection, payment transactions and other services), providing financial advice to clients and coordination with other organizational parts 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 ensures the fulfillment of all relevant regulatory constraints and provides transaction execution services in the relevant financial markets for customers and sales functions;

- the **Administrative & Financial Governance Office** assists the Bank's CFO in the set-up, implementation and application of the Administrative and Financial Governance Model in line with the Group standards and regulations, reviews and assesses adequacy and effectiveness of the administrative and accounting procedures, as well as of the internal controls system on financial information through identification and evaluation of those processes that affect financial reporting and the relevant risks and controls. Furthermore, it reports to the Parent Company about the execution and the outcomes of the testing program, identified weaknesses and implementation of the related remedial actions;

- 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. Furthermore, this function analyses trends of specific credit indicators aiming at identifying retail products/client sub-portfolios showing increase of risk and in collaboration with the relevant functions defines proper corrective actions

- 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;

Business description of the Bank (continued)

Logistics areas (continued)

- 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.

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)

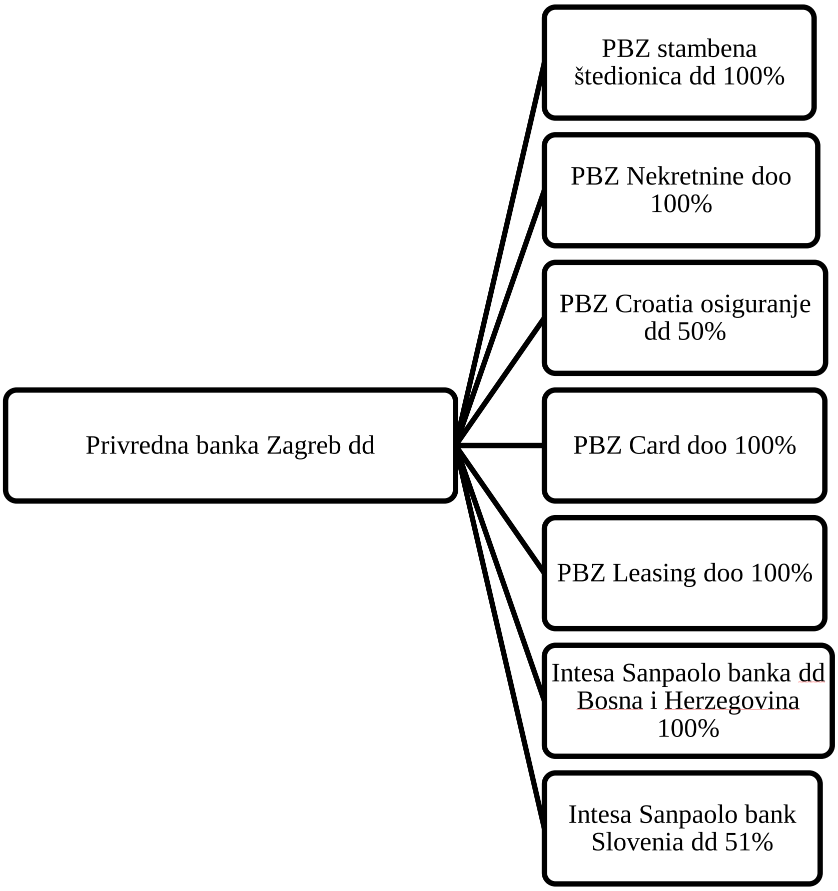
- the **Customer Satisfaction Office** is responsible for measuring and monitoring customer satisfaction, continuously proposing, implementing and managing action plans and initiatives aimed at strengthening satisfaction and loyalty of Bank's customers through improving existing and implementing new 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 Bosna and Herzegovina in 2015 and Banka Intesa Sanpaolo dd Slovenia in July 2017 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, Bosna and Herzegovina and Slovenia. At the end of 2017 the Group employs some 5,355 employees and serves over 2.0 million both private and corporate clients in the three countries. PBZ Group is a well-organised institution whose market share in the overall banking system stands at 18.9 percent in Croatia (data from October 2017), 9.4 percent in Bosna and Herzegovina and 6.3 percent in Slovenia.

On 31 December 2017 the Group consisted of Privredna banka Zagreb dd and 6 subsidiaries and one associate (31 December 2016: 5 subsidiaries and one associate).

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 doing business with charge and credit cards of the citizens and legal entities, including business with merchants, which implies signing agreements with merchants for the purpose of card acceptance. The Company also offers a complete range of travel services. In the assortment of the company there are about forty American Express and Visa, Visa Electron, Mastercard and Maestro products of Privredna banka Zagreb, including a rich choice of charge, debit, debit delayed, credit, pre-paid and other cards intended for natural and legal persons. The success of PBZ Card is based on the rich knowledge and experience built for more than forty-five years of presence of American Express on the Croatian market, leading position of the American Express brand on charge and revolving credit cards market in Croatia, Visa and Mastercard brand values and a strong position, which was built by Privredna banka Zagreb as the leading bank in the introduction of new technologies and products in card business.

At the end of the last year, taking into account the number of cards, PBZ Group held 27 percent of the total Croatian active cards market, including the leading position on the credit cards market with a share of 33.3 percent. The total turnover of the cardholders per American Express, Visa and Mastercard of PBZ Group in 2017 accounted for 28.75 percent of the total turnover of Croatian card products market made in the first three quarters of the last year. In the same year, PBZ Card maintained its leading position on the total number of EFT POS terminals, in relation to which it holds 27.3 percent of the market.

Business description of the Group (continued)

PBZ Card (continued)

The Company has maintained and additional strengthened its leading position on the domestic card market during 2017, by offering top-quality products and services to its customers and business partners. The year was marked by the enhancements of certain products and services, as well as numerous activities of encouraging and rewarding the consumption of existing users as well as attracting new users through specially designed marketing and sales activities, such as award-winning contests and competitions, exemption from subscription and membership fees, special events, savings programs for card holders, discounts and gifts etc., which included various products of all three card brands: American Express, Visa and Mastercard. Numerous marketing and promotional activities, organised in cooperation with prominent business partners – points of sale, are supported by optimizing the utilisation of communication channels, both internal and external, with a special emphasis on digital communication channels.

PBZ Card's travel services, including high-quality travel services integrated with the services and numerous advantages of card business, resulted with a great success also tin the last year, especially in the segment of foreign language courses, cruises and long-distance journeys, and have been recertified pursuant to ISO 9001: 2015 standards, thus confirming the consistency and continuity of the quality of these services in line with the highest international standards.

The year was also marked by strengthening the segment of innovative contactless forms of payment, including contactless Visa and American Express cards and PBZ Wave2Pay – a contactless mobile payment service, based on the modern technology of contactless mobile payment – Host Card Emulation (HCE) technology for NFC (Near-Field Communication) mobile payments on the POS devices of the PBZ Group for American and Visa Inspire card holders.

The activities related to the segment of contactless payments during 2017 included an increase in number of its users, planned marketing activities, and strengthening consumers' awareness of the benefits and importance of contactless, mobile payment including simpler, faster and safer payments. Also during the year, in cooperation with business partners, there was a continuous increase in the number of points of sale allowing a contactless payment. At the end of the year, contactless payment services were available at approximately 29,000 POS terminals, i.e. 22,300 points of sale in the Republic of Croatia, which makes 87 percent of PBZ Group's POS network, the largest POS devices network in the country.

During the year, the intensive activities on the migration project from the existing CMS system (back office support for card business) extended to a new EXACT platform, which aims to standardise information resources, unify an existing infrastructure, make technological improvements, standardise card portfolio and functionalities and achieve certain savings.

The so-called unattended terminals, which were released in 2016 and allow customers to pay their goods and services by means of unattended cards and the presence of retailers, recorded success also in the year 2017. These terminals enable contactless and contactless payment by means of the cards with the highest security standards, and are well accepted especially for payment on self-service kiosks, parking lots, purchase of public transport tickets, fuelling at gas stations, etc., including various segments within Croatian market.

In 2017, further adjustments were made to regulatory changes related to the entry into force of the Regulation of the European Parliament and the Council on inter-bank charges for card-based transactions.

In the past year, a number of activities has been carried out to strengthen the reputation of PBZ Card as a socially responsible company, through the promotion of important cultural, artistic, sports and other institutions and events in the community in which it operates. The intensive work continued, as well as the promotion of the humanitarian project launched by PBZ and PBZ Card under the name "Do Good Deeds Every Day" and the American Express card with heart, supporting two important projects for the benefit of children and youth in Croatia: "Monitoring of Children Exposed to Neurological risks" launched by the Ministry of Health and "For Better Life of Children Living in Social Welfare Institutions" launched by the Ministry of Demography, Family, Youth and Social Policy, by donating one HRK per each transaction paid with this card for these two projects, in 50:50 ratio. This long-term and continuous project to assist the community in which the Company operates achieved exceptional results also in 2017. Thus, since 2008, when the project was launched, by the end of last year, a total of about HRK 11.7 million was collected, including the three million HRK collected only in 2017, which is the highest amount ever collected annually. By the end of last year, 32 donations have been granted, including 24 donations to hospitals throughout Croatia for the purchase of medical devices and eight donations to social welfare institutions for the purchase of the necessary equipment. During the year 2017, five significant new donations were granted within this project: Donations to the Training and Education Centre Dubrava, Clinical Hospital Centre Zagreb, General Hospital Zadar, General and War Veterans Hospital "Hrvatski ponos" Knin and Lipik Community Service Centre.

Business description of the Group (continued)

PBZ Stambena Štedionica

PBZ Stambena Štedionica is a member of the PBZ Group and in the 100 percent 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 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 105,000 active housing savings accounts and deposits amounting to HRK 1.53 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 283 million.

By the end of 2017, PBZ Leasing made over 5.9 thousand (2016.: 4.9 thousand) active lease arrangements with customers, which in financial terms reached HRK 938 million (2016; 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), seven 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 50 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, that during 2017 became 100 percent owner of the Bank.

As of September 2017, Intesa Sanpaolo Banka dd BiH is the 5th bank in Bosnia and Herzegovina by Total Assets, present in the country with 44 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 9.4 percent in Total Assets and 10.0 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 5.7 billion gross disbursement of loans during 2017.

Intesa Sanpaolo Bank Slovenia

Intesa Sanpaolo Bank, formerly known as Banka Koper, was founded in 1955 and is the 7th largest commercial bank in Slovenia in terms of total assets, and 6th largest bank in terms of loans and deposits. The bank operates through a network of 52 branch offices located in the major Slovenian cities throughout the country.

After more than 15 years of being part of the international banking group Intesa Sanpaolo, Banka Koper changed its name to Intesa Sanpaolo Bank. The adoption of the Group's name is part of a carefully prepared strategy to revamp the Group's operations in Slovenia by targeting new business areas in retail, wealth management and corporate finance.

Along with having the highest credit rating among Slovenian commercial banks, Intesa Sanpaolo Bank is also well-known as the most technologically advanced bank in the payment card business, and online and mobile banking. It provides solutions designed to respond to changes in consumer needs and behavior with high quality bank services in all key segments at the international level.

In July 2017, the Bank's 51 percent shareholding was obtained by former sister company Privredna Banka Zagreb dd, within the framework of an equity investments portfolio reorganization undertaken by the parent group.

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 2017.

At this point, pension funds under management have nearly 341 thousand members and net assets in personal accounts exceeding HRK 15.2 billion, which represents a sound base for the long-term stable and profitable operation of the company.

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 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 past year a regular Annual General Meeting was held on 27 March 2017, while an Extraordinary General Meeting was held on 29 November 2017.

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 Boccolini, President of the Supervisory Board, Intesa Sanpaolo – term of office from 1 April 2017

Draginja Đurić, Deputy President of the Supervisory Board, Banka Intesa ad Beograd – new term of office from 31 March 2017

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

Adriano Arietti, Member of the Supervisory Board, independent – term of office from 22 February 2017

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

Giulio Moreno, Member of the Supervisory Board, independent – term of office from 29 November 2017

Membership that ended in 2017:

Giovanni Gilli, President of the Supervisory Board– until 31 March 2017 (end of term)

Fabrizio Centrone, Member of the Supervisory Board – until 31 August 2017 (resignation)

Audit Committee

Pursuant to the Articles of Association of Privredna banka Zagreb d.d., the Supervisory Board established the Audit Committee at its 15th 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, one of which was also members of the Supervisory Board of the Bank. During 2017 six 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 2017 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

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

Gianluca Tiani, Member of the Audit Committee –term of office from 13 October 2017

Memberships that ended in 2017:

Fabrizio Centrone, Member of the Audit Committee –until 31 August 2017 (resignation)

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, and which mandate lasts for the duration of their term on 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 2017 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

Giovanni Boccolini, Committee President – term of office until 1 April 2020

Adriano Arietti, Member **–** term of office until 22 February 2020

Branko Jeren, Member **–** term of office until 21 April 2019

Memberships that ended in 2017:

Fabrizio Centrone, President – term of office until 31 August 2017

Giovanni Gilli, Member **–** term of office until 31 March 2017

Nomination Committee

Giovanni Boccolini , Committee President – term of office until 1 April 2020

Draginja Đurić, Member – new term of office until 1 April 2020

Branko Jeren, Member – new term of office from 21 April 2019

Memberships that ended in 2017:

Giovanni Gilli, President – term of office until 31 March 2017

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

Supervisory Board (continued)

Risk Committee

Paolo Sarcinelli, President – new term of office until 30 March 2019

Christophe Velle, Member – new term of office from 17 October 2019

Adriano Arietti, Member – new term of office from 22 February 2020

Memberships that ended in 2017:

Fabrizio Centrone, Member – term of office until 31 August 2017

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 of the Bank as at 31 December 2017 were 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.

Alessio Cioni, 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 Financial Operations Office under the authority of the Chief Financial Officer, and coordination of subsidiary banks in accordance with the Subsidiary Bank Coordination Committee, a term of office from 13 September 2017.

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.

Memberships that ended in 2017:

Gabriele Pace, Deputy President of the Management Board, term until 31 August 2017 (transferred to new function within ISP Group)

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 founded are:

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

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

- *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* – giving approval for the project set-up or, for the large projects, propose to the Bank's Management Board launching or withdrawing of project launching, supervision of the project portfolio realisation and project management quality, quarterly revision of project priorities, preparation of the Master plan for the next period.
- *Coordination of Internal Controls Committee* – is a permanent consulting body which acts within the rights and area determined by the Management Board of the Bank with the aim to strengthen the coordination and cooperation of the Bank's controlling functions in order to facilitate the integration of risk management processes.
- *Subsidiary Bank Coordination Committee* – is a permanent body responsible for reaching decisions and counseling with the mission to define the operating strategy for the coordinated development of subsidiary banks of the Bank while ensuring the effective implementation of ISP Group and PBZ Group initiatives, sharing of best practices, and the application of strong management and the optimization of resource allocation.

  Discontinued in 2017:
- *Supervision of Real-Estate Committee*

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

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 3 April 2017 (Official Gazette 30/17)
- 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
- Office for Administrative and Financial Governance 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
- Internal Controls Coordination Committee established to strengthen the coordination and the cooperation among the various Bank's control functions, facilitating the integration of risk management process
- 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
▪ Credit risk ▪ Liqudity risk ▪ Operational risk ▪ Interest rate risk	▪ Strategic risk ▪ Reputational risk ▪ Outsourcing risk	▪ Market risk ▪ Equity risk in banking book ▪ Real estate risk ▪ Risk of excessive financial leverage

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 therefore the credit risk represents the most significant risk for 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 2017, 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 2018, Bank will continue to treat liquidity risk as highly important, with ongoing focus on ensuring continuously sufficient level of liquidity and constant alignment with regulatory requirements and other valid regulations. Moreover, adequate focus is 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 and management, due to changes in customers' risk taking preferences and therewith related changes in interest rate risk exposure, management of interest rate risk was under specific focus. Namely, in last period recorded is change is risk taking preferences of clients and increased demand for loans with fixed interest rates which impacts interest rate risk exposure of the Bank. Although Bank timely recognized above explained changes and relevant functions continuously monitored the changes in risk profile and those changes were timely and adequately included in decision making process, 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[1] is of strategic importance of the Bank, significance of this risk is considered **as low**.

[1] 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 2017* (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 organizational structure of the Bank and ensures good functioning of all organizational 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 Policy on the Structure of 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 of the Bank 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), the Member of the Management Board of the Bank appointed in 2017 meets all the prescribed criteria from the perspective of the knowledge, expertise, experience, skills, and competences so that the Management Board as a whole has access the necessary competencies and expertise.

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 seven members, 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 Policy on the Structure of the Supervisory Board of the Bank.

As regards the Supervisory Board of the Bank, the Policy on the Structure 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 1/7 of Supervisory Board members represent the underrepresented gender – women).

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 2017 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 authorized 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 authorized 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. **Has the company accepted implementation of the code of corporate governance of the Zagreb Stock Exchange?**
   Yes.

2. **Does the Company have its own code of corporate governance?**
   No.

3. **Have any principles of the code of corporate governance been adopted as part of the company's internal policies?**
   Yes.

4. **Does the Company disclose harmonization with the principles of corporate governance in its annual financial statements?**
   Yes.

SHAREHOLDERS AND GENERAL MEETING

5. **Is the company in a cross-shareholding relationship with another company or other companies? (If yes, 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. 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 Associaton.

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 AS AT 31 DECEMBER 2017

Božo Prka, President;

Alessio Cioni, 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 Boccolini, President;

Draginja Đurić, Deputy President;

Paolo Sarcinelli, Member;

Christophe Velle, Member;

Branko Jeren, Member;

Adriano Arietti, Member:

Giulio Moreno, Member.

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. **Does the company have any independent members on its Supervisory or Management Board? (If not, explain)**
    Yes.

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 management or each executive director received from the company or from other persons related to the company, including the structure of such remuneration, been made public (in annual financial statements)? (If not, explain)**
Yes. 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. **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 (in annual financial statements)? (If not, explain)**
Yes. Data on all remunerations to the Supervisory Board members are published in the decisions of the General Meeting.

27. **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 promptly and no later than three business days, after such a change occurs? (If not, explain)**
Yes. During 2017, there was no change (increase/decrease) the number of shares held by Management Board members. The Supervisory Board members haven't Bank's shares.

28. **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.

29. **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.).

30. **Did they obtain prior approval of the Supervisory or Management Board? (If not, explain)**
Yes, to the extent where such prior approval was needed in accordance with applicable regulations and/or internal acts of the Bank.

31. **Are important elements of all such contracts or agreements included in the annual report? (If not, explain)**
Yes, to the extent required.

32. **Did the Supervisory or Management Board establish the appointment committee?**
Yes.

33. **Did the Supervisory or Management Board establish the remuneration committee?**
Yes.

34. **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)

35. **Was the majority of the audit committee members selected from the group of independent members of the Supervisory Board? (If not, explain)**
No. Under the current law there was no such obligation, the composition of the Audit Committee would be in line with the provisions of the new Audit Act effective from January 1, 2018.

36. **Did the audit 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.

37. **Did the audit 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.

38. **Has the audit 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.

39. **If there is no internal audit system in the company, did the audit committee consider the need to establish it? (If not, explain)**
No, since internal audit function is established.

40. **Did the audit 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.

41. **Did the audit 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.

42. **Did the audit 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.

43. **Did the audit 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.

44. **Was the documentation relevant for the work of the Supervisory Board submitted to all members on time? (If not, explain)**
Yes.

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

Code of Corporate Governance – Annual questionnaire (continued)

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. 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)
No. There is no such legal obligation. A remuneration policy statement was published separately from the Annual report.

48. 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.

49. 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.

50. 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

51. **Does the company have an external auditor?**
    Yes.

52. **Is the external auditor of the company related with the company in terms of ownership or interests?**
    No.

53. **Is the external auditor of the company providing to the company, him/herself or through related persons, other services?**
    No.

54. **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.

55. **Does the company have internal auditors?**
    Yes.

56. **Does the company have an internal audit system in place? (If not, explain)**
    Yes.

TRANSPARANCY AND THE PUBLIC OF ORGANIZATION OF BUSINESS

57. **Are the semi-annual, annual and quarterly reports available to the shareholders?**
    Yes.

58. **Did the company prepare the calendar of important events?**
    Yes.

59. **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.

60. **Did the company establish mechanisms to ensure supervision of the flow of inside information and possible abuse thereof?**
    Yes.

61. **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 yes, explain)**
    No.

62. **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.

63. **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 the 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, from March 2017 (Official Gazette 30/2017).

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 65 to 226 and other information on pages 3 to 56 and 227 to 255 have been approved by the Management Board on 15 February 2018 as confirmed by the signatures below.

For and on behalf of Privredna banka Zagreb dd

Dinko Lucić,
President of the Management Board

Alessio Cioni
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*

Ivan Krolo, *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 Financial Statements

Opinion

We have audited the financial statements of Privredna banka Zagreb dd ("the Bank") and its subsidiaries and associates ("the Group"), which comprise the statements of financial position of the Bank and the Group as at 31 December 2017, and the statements of comprehensive income, cash flows and changes in equity of the Bank and the Group for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

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 2017 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 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 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 financial statements of the current period. These matters were addressed in the context of our audit of the 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 2017, in the consolidated financial statements gross loans and advances to customers amount to HRK 68,940 million, related impairment allowance amounts to HRK 3,830 million and impairment loss recognised in the income statement amounts to HRK 823 million (31 December 2016: gross loans and advances: HRK 69,653 million, impairment allowance: HRK 4,223 million, impairment loss recognised in the income statement: HRK 602 million).

As at 31 December 2017, in the separate financial statements gross loans and advances to customers amount to HRK 47,367 million, impairment allowance amounts to HRK 2,632 million and impairment loss recognised in the income statement amounts to HRK 608 million (31 December 2016: gross loans and advances: HRK 48,764 million, impairment allowance: HRK 2,877 million, impairment loss recognised in the income statement: HRK 389 million).

Refer to pages 84 and 85 (Significant accounting policies), page 106 (Accounting estimates and judgements in applying accounting policies), page 128 (note 23 Loans and advances to customers), and pages 184 to 197 and 200 (credit risk section of the note 49 Financial risk management policies).

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

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters (continued)

Key audit matter	How our audit addressed the matter
Impairment allowances represent management's best estimate of the credit losses incurred within the loans and advances at the reporting date. We focused on this area as the determination of impairment allowances requires a significant amount of judgment from the management over both the timing of recognition and the amounts of any such impairment. 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. 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.	Our audit procedures in this area included, among others: • 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. • For impairment allowances that are calculated individually: - Selecting a sample of individual loans and advances, 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 watch-listed, restructured or rescheduled exposures, loans to clients operating in higher risk industries, non-performing exposures with low provision coverage and unsecured exposures. - 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 2017. - For those loans where impairment triggers were identified, challenging key assumptions applied in the Bank's estimates of future cash flows used in the impairment calculation, such as discount rates and collateral values, where relevant, with the assistance of our own valuation specialists. • For collective impairment allowance: - Testing the underlying impairment models, including model approval and validation processes and, assisted by our own 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. - Critically assessing the rationale for the changes made to the model parameters in 2017, by reference to our understanding of the business, current economic trends and market practices. • 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.

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

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters (continued)

Acquisition of Banka Intesa Sanpaolo d.d., Slovenia – common control transaction

Corresponding figures in the consolidated financial statements were re-presented to reflect acquisition of Banka Intesa Sanpaolo d.d., Slovenia, as explained below.

As at 31 December 2017, in the separate financial statements investment in Banka Intesa Sanpaolo d.d., Slovenia amounts to HRK 977 million.

Refer to page 75 (Significant accounting policies, basis of consolidation), page 99 (note 4 Restatement of comparative information), and page 136 (note 26 Investments in subsidiaries and associates).

Key audit matter	How our audit addressed the matter
As disclosed in note 4 and note 26 of the financial statements, in July 2017 the Bank acquired a 51% stake in Banka Intesa Sanpaolo d.d., Slovenia ("Investee") from a parent company, Intesa Sanpaolo S.p.A. ("Transferor") with the Bank obtaining control over the Investee. The Bank's and the Investee's ultimate owner at the time of the acquisition was Intesa Sanpaolo S.p.A. Turin, hence the transaction represented a business combination involving entities under common control. As such, it was exempt from the accounting treatment prescribed in IFRS 3 *Business Combinations*. In the absence of specific guidance, entities involved in common control transactions should select an appropriate accounting policy, to be applied consistently, using the hierarchy described in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In both the consolidated and separate financial statements, the Bank used book value accounting and also, in the consolidated financial statements, it re-presented its comparatives as if the combination had occurred before the start of the earliest period presented. This transaction was determined to be our key audit matter because of the complexity involved in developing an appropriate accounting policy taking into account all pertinent facts and circumstances.	Our audit procedures in this area included, among others: • Examining the share purchase agreement between the Bank and the Transferor in order to obtain an understanding of the transaction, including, among other things, date of the acquisition, the entity being acquired and the transaction consideration; • Assessing the reasonableness of the Group's and the Bank's accounting policies applied to this business combination under common control, including the evaluation of whether it was consistent with those applied for similar transactions in the past; • Tracing the historical carrying amounts of the Investee's assets and liabilities to the relevant corresponding historical audited financial statements of that entity; • Obtaining from the Transferor a confirmation of the carrying amount of the Investee in the pre-acquisition separate financial statements of the Transferor; • Assessing the completeness and correctness of the acquisition-related disclosures included in note 4 and note 26 of the separate and consolidated financial statements.

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

Report on the Audit of the Financial Statements *(continued)*

Other Information

Management is responsible for the other information. The other information comprises of an Introduction, Report from the President of the Supervisory Board, Management Board Report of the Status of the Bank, Management Board Report for the Group, Macroeconomic Developments in Croatia in 2017, Business Description of the Bank, Business Description of the Group and The Statement on the Implementation of Corporate Governance Code included in the Annual Report of the Bank and the Group, but does not include the Financial Statements and our Auditor's Report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia ("Accounting Act"). Those procedures include considering whether:

- the Management Report has been prepared in accordance with the requirements of Articles 21 and 24 of the Accounting Act;
- the specific information in the Corporate Governance Statement required by Article 22, paragraph 1, items 3 and 4 of the Accounting Act ("relevant sections of the Corporate Governance Statement") has been prepared in accordance with the requirements of Article 22 of the Accounting Act; and
- the Corporate Governance Statement includes the information specified in Article 22, paragraph 1, items 2, 5, 6 and 7 of the Accounting Act.

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

- the information given in the Management Report and the relevant sections of the Corporate Governance Statement for the financial year for which the financial statements are prepared, is consistent, in all material respects, with the financial statements;
- the Management Report and the relevant sections of the Corporate Governance Statement have been prepared, in all material respects, in accordance with the requirements of Articles 21, 22 and 24 of the Accounting Act, respectively;
- the Corporate Governance Statement includes the information specified in Article 22 paragraph 1, items 2, 5, 6 and 7 of the Accounting Act.

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Management Report and Corporate Governance Statement. We have nothing to report in this respect.

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

Report on the Audit of the Financial Statements *(continued)*

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of the 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 financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or the Group or to cease operations, or has no realistic alternative but to do so.

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

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 controls.

- 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 and the Group's internal controls.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- 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 and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the 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 and the Group to cease to continue as a going concern.

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

Report on the Audit of the Financial Statements *(continued)*

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the 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 financial statements of the Group. 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 controls 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 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.

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 27 March 2017 (Official Gazette 30/17), the Management Board of the Bank has prepared the schedules ("the Schedules"), which comprise an alternative presentation of the Bank and the Group financial position as at 31 December 2017, and of the income statements, statements of cash flows and statements of changes in equity of the Bank and the Group for the year then ended, and a reconciliation ("the Reconciliation") of the Schedules with the financial statements. The Schedules and the Reconciliation are presented on pages 227 to 255. 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 65 to 226 on which we have expressed an opinion as set out above.

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

Report on Other Legal and Regulatory Requirements (continued)

We were appointed by those charged with governance on 27 March 2017 to audit the financial statements of the Bank and the Group for the year ended 31 December 2017. Our total uninterrupted period of engagement is 6 years, covering the periods ending 31 December 2012 to 31 December 2017. We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 15 February 2018;
- we have not provided any prohibited non-audit services (NASs) referred to in Article 44 of the Audit Act. We also remained independent of the audited entity in conducting the audit.

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

KPMG Croatia d.o.o. za reviziju

Croatian Certified Auditors
Eurotower, 17th floor

Ivana Lučića 2a

10000 Zagreb
Croatia

15 February 2018

Goran Horvat
Director, Croatian Certified Auditor

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

Income statement

For the year ended 31 December

(in HRK million)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Interest income	6	3,500	3,686	2,748	2,908
Interest expense	6	(526)	(736)	(374)	(573)
Net interest income		**2,974**	**2,950**	**2,374**	**2,335**
Fee and commission income	7a	1,848	1,774	811	754
Fee and commission expense	7b	(347)	(334)	(126)	(120)
Net fee and commission income		**1,501**	**1,440**	**685**	**634**
Dividend income	8	6	14	445	227
Net trading income and net gains on translation of monetary assets and liabilities	9	240	230	215	213
Fair value adjustments in hedge accounting	10	(1)	1	-	-
Other operating income	11	188	589	96	430
Total operating income		**4,908**	**5,224**	**3,815**	**3,839**
Impairment losses and provisions	14a	(823)	(602)	(608)	(389)
Release recognized on CHF conversion		-	30	-	30
Other impairment losses and provisions	14b	(6)	12	(1)	24
Personnel expenses	12	(1,102)	(1,081)	(730)	(718)
Depreciation, amortisation and impairment of goodwill	15	(198)	(244)	(118)	(113)
Other operating expenses	13	(1,143)	(1,158)	(684)	(688)
Share of profits from associates	26	14	24	-	-
Profit before income tax		**1,650**	**2,205**	**1,674**	**1,985**
Income tax expense	16	(304)	(466)	(231)	(380)
Profit for the year		**1,346**	**1,739**	**1,443**	**1,605**
Attributable to:					
Equity holders of the Bank		1,331	1,660	1,443	1,605
Non-controlling interests		15	79	-	-
		1,346	**1,739**	**1,443**	**1,605**

	Notes				**in HRK**
Basic and diluted earnings per share	55	70.0	87.3	75.9	84.4

The companying accounting policies and notes on pages 74 to 226 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Profit for the year	**1,346**	**1,739**	**1,443**	**1,605**
Other comprehensive income				
Revaluation of land and buildings	*290*	-	*106*	-
Actuarial gains on defined benefit pensions plans	-	*1*	-	-
	290	**1**	**106**	**-**
Deferred tax on tangible assets (Note 16f)	(51)	-	(19)	-
Items that will not be reclassified to profit or loss	**239**	**1**	**87**	**-**
Net fair value gains on available for sale financial assets transferred to the income statement	*(37)*	*(139)*	*(15)*	*(95)*
Net change in fair value on available-for-sale financial assets	*58*	*32*	*51*	*11*
Foreign exchange differences on translation of foreign operations	*(9)*	*(29)*	-	-
	12	**(136)**	**36**	**(84)**
Deferred tax on available-for-sale financial assets (Note 16f)	(2)	19	(6)	17
Items that are or may be reclassified to profit or loss	**10**	**(117)**	**30**	**(67)**
Other comprehensive income for the year, net of tax	**249**	**(116)**	**117**	**(67)**
Total comprehensive income for the year, net of tax	**1,595**	**1,623**	**1,560**	**1,538**
Attributable to:				
Equity holders of the Bank	1,541	1,572	1,560	1,538
Non-controlling interests	54	51	-	-
	1,595	**1,623**	**1,560**	**1,538**

The accompanying accounting policies and notes on pages 74 to 226 are an integral part of these financial statements.

Statement of financial position

As at 31 December

(in HRK million)

		GROUP			BANK	
Assets	**Notes**	2017	Restated 2016	Restated 2015	2017	2016
Cash and current accounts with banks	17	18,711	14,292	11,660	15,466	12,338
Balances with the Croatian National Bank	18	4,185	3,916	4,550	4,185	3,916
Financial assets at fair value through profit or loss	19	2,213	6,104	5,972	2,210	5,975
Derivative financial assets	20a,b	22	33	5	2	19
Fair value changes of the hedged items in portfolio hedge of interest rate risk	20c	1	-	-	-	-
Loans and advances to banks	22	2,414	3,614	4,796	1,493	1,731
Loans and advances to customers	23	64,900	65,177	62,305	44,562	45,667
Financial assets available for sale	24	7,573	4,085	3,638	4,145	370
Held-to-maturity investments	25	16	17	17	-	-
Investments in subsidiaries and associates	26	69	67	150	1,962	953
Intangible assets	27	227	189	216	162	124
Property and equipment	28	1,360	1,152	1,277	621	545
Investment property	29	8	168	131	1	50
Non-current assets held for sale	30	342	-	-	90	-
Deferred tax assets	16c	125	137	162	79	88
Other assets	31	724	735	747	515	274
Tax prepayments		22	22	165	4	-
Total assets		**102,912**	**99,708**	**95,791**	**75,497**	**72,050**

The accompanying accounting policies and notes on pages 74 to 226 are an integral part of these financial statements.

Statement of financial position (continued)

As at 31 December

(in HRK million)

		GROUP			BANK	
Liabilities	**Notes**	2017	Restated 2016	Restated 2015	2017	2016
Current accounts and deposits from banks	32	1,191	1,595	1,257	1,064	1,376
Current accounts and deposits from customers	33	78,157	74,284	71,745	57,173	54,108
Derivative financial liabilities	21a,b	13	22	16	7	5
Fair value changes of the hedged items in portfolio hedge of interest rate risk	21c	9	3	-	-	-
Interest-bearing borrowings	34	3,783	4,235	5,027	2,377	2,747
Subordinated liabilities	35	1	1	2	-	-
Other liabilities	36	2,354	1,932	1,596	677	481
Accrued expenses and deferred income	37	362	319	279	165	137
Provisions	38	351	362	400	249	257
Deferred tax liabilities	16d	86	33	52	30	5
Current tax liability		6	172	11	-	165
Total liabilities		**86,313**	**82,958**	**80,385**	**61,742**	**59,281**
Equity						
Share capital	40a	1,907	1,907	1,907	1,907	1,907
Share premium	40b	1,570	1,570	1,570	1,570	1,570
Treasury shares	40c	(76)	(76)	(76)	(76)	(76)
Other reserves	40e	1,369	1,271	1,351	296	302
Fair value reserve	40f	99	81	151	49	19
Retained earnings	40g	11,910	11,127	9,643	10,009	9,047
Merger reserve	40h	(1,231)	(254)	(254)	-	-
Total equity attributable to equity holders of the Bank		**15,548**	**15,626**	**14,292**	**13,755**	**12,769**
Non-controlling interests		**1,051**	**1,124**	**1,114**	**-**	**-**
Total equity		**16,599**	**16,750**	**15,406**	**13,755**	**12,769**
Total liabilities and equity		**102,912**	**99,708**	**95,791**	**75,497**	**72,050**

The accompanying accounting policies and notes on pages 74 to 226 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

(in HRK million)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Cash flows from operating activities					
Profit before income tax		1,650	2,205	1,674	1,985
Impairment losses on loans and advances to customers	14a	823	602	608	389
Other impairment losses and provisions	14b	6	(12)	1	(24)
Release of provisions recognized on CHF conversion	23f	-	(30)	-	(30)
Gain on disposal of property and equipment and intangible assets	11	(6)	(30)	(3)	(5)
Depreciation, amortisation and impairment of goodwill	15	198	244	118	113
Net (gains)/losses from securities at fair value through profit or loss	9	(8)	(14)	(9)	(14)
Share of profits from associates	26	(14)	(24)	-	-
Net interest income		(2,974)	(2,950)	(2,374)	(2,335)
Gain on disposal of associate	11	-	(162)	-	(241)
Net gain on disposal of available-for-sale securities	11	(53)	(274)	(16)	(125)
Dividend income	8	(6)	(14)	(445)	(227)
		(384)	**(459)**	**(446)**	**(514)**
Decrease/(increase) in operating assets					
Balances with the Croatian National Bank		(269)	634	(269)	634
Loans and advances to banks		910	(223)	99	48
Loans and advances to customers		(166)	(3,495)	542	(1,837)
Financial assets at fair value through profit or loss and financial assets available for sale		466	(401)	63	(215)
Other assets		(310)	(189)	(291)	7
(Increase)/decrease in operating assets		***631***	***(3,674)***	***144***	***(1,363)***
Increase/(decrease) in operating liabilities					
Current accounts and deposits from banks		(403)	332	(313)	(3)
Current accounts and deposits from customers		3,987	2,709	3,215	1,436
Other liabilities		452	379	217	165
Increase/(decrease) in operating liabilities		***4,036***	***3,420***	***3,119***	***1,598***
Interest received		3,136	3,765	2,710	2,931
Interest paid		(643)	(900)	(524)	(706)
Dividends received		6	32	445	227
Net cash inflow from operating activities before income taxes paid		**6,782**	**2,184**	**5,448**	**2,173**
Income tax paid		(458)	(137)	(391)	(58)
Net cash from operating activities		**6,324**	**2,047**	**5,057**	**2,115**

The accompanying accounting policies and notes on pages 74 to 226 are an integral part of these financial statements.

Statement of cash flows (continued)

For the year ended 31 December

(in HRK million)

	Notes	**GROUP** 2017	Restated 2016	**BANK** 2017	2016
Cash flows from investing activities					
Purchase of property and equipment, intangible assets and investment property	27, 28, 29	(285)	(173)	(131)	(98)
Disposal of property and equipment, intangible assets and investment property	27, 28, 29	112	77	3	12
Purchase of subsidiary	26	-	-	-	-
Cash paid for the aquisition of Intesa Sanpaolo Bank dd		(1,071)	-	(1,071)	-
Cash paid for the increase in investments		(32)		(32)	
Cash received from sale of associate	26	-	251	-	251
Net cash used in investing activities		**(1,276)**	**155**	**(1,231)**	**165**
Cash flows from financing activities					
Dividends paid to equity holders of the parent		(481)	(193)	(481)	(193)
Decrease in interest-bearing borrowings and subordinated liabilities		(450)	(796)	(369)	(95)
Net cash used in financing activities		**(931)**	**(989)**	**(850)**	**(288)**
Net increase in cash and cash equivalents		**4,117**	**1,213**	**2,976**	**1,992**
Cash and cash equivalents as at 1 January		16,195	14,981	14,016	12,019
Effect of exchange rate fluctuations on cash held		(20)	1	(20)	5
Cash and cash equivalents as at 31 December	**41**	**20,292**	**16,195**	**16,972**	**14,016**

The accompanying accounting policies and notes on pages 74 to 226 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**
Group									
Balance as at 1 January 2017	**1,907**	**1,570**	**(76)**	**1,271**	**81**	**11,127**	**(254)**	**1,124**	**16,750**
Other comprehensive income									
Net change in fair value on available-for-sale financial assets	-	-	-	-	50	-	-	8	**58**
Net fair value gains on available for sale financial assets transferred to the income statement	-	-	-	-	(28)	-	-	(9)	**(37)**
Deferred tax on available-for-sale financial assets (Note 16f)	-	-	-	-	(4)			2	**(2)**
Revaluation of land and buildings	-	-	-	239	-	-	-	51	**290**
Deferred tax on tangible assets (Note 16f)	-	-	-	(41)	-	-	-	(10)	**(51)**
Foreign exchange differences on translation of foreign operations	-	-	-	(6)	-	-	-	(3)	**(9)**
Total other comprehensive income	**-**	**-**	**-**	**192**	**18**	**-**	**-**	**39**	**249**
Profit for the year	-	-	-	-	-	1,331	-	15	**1,346**
Total comprehensive income for the year	**-**	**-**	**-**	**192**	**18**	**1,331**	**-**	**54**	**1,595**
Dividends paid	-	-	-	-	-	(481)	-	-	**(481)**
Acquisition of Banka Intesa Sanpaolo d.d. Slovenia	-	-	-	(94)	-	-	(977)	-	**(1,071)**
Dividend paid by Banka Intesa Sanpaolo d.d. Slovenia	-	-	-	-	-	(78)	-	(78)	**(156)**
Positive reserve arising from increase in investment in Intesa Sanpaolo Banka d.d. Bosnia and Herzegovina	-	-	-	-	-	11	-	(49)	**(38)**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**(94)**	**-**	**(548)**	**(977)**	**(127)**	**(1,746)**
Balance as at 31 December 2017	**1,907**	**1,570**	**(76)**	**1,369**	**99**	**11,910**	**(1,231)**	**1,051**	**16,599**

The accompanying accounting policies and notes on pages 74 to 226 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	Merger reserve	Non-controlling interest	**Total**
Balance as at 1 January 2016	**1,907**	**1,570**	**(76)**	**443**	**108**	**9,597**	**(369)**	**45**	**13,225**
Acquisition of Banka Intesa Sanpaolo d.d. Slovenia	-	-	-	908	43	46	115	1,069	**2,181**
Balance as at 1 January 2016, restated	**1,907**	**1,570**	**(76)**	**1,351**	**151**	**9,643**	**(254)**	**1,114**	**15,406**
Other comprehensive income									
Net change in fair value on available-for-sale financial assets	-	-	-	-	31	-	-	1	**32**
Net fair value gains on available for sale financial assets transferred to the income statement	-	-	-	-	(117)	-	-	(22)	**(139)**
Deferred tax on available-for-sale financial assets (Note 16f)	-	-	-	-	16	-	-	3	**19**
Foreign exchange differences on translation of foreign operations	-	-	-	(19)	-	-	-	(10)	**(29)**
Total other comprehensive income	**-**	**-**	**-**	**(19)**	**(70)**	**-**	**-**	**(28)**	**(117)**
Profit for the year	-	-	-	-	-	1,660	-	79	**1,739**
Total comprehensive income for the year	**-**	**-**	**-**	**(19)**	**(70)**	**1,660**	**-**	**51**	**1,622**
Dividends paid	-	-	-	-	-	(193)	-	-	**(193)**
Transfer of reserves	-	-	-	(61)	-	61	-	-	**-**
Dividend paid by Banka Intesa Sanpaolo d.d. Slovenia	-	-	-	-	-	(45)	-	(41)	**(86)**
Actuarial gains on defined benefit pension plans	-	-	-	-	-	1	-	-	**1**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**(61)**	**-**	**(176)**	**-**	**(41)**	**(278)**
Balance as at 31 December 2016	**1,907**	**1,570**	**(76)**	**1,271**	**81**	**11,127**	**(254)**	**1,124**	**16,750**

The accompanying accounting policies and notes on pages 74 to 226 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**
Bank							
Balance as at 1 January 2017	**1,907**	**1,570**	**(76)**	**302**	**19**	**9,047**	**12,769**
Other comprehensive income							
Net change in fair value on available-for-sale financial assets	-	-	-	-	51	-	**51**
Net fair value gains on available for sale financial assets transferred to the income statement	-	-	-	-	(15)	-	**(15)**
Deferred tax on available-for-sale financial assets (Note 16f)	-	-	-	-	(6)	-	**(6)**
Revaluation of land and buildings	-	-	-	106	-	-	**106**
Deferred tax on tangible assets (Note 16f)	-	-	-	(19)	-	-	**(19)**
Total other comprehensive income	**-**	**-**	**-**	**87**	**30**	**-**	**117**
Profit for the year	-	-	-	-	-	1,443	**1,443**
Total comprehensive income for the year	**-**	**-**	**-**	**87**	**30**	**1,443**	**1,560**
Dividends paid	-	-	-	-	-	(481)	**(481)**
Negative reserve from the acquisition of Banka Intesa Sanpaolo d.d. Slovenia arising from the common control transaction	-	-	-	(93)	-	-	**(93)**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**(93)**	**-**	**(481)**	**(574)**
Balance as at 31 December 2017	**1,907**	**1,570**	**(76)**	**296**	**49**	**10,009**	**13,755**
Balance as at 1 January 2016	**1,907**	**1,570**	**(76)**	**302**	**86**	**7,635**	**11,424**
Other comprehensive income							
Net change in fair value on available-for-sale financial assets	-	-	-	-	11	-	**11**
Net fair value gains on available for sale financial assets transferred to the income statement	-	-	-	-	(95)	-	**(95)**
Deferred tax on available-for-sale financial assets (Note 16f)	-	-	-	-	17	-	**17**
Total other comprehensive income	**-**	**-**	**-**	**-**	**(67)**	**-**	**(67)**
Profit for the year	-	-	-	-	-	1,605	**1,605**
Total comprehensive income for the year	**-**	**-**	**-**	**-**	**(67)**	**1,605**	**1,538**
Dividends paid	-	-	-	-	-	(193)	**(193)**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**-**	**-**	**(193)**	**(193)**
Balance as at 31 December 2016	**1,907**	**1,570**	**(76)**	**302**	**19**	**9,047**	**12,769**

The accompanying accounting policies and notes on pages 74 to 226 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, Bosnia and Herzegovina and Republic of Slovenia. 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 15 February 2018 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 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 2017 amounted to EUR 1 = HRK 7.514, CHF 1= HRK 6.432, USD 1 = HRK 6.270 and BAM 1 = HRK 3.842 (31 December 2016: EUR 1 = HRK 7.558, CHF 1= HRK 7.036, USD 1 = HRK 7.169 and BAM 1 = HRK 3.857).
During 2017 and 2016 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 5.

e) Acquisition of Banka Intesa Sanpaolo dd, Slovenia

The structure of the Group was changed following a Group reorganisation in 2017.

As of 20 July 2017 the Bank purchased a 51% stake in Banka Intesa Sanpaolo dd Slovenia from Intesa Sanpaolo S.p.A. Turin which is the ultimate owner of both banks.

The transaction represented a business combination involving entities under common control. As such, it was exempt from the accounting treatment prescribed in IFRS 3 Business Combinations. Entities involved in common control transactions should select an appropriate accounting policy, to be applied consistently, using the hierarchy described in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. The transaction is accounted for in line with the book value accounting allowed under IFRS 3. For details, please refer to Note 4 Restatement of comparative information and note 26 Investment in subsidiaries and associates.

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 l 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 (during the reporting period). Information about the Group's fund management activities is set out in Note 42.

ix) Accounting policies of subsidiaries

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

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 effective interest rate method.

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:

Contributions to the Pension Fund	20.00%
Contributions to the State Health Care Fund	15.00%
Contributions to the Unemployment Fund	1.70%
Injuries at work	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.

v) Retirement benefit obligation

Valuations of these obligations are carried out by independent qualified actuaries, by using the book reserve method.

The Group's obligation for the current service cost of providing pension benefits and the increment in the present value of the defined benefit obligation due to the approaching beginning of the defined benefit liability (interest cost) was assessed. The increase in the benefit scheme liabilities in excess of the above two assessments is recognised as the actuarial gain or loss. The defined benefit scheme liabilities are measured on an actuarial basis using the projected unit credit method, which measures actuarial liabilities in accordance with the expected wage/salary increase from the valuation date until the foreseen retirement of the employed person.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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.

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)

l) 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. For collective impairment, the Group uses days-past-due method on a portfolio basis for various segments and vintages, and the recoverable amounts are calculated using the internally developed LGD model. 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". These 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.

Derivative financial instruments include foreign exchange forward contracts, foreign exchange swaps and interest rate cap contracts.

n) Hedge accounting

The Group uses derivative financial instruments to manage its exposures to interest rate risk. Such derivative financial instruments are initially recognised at fair value on the date on which they are entered to and are subsequently re-measured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

For the purpose of hedge accounting, hedges could refer to:

- Fair value hedge – a hedge of exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment;
- Cash flow hedge – a hedge of the exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction;
- Hedge of a net investment in a foreign currency.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Group will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are tested regularly throughout their life to determine that they actually have been highly effective throughout the financial reporting periods for which they are designated.

The Group uses fair value hedge to cover exposure to changes in the fair value attributable to the different risk categories of assets and liabilities in the statement of financial position, or a portion of these or to cover portfolios of financial assets and liabilities.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

o) 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.

p) 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.

q) 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.

r) 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.

s) 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.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

t) Property and equipment

Property and equipment are stated at historical cost or deemed cost less accumulated depreciation and impairment losses, except for owner-occupied property which have been measured according to the revaluation method. The latter method requires that property, whose fair value can be measured reliably, to be recognized at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value of land and buildings is measured on the basis of market benchmarks, in an appraisal that is normally prepared by professionally qualified appraisers. The frequency of revaluations depends upon the changes in fair value of items of property being revalued.

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.

When an item of property is revalued, the carrying value of that asset is adjusted to the revalued amount so that the accumulated depreciation is eliminated against the gross carrying amount of the asset.

After initial recognition of property:

- if an asset's carrying amount is increased as a result of revaluation, the increase is recognized in Other comprehensive income and accumulated in equity under the revaluation reserve caption
- if the carrying amount is decreased as a result of revaluation, the decrease is recognized in Profit or loss
- if an asset's carrying amount is increased as a result of revaluation, the increase is recognized in Profit or loss to the extent that it reverses a revaluation decrease of the same property previously recognized in Profit or loss
- if the carrying amount is decreased as a result of revaluation, the decrease is recognized in Other comprehensive income to the extent of any credit balance existing in the revaluation reserve in respect of that asset.

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)

u) 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. The estimated useful lives are as follows:

Licence fees	4 years
Research and development expenditure	5 years
Computer software	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, Međimurska 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.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

v) 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 at its fair value.

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.

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

The Group classifies a non-current asset as held for sale (or disposal groups comprising assets and liabilities) assets that are expected to be recovered primarily through sale 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 and subsequent gains or losses on remeasurement are recognised in income statement. Gains are not recognised in excess of any cumulative impairment loss. Any impairment loss on a disposal group first is allocated to goodwill, and then to the remaining assets and liabilities on a pro-rata basis, except that no loss is allocated to financial assets and deferred tax assets, which continue to be measured in accordance with the Group’s accounting policies.

At reclassification back, on change of intent or if the conditions required by IFRS 5 cease to be applicable, the Group does not restate comparative information in the balance sheet. Upon reclassification the valuation is adjusted in accordance with relevant standards, as if the reclassification had not occurred.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

x) Foreclosed assets

Sometimes the Group recovers assets that were originally received as collateral for loan, after exercising contractual rights or undertaking specific legal action. When the assets are recognised on the balance sheet for the first time, it is recognised at its fair value. Any difference between its fair value and the carrying amount of the loan that triggered recovery of the asset is considered an impairment loss on loan. After initial recognition, the repossessed assets are measured according to the relevant accounting standard, depending on the scope for holding the property. Generally, Group measures repossessed assets according to IAS 2, except in rare circumstances when the asset is put in use.

y) 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.

z) 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.

aa) 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.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

bb) 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.

cc) Retained earnings

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

dd) 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.

ee) 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 42.

ff) 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, credit institutions are presented in operating segments. With the exception of PBZ Card, all other 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 48).

gg) 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.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

hh) 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 accordance with the guidance provided by the European Securities and Markets Authority (ESMA), regarding the requirements of IAS 8, paragraphs 30 and 31, information on the implementation of IFRS 9 - Financial Instruments in the PBZ Group is provided below.

Regulatory provisions

As already known and analysed in the Financial Statements for 2016, the new accounting standard IFRS 9, published in July 2014 by the IASB and approved by the European Commission by Regulation no. 2067/2016, shall as of 1 January 2018 replace the existing IAS 39 which regulated recognition and measurement of financial instruments.

IFRS 9 is divided into three main phases: classification and measurement of financial instruments, impairment and hedge accounting.

With regard to the first area, IFRS 9 provides that the classification of financial assets is determined, on the one hand, by characteristics of the associated contractual cash flows and, on the other hand, by financial instrument management intent (business model). Instead of the previous four accounting categories, financial assets, according to IFRS 9, can be classified into three categories: Financial assets measured at amortised cost, Financial assets measured at fair value through other comprehensive income (for debt instruments, reserves are transferred to income statement in case of discontinuation of the instrument) and Financial assets measured at fair value through profit or loss. Financial assets can be classified in the first two categories and valued at amortised cost or fair value through other comprehensive income only if it is proved that it leads to cash flows that are solely principal and interest payments (so-called “solely payment of principal and interest” – “SPPI test”). Equity securities are always classified in the third category and are valued at fair value through profit or loss, unless the entity chooses (irrevocably, at the time of the initial entry) that shares which are not held for trading are classified at fair value through other comprehensive income. In that case, reserves recognized within other comprehensive income will never be transferred to the profit and loss account, even in the event of termination of a financial instrument (financial assets valued at fair value through other comprehensive income without "recycling").

Regarding the classification and valuation of financial liabilities, significant changes are not introduced in relation to the present standard.

In respect of impairment, for instruments valued at amortised cost and at fair value through other comprehensive income (other than equity instruments), a model based on the concept of expected losses is introduced instead of the current “loss incurred”, with an aim of faster loss recognition. IFRS 9 requires companies to enter the expected losses at the level of losses expected in the next 12 months (stage 1) from the initial entry of the financial instrument. The time horizon for calculating the expected loss becomes the entire remaining life of the asset that is the subject of the valuation where the credit quality of the financial instrument has experienced a “significant” credit risk deterioration in relation to the initial measurement (stage 2) or in case the asset is partially or fully non-performing (Stage 3). More specifically, the introduction of new impairment provisions includes:

- Allocation of *performing* financial assets at different levels of credit risk ("staging"), corresponding to value adjustments based on expected losses over the next 12 months (the so-called “Stage 1”) or lifetime for the entire remaining duration of the instrument (the so-called “Stage 2”), in the presence of a significant increase in credit risk;
- Allocation of partially or fully non-performing financial assets in the so-called “Stage 3“, always with value adjustments based on expected losses over the entire duration of the instrument;
- Inclusion of Expected Credit Losses (“ECL”) in the calculation, as well as the expected future changes of the macroeconomic scenario.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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

Implementation project

Given the prevailing impact of the changes introduced by IFRS 9, both on the business and on the organization and reporting method, from the beginning of 2016, the PBZ Group has launched a special project aimed at exploring different areas of the impact of this standard, defining its qualitative and quantitative impact, as well as identifying and implementing program and organizational changes required for harmonized, organizational and effective implementation within the Group as a whole and for each individual entity within the Group.

Within the CFO and CRO areas, thematic working groups were established, based on provisions of the standard.

The said project, which is approaching its final stages, is at this point focused on supporting and monitoring of activities related to effects of the first implementation - First Time Adoption (FTA) of the new Standard and the implementation of the latest program and organizational measures aimed at ensuring consistent application of new rules.

Before beginning the analysis of the main project activities in relation to the mentioned areas of the IFRS 9 impact, we should refer to “general” options carried out by the PBZ Group in the area of application of the new standard, to the effect of applying new “impairment” rules on regulatory capital, according to the latest amendments introduced by solvency regulations and the presence of comparative states during the accounting period of the first application of the standard. In particular:

- On 12 December 2017, the European Parliament and the Council issued the Regulation (EU) 2017/2395 “Transitional provisions aimed at mitigating the impact of the introduction of IFRS 9 on regulatory capital” amending the Regulation 575/2013 CRR by introducing a new Article 473 bis “Introduction of IFRS 9”, which offers banks the ability to reduce the impact on regulatory capital arising from the introduction of IFRS 9 accounting standard in the transition period of 5 years (March 2018 to December 2022) by gradually including the decreasing volume of the impact into CET1. The PBZ Group has chosen the so-called “static approach” to be applied to the impact resulting from the comparison between IAS 39 value adjustments, existing as at 31 December 2017, and value adjustments arising from IFRS 9 up to 1 January 2018. Banks that have chosen transitional treatment will, in any case, as of 2018 have to provide the data on available capital, risk-weighted assets, capital adequacy and leverage ratios, as provided by the Guidelines adopted on 12 January 2018;
- In relation to the presentation of impacts of the first application of the standard, the Group shall adopt the option provided in paragraph 7.2.15 of IFRS 9 and in paragraphs E1 and E2 of IFRS 1 “First-time Adoption of International Financial Reporting Standards”, according to which - without prejudice to retrospective application of the new measurement and reporting rules required by the Standard - the compulsory presentation of comparative data in the first-time financial statements is not foreseen on the basis of the provisions of the new standard.

A brief analysis of the activities carried out within the project and the finalization phase in regards to to the main areas of impact, as defined above, is presented below.

Classification and Measurement

In order to comply with IFRS 9 rules - introducing a model that classifies financial assets defined, on the one hand, by contractual features of cash flows of instruments and, on the other hand, by management intent for which they are held - defines the methods of implementing the test of contractual characteristics of cash flows (the so-called SPPI Test) and finalizes business models adopted by various Structures through which the Group operates.

Concerning the SPPI Test on financial assets, the methodology to be used was defined - and at the same time - an analysis of the composition of the existing portfolio of securities and loans was carried out in order to identify the correct classification at the time of the first application of the new standard.

With regard to debt securities, a detailed examination of cash flow characteristics of instruments classified by amortized cost and in the category of financial assets available for sale in accordance with IAS 39 was carried out in order to identify activities that, without passing the SPPI test, have to be valued at fair value through profit or loss in accordance with IFRS 9. From the analyses conducted, it was concluded that the Group does not have debt securities falling on the SPPI test. It should also be noted that based on the detailed analysis and clarification provided by the Interpretation Committee, investment funds (open and closed funds) must be valued at fair value through profit or loss.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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

For the credit sector, the project conducted modular analysis taking into account the significance of the portfolio, its homogeneity and Business Department. In this respect, differentiated approaches to credit portfolios were used for physical and legal persons, and only marginal cases emerged in that context, which, in terms of specific contractual provisions or the nature of financing, determine not passing the SPPI test. Therefore, there are no significant impacts during the first application in the credit sector.

Regarding the second trigger for the financial asset classification (business model), the process of defining business models, at the level of each department, to be adopted in accordance with IFRS 9 has been completed. For “Hold to Collect” portfolios, thresholds have been defined to examine permitted frequent, but not significant, sales (both individually and collectively), or non-frequent sales, even if they are significant; At the same time, sales identification parameters that are consistent with this business model were set up since they can be attributed to increased credit risk. Based on the analyses carried out, the portfolio of securities, now classified at amortized cost, generally shows a decline in turnover, in accordance with the "Hold to Collect" business model strategy. Regarding debt securities currently classified as available-for-sale assets, the adoption of “Hold to Collect and Sell” business model was defined for the majority of portfolio; Only in limited cases, with regard to small portfolios, some portfolio reclassifications have been carried out in FTA in order to take into account the existing business model at the date of first application of IFRS 9.

In addition, the current way of credit management, regarding physical and legal persons, can be attributed to the “Hold to Collect” business model, in principle.

In more general terms, finally, in relation to management intentions for which the financial asset is held, it is reported that a separate document has been approved by the appropriate management levels in order to define core business model elements, citing the role regarding the classification model prescribed by the IFRS 9 standard.

As regards equity securities, instruments (classified in the category of financial assets available for sale in accordance with IAS 39) have been identified for which the FTA applies the option of classification by fair value through other comprehensive income (without “recycling” in profit and loss account); In addition, general criteria that must regularly lead the choice have been defined and the associated organisational process was formalised.

Impairment

Regarding the area of impairment:

- Methods for measuring change of credit quality of positions in the portfolio of financial assets are measured at amortized cost or at fair value through other comprehensive income;
- Criteria for determining significant increase in credit risk are defined for the purpose of proper allocation of performing exposures in “Stage 1” or “Stage 2”. On the other hand, in view of partially or fully non-performing exposure, the alignment of the established accounting and regulatory definitions – present today – allows the current rules of exposure classification as partially or fully non-performing to be considered as equivalent to the rules of exposure classification within “Stage 3”;
- Models were created - including forward looking data - that will be used for calculation of “expected credit loss” (ECL) during the next 12 months (for exposure in stage 1) and for the remaining duration of the instrument or lifetime (for exposure in Stage 2 and Stage 3). In order to take into account the forward looking data and the macroeconomic scenarios that the Group could encounter, it was decided to adopt, as further detailed in the text below, the so-called „Most likely scenario + add on” approach.

Regarding the monitoring of credit quality, and in line with the standard and guidelines of the supervisory body on the way of applying accounting standards for larger institutions, efforts have been made in conducting the timely credit quality analysis of each individual credit relationship (both in the form of card exposure and in the form of credit exposure) for the purpose of identifying any “significant deterioration” from the date of first entry and the consequent need for classification in Stage 2, as well as the conditions for returning to Stage 1 from Stage 2. In other words, the elected choice, for each case separately and for each reporting date, implies a comparison of the credit quality of the financial instrument at the time of valuation and at the time of issuance or purchase with the purpose of determining whether the criteria for classification to Stage 2 have been met.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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

Concerning the foregoing, the elements that will be the main determinants for identification of significant credit risk deterioration since the moment of initial entry are the following :

- Default probability change in relation to the moment of initial entry of the financial instrument in the financial statements. It is therefore an assessment implemented by adopting the "relative" criterion, which is configured as the main criteria;
- Eventual presence of due amount which remains overdue over 30 days. In the event of such case the credit risk of such exposure is considered “significantly increased” and is classified to Stage 2;
- Existence of “forbearance” measures;
- Finally, certain indicators of the internal credit risk tracking system will be taken into account – for the purpose of transition between “Stages" and where appropriate.

As described above, the inclusion of “forward looking” factors, particularly macroeconomic scenarios, is absolutely important element for estimating expected losses. From a methodological point of view, several possible alternative approaches were analysed to take these elements into account. In relation to different options considered, the Group has decided to adopt the approach representing the so-called “Most likely scenario + Add-on” which, for the purpose of calculating expected credit loss (ECL) and “stage assignment”, implies taking into account the loss by credits set for the baseline scenario, with the attributed add-on aimed at reflecting the effects resulting from the possibility of the realisation of alternative of macroeconomic scenarios.

Finally, special considerations also apply to the exposures classified in the so-called “Stage 3”. Although the essential definition of non-performing loans in IFRS 9 is equal to existing accounting standards, ECL calculations for the entire lifetime led to methodological considerations and for the needs of estimates to be implemented in this section, mainly in relation to:

- Inclusion of “forward looking” data;
- Consideration of alternative scenarios for collection, such as sale of non-performing portfolio, which must be attributed to the probability of realization in the context of the overall assessment;
- Collection estimates and deadlines, as well as probability of migration to lower categories.

The competent management bodies have approved the methodology for carrying out the impairment of assets.

Impact on information systems

Rational and efficient process of implementing new features introduced by IFRS 9 in the area of Classification and Measurement, primarily the impairment, has led to the need to carry out operations that have a significant impact on the IT area. Specific analyses have been carried out to this purpose, which led to identification of the main areas of impact; Consequently, targeting program architectures that need to be implemented have been set out and programs and procedures that need to be adjusted were identified, as well as the modifications that need to be made.

System interventions - set to meet the new requirements defined by the standard in terms of portfolio classification, credit risk measurement, accounting and disclosure - were, therefore, related to the implementation of already existing functionalities necessary for that purpose, as well as for the purpose of the integration of new software applications necessary for more effective and efficient management of subject matters.

More specifically, as far as the area of Classification and Measurement is concerned, once the specific ways in which the SPPI Test will be carried out was defined, the programs and procedures for its implementation, where and when needed, have been identified and purchased, both for securities and for credit exposures in the narrow sense.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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

Concerning the area of "Impairment", after the main parameters to be considered for the purpose of assessing significant deterioration were executed, as well as ECL calculation methods (taking into account the "forward looking" elements), risk management programs at which one-position credit risk tracking and the calculation of the relevant ECL will be performed have been identified and implemented, as well as the necessary adjustments and upgrades. Similar analyses and interventions have been defined and are in the advanced stage of the implementation as regards the adjustment of accounting programs and for the purpose of guaranteeing appropriate publications in the financial statements.

Generally, these activities are defined and implemented in a centralized way within the Bank for all Group companies that have common or identical information systems as the parent company. On the other hand, controlled companies (for example, foreign controlled companies) that have different software systems have been implementing the changes independently and in line with the peculiarities of their business to ensure compliance with the guidelines issued by the same parent company.

Organizational impacts and additional development

Similar organizational measures were implemented simultaneously with IT implementations. Main organizational impacts concerned the revision and adaptation of existing operational processes, design and implementation of new processes and associated control measures, as well as revision of size and expansion of skills available within different structures - operational, management and control.

Activities related to the area of Classification and Measurement primarily concerned the business structures, with the aim of identifying and determining the business model, as well as defining the procedures for managing and monitoring the process of conducting the SPPI Tests.

Regarding the "Impairment", the Group's target consisted of more effective and integrated implementation of on-going credit risk monitoring method, in accordance with IFRS 9, in order to ensure preventive measures to monitor potential reclassification of positions in Stage 2 and the disclosure of consistent and timely value adjustments in relation to actual credit risk.

Finally, the introduction of IFRS 9 also included an analysis in the sense of commercial offer (and, consequently, in terms of possible revision of product catalogue).

Consequently, the said analysis took into account the following main impacts on the Group's banking business arising from the combination of different thematic areas of the new standard:

- Possible need/opportunity – at least for certain portfolios – to review the adopted credit strategies again;
- Modification of certain products in the catalogue (potentially including the relevant price and duration, depending on the accompanying collateral, as well as collection mechanisms);
- Possible redefinition of the mission of certain business units, with associated portfolio management implications, control methods, risk assessment/measures and the associated limits and maximum amounts.

Process of approaching to "First Time Adoption" (FTA) of IFRS 9

The PBZ Group, starting from the second half of 2017, launched the so-called "parallel running" of the application of the new standard, which provides gradual modular approach, in accordance with the availability of required information and software support. Such "parallel running" has set the objective of verifying the correct implementation of the novelty management support program introduced by IFRS 9 and a more coherent FTA impact assessment.

Notes to the financial statements (continued)

3 Significant accounting policies (continued)

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

FTA impacts

Based on the above, the following is an estimate of the impact expected for first-time adoption of IFRS 9 on consolidated net assets of PBZ Group as at 1 January 2018. These impacts, which concern both the amount and the composition of net assets, arise mainly:

- From the obligation to redefine the value adjustments of financial assets in the portfolio (both performing and non-performing) using the expected loss model - with the inclusion of multiple forward-looking components - in return for the existing loss model. Specifically, in relation to performing exposures, the increase in value adjustments is attributable to (i) allocation of the portion of the performing portfolio to "Stage 2" based on defined allocation criteria, with the consequent need to calculate the expected loss for the entire remaining life of financial assets, and (ii) inclusion of "forward looking" parameters arising from future macroeconomic scenarios in the calculation of expected losses. Regarding partially or fully non-performing loans, the impact is essentially caused by inclusion of forward looking parameters arising from the consideration of future macroeconomic scenarios in calculation for all NPL categories and the inclusion of sales scenario foreseen by the company's objective to reduce non-performing assets, for the part of the portfolio of non-performing receivables with features of transferability;
- From the need to reclassify the individual financial assets in the portfolio based on the combined result of two classification triggers provided by the standard: the business model on which these instruments are managed and the contractual characteristics of the related cash flows (SPPI Test).

(in HRK million)

Group	**Impact on consolidated net assets as at 1 January 2018 (FTA)**
Performing loans impairment	700
Performing debt securities impairment	37
Non-performing loans impairment	147
Reclassification of financial instruments	(10)
	874

Notes to the financial statements (continued)

4 Restatement of comparative information

As further explained in note 26 of the financial statements in July 2017 the Bank acquired a 51% stake in Banka Intesa Sanpaolo dd Slovenia ("BISP SLO") from Intesa Sanpaolo S.p.A. Turin which is the ultimate owner of both banks.

The transaction represented a business combination involving entities under common control. As such, it was exempt from the accounting treatment prescribed in IFRS 3 Business Combinations. In the absence of specific guidance, entities involved in common control transactions should select an appropriate accounting policy, to be applied consistently, using the hierarchy described in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

In addition, certain comparative amounts have been reclassified to conform to the current period's presentation and are presented in the column other reclassifications. The effects on the Group's financial position, financial performance and cash flows are set out in the following tables:

Consolidated income statement

For the year ended 31 December 2016

(in HRK million)

	As previously reported	BISP SLO*	Restated
Interest income	3,300	386	3,686
Interest expense	(676)	(60)	(736)
Net interest income	**2,624**	**326**	**2,950**
Fee and commission income	1,491	283	1,774
Fee and commission expense	(245)	(89)	(334)
Net fee and commission income	**1,246**	**194**	**1,440**
Dividend income	9	5	14
Net trading income and net gains on translation of monetary assets and liabilities	227	3	230
Fair value adjustments in hedge accounting	-	1	1
Other operating income	412	177	589
Total operating income	**4,518**	**706**	**5,224**
Impairment losses on loans and advances to customers	(436)	(166)	(602)
Release recognised on CHF conversion	30	-	30
Other impairment losses and provisions	16	(4)	12
Personnel expenses	(872)	(209)	(1,081)
Depreciation, amortisation and impairment of goodwill	(205)	(39)	(244)
Other operating expenses	(1,043)	(115)	(1,158)
Share of profits from associates	24	-	24
Profit before income tax	**2,032**	**173**	**2,205**
Income tax expense	(445)	(21)	**(466)**
Profit for the year	**1,587**	**152**	**1,739**
Attributable to:			
Equity holders of the parent	1,582	78	**1,660**
Non-controlling interest	5	74	**79**
	1,587	**152**	**1,739**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of financial position

As at 31 December 2016

(in HRK million)

Assets	As previously reported	BISP SLO*	Restated
Cash and current accounts with banks	12,970	1,322	**14,292**
Balances with the Croatian National Bank	3,916	-	**3,916**
Financial assets at fair value through profit or loss	6,103	1	**6,104**
Derivative financial assets	25	8	**33**
Loans and advances to banks	2,806	808	**3,614**
Loans and advances to customers	52,885	12,292	**65,177**
Financial assets available for sale	1,405	2,680	**4,085**
Held-to-maturity investments	17	-	**17**
Investments in subsidiaries and associates	67	-	**67**
Intangible assets	158	31	**189**
Property and equipment	1,030	122	**1,152**
Investment property	62	106	**168**
Deferred tax assets	130	7	**137**
Other assets	532	203	**735**
Tax prepayments	22	-	**22**
Total assets	**82,128**	**17,580**	**99,708**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of financial position (continued)

As at 31 December 2016

(in HRK million)

Liabilities	As previously reported	BISP SLO*	Restated
Current accounts and deposits from banks	1,125	470	**1,595**
Current accounts and deposits from customers	60,378	13,906	**74,284**
Derivative financial liabilities	11	11	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	3	**3**
Interest-bearing borrowings	3,571	664	**4,235**
Subordinated liabilities	1	-	**1**
Other liabilities	1,749	183	**1,932**
Accrued expenses and deferred income	264	55	**319**
Provisions	284	78	**362**
Deferred tax liabilities	21	12	**33**
Current tax liability	165	7	**172**
Total liabilities	**67,569**	**15,389**	**82,958**
Equity attributable to equity holders of the parent			
Share capital	1,907	-	**1,907**
Share premium	1,570	-	**1,570**
Treasury shares	(76)	-	**(76)**
Other reserves	372	899	**1,271**
Fair value reserve	56	25	**81**
Retained earnings	11,049	78	**11,127**
Merger reserve	(369)	115	**(254)**
Total equity attributable to equity holders of the Bank	**14,509**	**1,117**	**15,626**
Non-controlling interests	**50**	**1,074**	**1,124**
Total equity	**14,559**	**2,191**	**16,750**
Total liabilities and equity	**82,128**	**17,580**	**99,708**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of financial position (continued)

As at 31 December 2015

(in HRK million)

Assets	As previously reported	BISP SLO*	Restated
Cash and current accounts with banks	9,995	1,665	**11,660**
Balances with the Croatian National Bank	4,550	-	**4,550**
Financial assets at fair value through profit or loss	5,970	2	**5,972**
Derivative financial assets	4	1	**5**
Loans and advances to banks	3,450	1,346	**4,796**
Loans and advances to customers	50,985	11,320	**62,305**
Financial assets available for sale	1,118	2,520	**3,638**
Held-to-maturity investments	17	-	**17**
Investments in subsidiaries and associates	150	-	**150**
Intangible assets	182	34	**216**
Property and equipment	1,132	145	**1,277**
Investment property	23	108	**131**
Deferred tax assets	141	20	**161**
Other assets	549	199	**748**
Tax prepayments	157	8	**165**
Total assets	**78,423**	**17,368**	**95,791**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of financial position (continued)

As at 31 December 2015

(in HRK million)

Liabilities	As previously reported	BISP SLO*	Other reclassifi-cations**	Restated
Current accounts and deposits from banks	1,083	174	-	**1,257**
Current accounts and deposits from customers	58,180	13,565	-	**71,745**
Derivative financial liabilities	15	1	-	**16**
Interest-bearing borrowings	3,884	1,143	-	**5,027**
Subordinated liabilities	2	-	-	**2**
Other liabilities	1,438	158	-	**1,596**
Accrued expenses and deferred income	238	41	-	**279**
Provisions	313	87	-	**400**
Deferred tax liabilities	34	18	-	**52**
Current tax liability	11	-	-	**11**
Total liabilities	**65,198**	**15,187**	**-**	**80,385**
Equity attributable to equity holders of the parent				
Share capital	1,907	-	-	**1,907**
Share premium	1,570	-	-	**1,570**
Treasury shares	(76)	-	-	**(76)**
Other reserves	466	908	(23)	**1,351**
Fair value reserve	108	43	-	**151**
Retained earnings	9,553	46	44	**9,643**
Merger reserve	(348)	115	(21)	**(254)**
Total equity attributable to equity holders of the Bank	**13,180**	**1,112**	**-**	**14,292**
Non-controlling interests	45	1,069	-	1,114
Total equity	**13,225**	**2,181**	**-**	**15,406**
Total liabilities and equity	**78,423**	**17,368**	**-**	**95,791**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments

(**) to achieve a consistent presentation of elimination of minority interest used for consolidation of Banka Intesa Sanpaolo d.d. Slovenia, the elimination of minority interests related to share capital and other reserves of Intesa Sanpaolo Banka d.d. Bosnia & Herzegovina which was previously eliminated from retained earnings has been reclassified as if it was eliminated from merger reserve and other reserves.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of cash flows

For the year ended 31 December2016

			(in HRK million)
	As previously reported	BISP SLO*	Restated
Cash flows from operating activities			
Profit before income tax	2,032	173	**2,205**
Impairment losses on loans and advances to customers	436	166	**602**
Other impairment losses and provisions	(16)	4	**(12)**
Release of provisions recognized on CHF conversion	(30)	-	**(30)**
Gain on disposal of property and equipment and intangible assets	(22)	(8)	**(30)**
Depreciation and amortisation	205	39	**244**
Net (gains)/losses from securities at fair value through profit or loss	(14)	-	**(14)**
Share of profits from associates	(24)	-	**(24)**
Net interest income	(2,624)	(326)	**(2,950)**
Gain on disposal of associate	(162)	-	**(162)**
Net gain on disposal of AFS securities	(125)	(149)	**(274)**
Dividend income	(9)	(5)	**(14)**
	(353)	**(106)**	**(459)**
Decrease/(increase) in operating assets			
Balances with the Croatian National Bank	634	-	**634**
Loans and advances to banks	(557)	334	**(223)**
Loans and advances to customers	(2,307)	(1,188)	**(3,495)**
Financial assets at fair value through profit or loss and financial assets available for sale	(390)	(11)	**(401)**
Other assets	(17)	(172)	**(189)**
(Increase)/decrease in operating assets	***(2,637)***	***(1,037)***	**(3,674)**
Increase/(decrease) in operating liabilities			
Current accounts and deposits from banks	36	296	**332**
Current accounts and deposits from customers	2,343	366	**2,709**
Other liabilities	328	51	**379**
Increase/(decrease) in operating liabilities	***2,707***	***713***	**3,420**
Interest received	3,327	438	**3,765**
Interest paid	(812)	(88)	**(900)**
Dividends received	27	5	**32**
Net cash inflow from operating activities before income taxes paid	**2,259**	**(75)**	**2,184**
Income tax paid	(146)	9	**(137)**
Net cash from operating activities	**2,113**	**(66)**	**2,047**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

4 Restatement of comparative information (continued)

Consolidated statement of cash flows

For the year ended 31 December 2016

			(in HRK million)
	As previously reported	BISP SLO*	Restated
Cash flows from investing activities			
Purchase of property and equipment, intangible assets and investment property	(160)	(13)	**(173)**
Disposal of property and equipment, intangible assets and investment property	64	13	**77**
Cash received from sale of associate	251	-	**251**
Net cash used in investing activities	**155**	-	**155**
Cash flows from financing activities			
Dividends paid to equity holders of the parent	(193)	-	**(193)**
Decrease in interest-bearing borrowings and subordinated liabilities	(317)	(479)	**(796)**
Net cash used in financing activities	**(510)**	**(479)**	**(989)**
Net increase/(decrease) in cash and cash equivalents	**1,758**	**(545)**	**1,213**
Cash and cash equivalents as at 1 January	12,989	1,992	**14,981**
Effect of exchange rate fluctuations on cash held	5	(4)	**1**
Cash and cash equivalents as at 31 December	**14,752**	**1,443**	**16,195**

(*) reported figures adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

5 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 47) and financial risk management (Note 49).

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, (2016: corporate exposure with total balance exceeding HRK 3.8 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.

Notes to the financial statements (continued)

5 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 are explained in Note 27.

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 47.

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)

5 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 38a the Group and the Bank provided HRK 59 million (2016: HRK 67 million) and HRK 32 million (2016: HRK 46 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 revaluation model for property and equipment and investment property. The criterion of revaluation model requires that the asset have to be amortized on the basis of new revalued value. Investment property at fair value will no longer be amortized.

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 gross carrying value 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) Changes to the accounting policies on property

Compared to previous financial statements, in the Annual Report as at 31 December 2017, the PBZ Group has changed the accounting criteria for the disclosure and measurement of the following classes of tangible assets:

- property (governed by IAS 16 "Property, Plant and Equipment);
- property held for investment (governed by IAS 40 "Investment property").

More specifically, the modifications imply:

- change from the cost model to the redetermination of value for measurement subsequent to initial disclosure of property;
- change from accounting at cost to accounting at fair value for investment property.

It is believed that in this way of presentation, and in line with IAS 8 that governs the cases when it is permissible to modify application of the accounting standard, it will be possible to provide users of the financial reports with reliable and more significant information on the effects of business management and the Group's overall capital-financial position and results.

Expressing the overall property in current values, according to the "revaluation model" in IAS 16, and investment property using the fair value approach suggested by IAS 40, will allow:

- greater alignment of financial information with future strategies to manage the Group's property;
- a more immediate understanding of the economic-capital effects of the actions envisioned in the Business Plan;
- constant matching of the book values of the property with market value.

Notes to the financial statements (continued)

5 Accounting estimates and judgments in applying accounting policies (continued)

n) Changes to the accounting policies on property (continued)

As mentioned, the above amendment, applied from the current financial statements, has led in particular to:

- change from the cost model to revaluation after initial disclosure of property;
- change from measurement at cost to measurement at fair value for investment property.

Usually, voluntary changes to the accounting standards, such as those under discussion, require revaluation of initial balances and the provision of comparative information. However, IAS 8 introduces an exception to the usual treatment for this category: more specifically, paragraph 17 of the Standard states that a change in an accounting policy shall be dealt with as a revaluation in accordance with IAS 16 for a revaluation, without requiring any re-exposure of previous positions.

Consequently, in the light of the requirements of IAS 16 on the subject, revaluation of current values resulting from the change in accounting standard has produced both capital effects attributable to positive revaluation to be disclosed in net equity and economic effects attributable to the negative revaluation component recognised in Profit and loss.

Considering that the change in the valuation criterion occurred at the end of the year, amortisation for 2017 has been calculated using the preceding cost criterion; therefore, all property, has been amortised up to 31 December 2017. As of 2018, property, valued using the criterion of revaluation according to IAS 16, will continue to be amortised for the useful life; under IAS 40, as investment property is measured at fair value through profit and loss, it will not be amortised.

At the level of financial statements, as analysed in Note 28, the above modification has led to the disclosure, in a dedicated valuation reserve, of revaluation surplus in the amount of HRK 290 million for the Group and 106 million for the Bank. In addition to revaluation surplus, a net gain of HRK 12 million for the Bank is recognised directly in the income statement under Note 11.

Notes to the financial statements (continued)

6 Net interest income

a) Interest income – analysis by source

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Retail	2,011	2,073	1,625	1,696
Corporate	962	1,017	678	702
Public sector and other institutions	483	563	421	493
Banks	44	33	24	17
	3,500	**3,686**	**2,748**	**2,908**

b) Interest income – analysis by financial assets category

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Loans and advances to customers	3,298	3,437	2,614	2,740
Financial assets available for sale	78	71	23	7
Debt securities classified as loans and receivables	39	62	38	59
Financial assets initially designated at fair value through profit or loss	31	69	31	68
Loans and advances to banks	22	19	23	17
Financial assets held for trading	19	17	19	17
Derivative assets held for hedge accounting	12	10	-	-
Held-to-maturity investments	1	1	-	-
	3,500	**3,686**	**2,748**	**2,908**

Interest income includes collected interest income from impaired loans of the Group of HRK 160 million (2016: HRK 235 million) and of the Bank of HRK 97 million (2016: HRK 172 million).

Notes to the financial statements (continued)

6 Net interest income (continued)

c) Interest expense – analysis by recipient

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Retail	352	537	266	437
Banks	126	129	75	90
Corporate	27	42	18	25
Public sector and other institutions	21	28	15	21
	526	**736**	**374**	**573**

d) Interest expense – analysis by product

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Current accounts and deposits from retail customers	352	537	266	437
Interest-bearing borrowings	69	89	43	59
Current accounts and deposits from corporate customers and public sector	48	67	33	44
Current accounts and deposits from banks	29	29	32	33
Derivative assets held for hedge accounting	28	14	-	-
	526	**736**	**374**	**573**

Notes to the financial statements (continued)

7 Net fee and commission income

a) Fee and commission income

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Credit cards	892	872	122	119
Payment transactions	480	457	381	360
Customer services	178	175	87	79
Investment banking fees	84	74	42	37
Guarantees	59	57	42	39
Investment management, brokerage and consultancy	48	62	44	58
Other	107	77	93	62
	1,848	**1,774**	**811**	**754**

b) Fee and commission expense

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Credit cards	247	236	82	74
Payment transactions	51	52	28	29
Bank charges	13	12	8	6
Other	36	34	8	11
	347	**334**	**126**	**120**

8 Dividend income

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Dividends from subsidiaries	-	-	431	200
Dividends from associates	-	-	12	18
Dividends from other equity securities	6	14	2	9
	6	**14**	**445**	**227**

Notes to the financial statements (continued)

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

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Foreign exchange spot trading	212	207	204	189
Net gains/(losses) from translation of monetary assets and liabilities denominated in foreign currency	70	(49)	52	(48)
Net trading (expense)/income from forward foreign exchange contracts and swaps	(50)	58	(50)	58
Net gains on financial assets held for trading	21	22	21	22
Net (losses) from securities initially designated at fair value through profit or loss	(13)	(8)	(12)	(8)
	240	**230**	**215**	**213**

10 Fair value adjustments in hedge accounting

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Net effect on derivatives used as hedging instruments	21	-	-	-
Net effect on hedged items	(22)	1	-	-
	(1)	**1**	-	-

11 Other operating income

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Rental income from investment property and assets under operating lease	66	65	3	8
Net gain on disposal of available-for-sale securities	53	274	16	125
Gain on disposal of property and equipment, intangible assets and investment property	6	30	3	5
Gain on disposal of associate Intesa Sanpaolo Card (note 26)	-	162	-	241
Other income	63	58	62	51
Net value adjustment from valuation of tangible assets (IAS 16)	-	-	12	-
	188	**589**	**96**	**430**

Notes to the financial statements (continued)

12 Personnel expenses

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Net salaries	581	550	385	359
Contributions for pension insurance	156	149	109	104
Taxes and surtaxes	115	117	80	82
Contributions for health insurance	113	109	83	80
Other personnel expenses	137	156	73	93
	1,102	**1,081**	**730**	**718**

During the year the average number of employees within the Group based on full-time employment equivalence was 4,922 (2016: 4,852) of which the Bank accounted for 3,395 (2016: 3,325) employees.

13 Other operating expenses

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Materials and services	450	461	360	350
Deposit insurance premium	149	151	121	122
Rental expenses	69	66	68	69
Indirect and other taxes	19	23	14	16
Other expenses	456	457	121	131
	1,143	**1,158**	**684**	**688**

Notes to the financial statements (continued)

14 Impairment losses and provisions

a) Impairment losses on loans and advances to customers

(in HRK million)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Impairment losses on loans and advances to customers	23c	796	579	589	373
Legal expenses related to loans and advances to customers		27	23	19	16
		823	**602**	**608**	**389**

Impairment losses on loans and advances to customers for the Group includes HRK 112 million of profit from receivables sold during the year (2016: profit of HRK 1 million) and for the Bank HRK 107 million (2016: profit of HRK 1 million).

b) Other impairment losses and provisions

(in HRK million)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
(Release of provisions)/provisions for off-balance-sheet items	38a	(2)	(46)	8	(34)
Movement in impairment losses on other assets	31	17	22	13	9
Release of provisions for loans and advances to banks	22b	(13)	(15)	(13)	(15)
Provisions for court cases/(Release of provisions)	38a	4	13	(5)	8
Movement in impairment loss on financial assets available for sale	24	-	12	-	9
Provision for retirement benefit obligations	38b	2	3	-	-
(Release of provisions) for other items	38a	(2)	(1)	(2)	(1)
		6	**(12)**	**1**	**(24)**

The impairment loss recognised in 2016 on financial assets available for sale in the amount of HRK 12 million for the Group and HRK 9 million for the Bank relates to impairment losses on financial assets which first became impaired that year.

Notes to the financial statements (continued)

15 Depreciation and amortisation and impairment of goodwill

(in HRK million)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Depreciation and impairment of property and equipment	28	123	137	62	69
Amortisation of intangible assets	27	69	58	54	42
Impairment of goodwill	27	-	40	-	-
Depreciation and impairment of investment property	29	6	9	2	2
		198	**244**	**118**	**113**

Depreciation of property and equipment includes HRK 36 million of depreciation of assets under operating lease (2016: HRK 37 million). Depreciation of investment property for 2016 includes HRK 4 million impairment for the Group.

16 Income tax expense

a) Income tax expense recognised in the income statement

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Current income tax charge	292	441	222	368
Net deferred tax charge	12	25	9	12
Income tax expense recognised in the income statement	**304**	**466**	**231**	**380**

Notes to the financial statements (continued)

16 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	
	2017	Restated 2016	2017	2016
Accounting profit before tax	**1,650**	**2,205**	**1,674**	**1,985**
Tax calculated at rate of 18% (2016: 20%)	297	441	301	397
Effect of different tax rates in Bosnia and Herzegovina	(8)	(11)	-	-
Effect of different tax rates in Slovenia	(1)	(5)	-	-
Tax effects of:				
Non-deductible expenses	33	65	11	30
Tax exempt income	(16)	(21)	(80)	(46)
Expenses/income included directly in income tax expense	(1)	(3)	(1)	(1)
Total income tax expense	**304**	**466**	**231**	**380**
Effective income tax rate	**18.4%**	**21.1%**	**13.8%**	**19.1%**

c) Deferred tax assets

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Timing differences				
On unrealised losses on financial assets at fair value through profit or loss	38	39	38	39
On impairment of loans	31	34	-	-
On deferred fees	24	29	22	26
On impairment of real estate	9	13	6	10
On unrealised losses on available-for-sale financial assets	2	2	-	-
On other items	21	20	13	13
Deferred tax assets	**125**	**137**	**79**	**88**

Notes to the financial statements (continued)

16 Income tax expense (continued)

d) Deferred tax liabilities

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Timing differences				
On unrealised gains on tangible assets	51	-	19	-
On unrealised gains on available-for-sale financial assets	35	33	11	5
Deferred tax liabilities	**86**	**33**	**30**	**5**

e) Movement in deferred tax assets

(in HRK million)

Group

	Total	Deferred fees	Impairment of real estate	Unrealised losses on financial assets at fair value through profit or loss	Impairment on available for sale financial assets	Other items	Impairment of loans
Balance as at 1 January 2017	**137**	**29**	**13**	**39**	**2**	**20**	**34**
Increase credited to income statement	***36***	*9*	-	*3*	-	*23*	*1*
Utilisation charged to income statement	***(48)***	*(14)*	*(4)*	*(4)*	-	*(22)*	*(4)*
Net amount charged to income statement	**(12)**	(5)	(4)	(1)	-	1	(3)
Balance as at 31 December 2017	**125**	**24**	**9**	**38**	**2**	**21**	**31**
Balance as at 1 January 2016, restated	**162**	**41**	**13**	**42**	**1**	**28**	**37**
Increase credited to income statement	***44***	*12*	-	*4*	*1*	*24*	*3*
Charge due to decrease of tax rate (from 20% to 18%)	***(26)***	*(5)*	-	*(4)*	-	*(13)*	*(4)*
Utilisation charged to income statement	***(43)***	*(19)*	-	*(3)*	-	*(19)*	*(2)*
Net amount charged to income statement	**(25)**	(12)	-	(3)	1	(8)	(3)
Balance as at 31 December 2016, restated	**137**	**29**	**13**	**39**	**2**	**20**	**34**

Notes to the financial statements (continued)

16 Income tax expense (continued)

e) Movement in deferred tax assets (continued)

(in HRK million)

Bank	Total	Deferred fees	Impairment of real estate	Unrealised losses on financial assets at fair value through profit or loss	Other items
Balance as at 1 January 2017	**88**	**26**	**10**	**39**	**13**
Increase credited to income statement	***33***	*9*	-	*3*	*21*
Utilisation charged to income statement	***(42)***	*(13)*	*(4)*	*(4)*	*(21)*
Net amount charged to income statement	**(9)**	(4)	(4)	(1)	-
Balance as at 31 December 2017	**79**	**22**	**6**	**38**	**13**
Balance as at 1 January 2016	**100**	**36**	**10**	**42**	**12**
Increase credited to income statement	***38***	*12*	-	*4*	*22*
Charge due to decrease of tax rate (from 20% to 18%)	***(10)***	*(4)*	-	*(4)*	*(2)*
Utilisation charged to income statement	***(40)***	*(18)*	-	*(3)*	*(19)*
Net amount charged to income statement	**(12)**	(10)	-	(3)	1
Balance as at 31 December 2016	**88**	**26**	**10**	**39**	**13**

Notes to the financial statements (continued)

16 Income tax expense (continued)

f) Movement in deferred tax liabilities

(in HRK million)

Group

	Total	Unrealised gains on available-for-sale financial assets	Unrealised gains on tangible assets
Balance as at 1 January 2017	**33**	**33**	**-**
Increase in DTL charged	53	2	51
Balance as at 31 December 2017	**86**	**35**	**51**
Balance as at 1 January 2016, restated	**52**	**52**	**-**
Decrease in DTL credited	(19)	(19)	-
Balance as at 31 December 2016, restated	**33**	**33**	**-**

Bank

	Total	Unrealised gains on available-for-sale financial assets	Unrealised gains on tangible assets
Balance as at 1 January 2017	**5**	**5**	**-**
Increase in DTL charged	25	6	19
Balance as at 31 December 2017	**30**	**11**	**19**
Balance as at 1 January 2016	**22**	**22**	**-**
Decrease in DTL credited	(17)	(17)	-
Balance as at 31 December 2016	**5**	**5**	**-**

Notes to the financial statements (continued)

17 Cash and current accounts with banks

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Current accounts with the CNB	11,694	6,600	11,694	6,600
Current accounts with foreign banks	4,386	5,539	2,139	4,209
Cash in hand	2,598	2,136	1,616	1,520
Current accounts with domestic banks	31	16	15	8
Other cash items	2	1	2	1
	18,711	**14,292**	**15,466**	**12,338**

18 Balances with the Croatian National Bank

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Obligatory reserve	4,185	3,916	4,185	3,916
	4,185	**3,916**	**4,185**	**3,916**

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 2017 amounted to 12% (2016: 12%) of kuna and foreign currency deposits and borrowings.

As at 31 December 2017, the required rate for the part of the obligatory reserve calculated based on kuna liabilities to be deposited with the CNB amounted to 70% (2016: 70%), while the remaining 30% (2016: 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.

No part of the obligatory reserve based on foreign currency liabilities must be deposited with the CNB (2016: 0%), so 100% (2016: 100%) must be held in the form of other liquid receivables what resulted in a decrease of obligatory reserve. 75% of the part of the obligatory reserve calculated based on foreign currency liabilities is required to be held in kuna and is added to the kuna part of the 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 2017 (2016: nil).

Notes to the financial statements (continued)

19 Financial assets at fair value through profit or loss

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Financial assets held for trading				
Republic of Croatia bonds	524	493	524	493
Equity securities	20	20	20	20
Accrued interest	6	5	6	5
	550	**518**	**550**	**518**
Listed securities	*550*	*518*	*550*	*518*
	550	**518**	**550**	**518**
Financial assets initially designated at fair value through profit or loss				
Ministry of Finance treasury bills	1,652	5,453	1,652	5,418
Bonds issued by domestic corporate issuers	-	6	-	6
Municipal bonds	-	5	-	5
Equity securities	4	8	1	6
Accrued interest	7	22	7	22
	1,663	**5,494**	**1,660**	**5,457**
Listed securities	*4*	*19*	*1*	*17*
Unlisted securities	*1,659*	*5,475*	*1,659*	*5,440*
	1,663	**5,494**	**1,660**	**5,457**
Units in investment funds - quoted	-	92	-	-
	-	**92**	**-**	**-**
Financial assets at fair value through profit or loss	**2,213**	**6,104**	**2,210**	**5,975**

Notes to the financial statements (continued)

20 Derivative financial assets

a) Derivative financial assets classified as held for trading

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Fair value:				
Forward foreign exchange contracts and swaps	3	25	2	19
Interest rate cap	1	1	-	-
	4	**26**	**2**	**19**
Notional amount:				
Forward foreign exchange contracts and swaps	1,463	2,346	1,426	2,269
Interest rate cap	37	46	-	-
	1,500	**2,392**	**1,426**	**2,269**

The Group uses foreign currency forward and swap contracts to manage its exposure to foreign currency risk. Interest rate cap derivative contracts are used for the purpose of interest rate risk management.

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)

20 Derivative financial assets (continued)

b) Derivative financial assets held for hedge accounting

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Fair value:				
Interest rate swaps - micro hedge	10	4	-	-
Interest rate swaps - macro hedge	8	3	-	-
	18	**7**	**-**	**-**
Notional amount:				
Interest rate swaps - micro hedge	1,400	373	-	-
Interest rate swaps - macro hedge	431	115	-	-
	1,831	**488**	**-**	**-**

Derivative contracts held for hedge accounting are entered into for the purpose of interest-rate risk management. In financial environment of low interest rates the Group promoted its commercial activities by lunching long term loans fix interest rates. To overcome the interest rate risk interest rate swaps were made. The Group uses fair value hedge accounting techniques, where interest rate swaps hedges long-term financial assets (bonds and loans) with fixed interest rate.

c) Fair value changes of the hedged items in portfolio hedge of interest rate risk

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	-	-	-
	1	**-**	**-**	**-**

Notes to the financial statements (continued)

21 Derivative financial liabilities

a) Derivative financial liabilities classified as held for trading

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Fair value:				
Forward foreign exchange contracts and swaps	8	11	7	5
Interest rate cap contracts	-	-	-	-
	8	**11**	**7**	**5**
Notional amount:				
Forward foreign exchange contracts and swaps	1,467	2,332	1,431	2,254
Interest rate cap contracts	-	6	-	-
	1,467	**2,338**	**1,431**	**2,254**

b) Derivative financial liabilities held for hedge accounting

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Fair value:				
Interest rate swaps - micro hedge	4	11	-	-
Interest rate swaps - macro hedge	1	-	-	-
	5	**11**	**-**	**-**
Notional amount:				
Interest rate swaps - micro hedge	378	1,028	-	-
Interest rate swaps - macro hedge	304	157	-	-
	682	**1,185**	**-**	**-**

c) Fair value changes of the hedged items in portfolio hedge of interest rate risk

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	3	-	-
	9	**3**	**-**	**-**

Notes to the financial statements (continued)

22 Loans and advances to banks

a) Analysis by type of product

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Term deposits and placements	1,573	2,766	1,376	1,557
Loans	155	179	140	215
Obligatory reserve with CBBH	566	578	-	-
Obligatory reserve with BoS	143	132	-	-
	2,437	**3,655**	**1,516**	**1,772**
Impairment allowance	(23)	(41)	(23)	(41)
	2,414	**3,614**	**1,493**	**1,731**

Term deposits mainly relate to short-term deposits with local and foreign banks bearing an average annual interest rate in the range of (-1.0%) and 4.4% (2016: in the range of 0.3% and 2.5%).

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).

The obligatory reserve with the Bank of Slovenia ("BoS") represents amounts required to be deposited with Slovenia's central bank. Mandatory reserve is maintained, relative to the volume and structure of customer deposits. The current requirement regarding the calculation of the amount to be held as mandatory reserve is 1% of time deposits and issued debt securities with maturities up to two years.

b) Movement in impairment allowance

(in HRK million)

		GROUP		BANK	
	Note	2017	Restated 2016	2017	2016
Balance at 1 January		**41**	**56**	**41**	**56**
Net release for the year	14b	(13)	(15)	(13)	(15)
Amounts written off		(5)	-	(5)	-
Balance at 31 December		**23**	**41**	**23**	**41**

Notes to the financial statements (continued)

22 Loans and advances to banks (continued)

c) Geographical analysis

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Bosnia and Herzegovina	570	973	3	3
Switzerland	506	503	506	503
Republic of Croatia	336	253	340	286
Austria	323	36	267	-
France	251	185	251	185
Slovenia	188	160	-	-
Italy	114	691	-	-
Germany	105	252	105	252
Norway	28	23	28	23
Great Britain	3	157	3	98
Belgium	-	417	-	417
Other countries	13	5	13	5
	2,437	**3,655**	**1,516**	**1,772**
Impairment allowance	(23)	(41)	(23)	(41)
	2,414	**3,614**	**1,493**	**1,731**

As at 31 December 2017 loans and advances to banks included reverse repurchase agreements in the amount of HRK 120 million for the Group and HRK 120 million for the Bank (2016: HRK 165 million for the Group and HRK 202 million for the Bank). Such agreements are secured with government bonds and treasury bills. For details on sale and repurchase agreements please refer to Note 49(a).

Notes to the financial statements (continued)

23 Loans and advances to customers

a) Analysis by type of customer

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Retail customers	35,367	33,649	24,832	23,843
Corporate customers	23,158	23,774	14,423	14,154
Public sector and other institutions	9,664	10,843	7,388	9,439
Debt securities	751	1,387	724	1,328
	68,940	**69,653**	**47,367**	**48,764**
Impairment allowance	(3,830)	(4,223)	(2,632)	(2,877)
Deferred interest and fees recognised as an adjustment to the effective yield	(190)	(232)	(153)	(199)
CHF conversion not yet finalised	(20)	(21)	(20)	(21)
	64,900	**65,177**	**44,562**	**45,667**

Debt securities of the Group include HRK 26 million (2016: HRK 74 million) and none for the Bank (2016: HRK 16 million), respectively, of Croatian bonds reclassified from available-for-sale financial assets in 2009, as well as HRK 12 million (2016: HRK 616 million) for the Group and the Bank of Croatian government bonds reclassified in 2009 from the held-for-trading category as described in Notes 24 and 47(d).

Notes to the financial statements (continued)

23 Loans and advances to customers (continued)

b) Analysis by sector

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Individuals	35,367	33,649	24,832	23,843
Construction	4,944	6,182	4,349	5,403
Public administration and defence; compulsory social security	4,530	5,935	3,376	4,784
Wholesale and retail trade; repair of motor vehicles and motorcycles	4,853	5,379	2,719	3,128
Manufacturing	4,747	4,772	2,667	2,650
Transporting and storage	3,247	3,264	1,002	1,080
Accommodation and food service activities	2,511	1,899	2,183	1,630
Real estate activities	1,800	1,642	1,633	1,376
Electricity, gas, steam and air conditioning supply	1,133	1,043	862	786
Professional, scientific and technical activities	920	968	695	730
Information and communication	713	900	115	279
Agriculture, forestry and fishing	1,049	880	959	766
Administrative and support service activities	1,010	821	167	153
Financial and insurance activities	317	604	437	887
Human health and social work activities	365	403	258	305
Education	319	372	267	326
Water supply; sewerage; waste management and remediation activities	256	272	201	224
Arts, entertainment and recreation	402	215	307	107
Other services activities	200	191	130	110
Mining and quarrying	135	170	86	105
Activities of extraterritorial organisations and bodies	122	92	122	92
	68,940	**69,653**	**47,367**	**48,764**

Loans and advances to customers also include finance lease receivables. For a more detailed analysis of finance lease receivables please refer to Note 43 *Leases*.

Notes to the financial statements (continued)

23 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	
Group							
Balance at 1 January 2017	**1,546**	**228**	**1,993**	**413**	**13**	**30**	**4,223**
Net (release)/charge in the income statement	(1)	(11)	840	(28)	(2)	(2)	**796**
Amounts written off	(404)	-	(765)	-	-	-	**(1,169)**
Foreign exchange loss	(10)	-	(5)	-	-	-	**(15)**
Translation differences in respect of foreign operations	(1)	-	(3)	(1)	-	-	**(5)**
Balance at 31 December 2017	**1,130**	**217**	**2,060**	**384**	**11**	**28**	**3,830**
Balance at 1 January 2016, restated	**1,687**	**240**	**2,768**	**447**	**13**	**24**	**5,179**
Net charge/(release) in the income statement	126	(12)	492	(33)	-	6	**579**
Amounts written off	(254)	-	(1,252)	-	-	-	**(1,506)**
Foreign exchange loss	(12)	-	(5)	-	-	-	**(17)**
Translation differences in respect of foreign operations	(1)	-	(10)	(1)	-	-	**(12)**
Balance at 31 December 2016, restated	**1,546**	**228**	**1,993**	**413**	**13**	**30**	**4,223**

Notes to the financial statements (continued)

23 Loans and advances to customers (continued)

c) Movement in impairment allowance on loans and advances to customers (continued)

(in HRK million)

	Retail		**Corporate**		**Public sector and other institutions**		**Total**
	Specific	IBNR	Specific	IBNR	Specific	IBNR	
Bank							
Balance at 1 January 2017	**1,232**	**160**	**1,128**	**320**	**9**	**28**	**2,877**
Net (release)/charge in the income statement	(39)	(12)	646	(3)	-	(3)	**589**
Amounts written off	(332)	-	(487)	-	-	-	**(819)**
Foreign exchange gain	(10)	-	(5)	-	-	-	**(15)**
Balance at 31 December 2017	**851**	**148**	**1,282**	**317**	**9**	**25**	**2,632**
Balance at 1 January 2016	**1,380**	**181**	**1,600**	**347**	**5**	**21**	**3,534**
Net charge/(release) in the income statement	99	(21)	311	(27)	4	7	**373**
Amounts written off	(235)	-	(778)	-	-	-	**(1,013)**
Foreign exchange gain	(12)	-	(5)	-	-	-	**(17)**
Balance at 31 December 2016	**1,232**	**160**	**1,128**	**320**	**9**	**28**	**2,877**

Notes to the financial statements (continued)

23 Loans and advances to customers (continued)

d) 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 131 million and HRK 0.3 million, respectively (2016: HRK 29 million and nill respectively). The repossessed collateral, which the Group is in the process of selling, is disclosed as foreclosed assets within Other assets (Note 31). In general, the Group does not occupy repossessed properties for business use.

e) Sale of receivables

In 2017, the Group sold HRK 818 million gross receivable (HRK 151 million net receivable) to a third party for HRK 264 million what resulted with a release of specific impairment allowance of HRK 667 million and the Bank sold HRK 687 million gross receivables (impaired in full amount at the moment of sale) for HRK 243 million what resulted with a release of specific impairment allowance of HRK 511 million.

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.

24 Financial assets available for sale

(in HRK million)

	GROUP		**BANK**	
	2017	Restated 2016	2017	2016
Debt securities	7,362	3,881	4,053	276
Equity securities	131	124	92	94
Investment in National Bank Resolution Fund	80	80	-	-
	7,573	**4,085**	**4,145**	**370**

In order to comply with the requirements of the National Bank Resolution Fund, Slovenian government bonds in the amount of HRK 85 million (2016: HRK 83 million) are pledged.

Notes to the financial statements (continued)

24 Financial assets available for sale (continued)

a) Available-for-sale debt securities

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Foreign government bonds	2,178	2,420	-	-
Republic of Croatia bonds	1,447	960	674	274
Ministry of Finance treasury bills	3,369	-	3,369	-
Foreign government treasury bills	301	245	-	-
Bank debt securities	21	157	-	-
Corporate debt securities	11	62	-	-
	7,327	**3,844**	**4,043**	**274**
Accrued interest	35	37	10	2
	7,362	**3,881**	**4,053**	**276**
Listed securities	3,923	3,783	679	276
Unlisted securities	3,439	98	3,374	-
	7,362	**3,881**	**4,053**	**276**

b) Available-for-sale equity securities

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Listed securities	35	38	28	26
Unlisted securities	96	86	64	68
Of which securities carried at fair value	*73*	*52*	*44*	*34*
Of which securities carried at cost	*23*	*34*	*20*	*34*
	131	**124**	**92**	**94**

Notes to the financial statements (continued)

24 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 47(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**	
	2017	Restated 2016	2017	2016
Cost/fair value at acquisition	23	81	20	81
Impairment losses	-	(47)	-	(47)
Carrying value of unlisted equity securities carried at cost	**23**	**34**	**20**	**34**

Notes to the financial statements (continued)

24 Financial assets available for sale (continued)

Movement in impairment losses

Group

(in HRK million)

	Notes	Unlisted equity securities	Listed equity securities	Total
Balance at 1 January 2016, restated		**47**	**-**	**47**
Impairment loss charged to income statement	14b	-	12	**12**
Balance at 31 December 2016, restated		**47**	**12**	**59**
Amounts written off		(47)	**-**	**(47)**
Balance at 31 December 2017		**-**	**12**	**12**

Bank

	Notes	Unlisted equity securities	Listed equity securities	Total
Balance at 1 January 2016		**47**	**-**	**47**
Impairment loss charged to income statement	14b	-	9	**9**
Balance at 31 December 2016		**47**	**9**	**56**
Amounts written off		(47)	-	**(47)**
Balance at 31 December 2017		**-**	**9**	**9**

Notes to the financial statements (continued)

25 Held-to-maturity investments

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Republic of Croatia bonds	16	17	-	-
	16	**17**	**-**	**-**

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.

26 Investments in subsidiaries and associates

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Consolidated subsidiaries	-	-	1,934	925
Associates accounted for under the equity method by the Group and at cost by the Bank	69	67	28	28
	69	**67**	**1,962**	**953**
Movements				
Balance at 1 January	**67**	**150**	**953**	**963**
Share of profits from associates	14	24	-	-
Disposal of associate Intesa Sanpaolo Card doo	-	(89)	-	(10)
Acquisition of Banka Intesa Sanpaolo d.d. Slovenia	-	-	977	-
Squeeze out of minority shareholders of Intesa Sanpaolo d.d. Bosnia & Herzegovina	-	-	32	-
Receipt of dividend	(12)	(18)	-	-
Balance at 31 December	**69**	**67**	**1,962**	**953**

Notes to the financial statements (continued)

26 Investments in subsidiaries and associates (continued)

The principal investments in subsidiaries and associates as at 31 December are as follows:

	COUNTRY	NATURE OF BUSINESS	2017 holding %	2016 holding %
CONSOLIDATED SUBSIDIARIES				
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	99	95
Banka Intesa Sanpaolo dd*	Slovenia	credit institution	51	-
ASSOCIATES				
PBZ Croatia osiguranje dd	Croatia	pension management	50	50

* the holding legal ownership of Banka Intesa Sanpaolo dd, Slovenia in 2016 was nil, but for the purpose of the consolidated annual report it was accounted for using an effective ownership of 51%

The Group considers that its 50% investment in PBZ Croatia osiguranje dd represent investment in associates (31 December 2016: 50% investment in PBZ Croatia osiguranje) 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)

	2017	2016	
	PBZ Croatia osiguranje	PBZ Croatia osiguranje	Intesa Sanpaolo Card Zagreb
Associates' statement of financial position			
Current assets	144	141	-
Non-current assets	1	1	-
Current liabilities	(3)	(5)	-
Non-current liabilities	(4)	(3)	-
Net assets of associates'	**138**	**134**	**-**
Attributable to PBZ Group	**69**	**67**	**-**
Associates' income statements			
Revenue	69	64	287
Expenses	(41)	(40)	(250)
Profit	**28**	**24**	**37**
Attributable to PBZ Group	**14**	**12**	**12**

Notes to the financial statements (continued)

26 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 doo Zagreb

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)
Associates' statement of financial position	
Current assets	105
Non-current assets	211
Current liabilities	(25)
Non-current liabilities	(4)
Net assets of associates'	**287**
Attributable to PBZ Group	**89**

Effect of disposal on the financial position of the Bank and the Group in 2016:

(in HRK million)

	GROUP	BANK
Associates' statement of financial position		
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)
Profit on disposal (note 11)	**162**	**241**
Income tax	(48)	(48)
Profit on disposal, net of tax	**114**	**193**

Notes to the financial statements (continued)

26 Investments in subsidiaries and associates (continued)

Acquisition of Banka Intesa Sanpaolo dd Slovenia – common control transaction

As of 20 July 2017 the Bank purchased a 51% stake in Banka Intesa Sanpaolo dd Slovenia (270,993 ordinary shares with 51% voting rights) from Intesa Sanpaolo S.p.A. Turin.

The sales price was determined based on the carrying value of the net asset of the purchased bank as of 31 December 2016 and amounted to HRK 1,071 million.

The date of acquisition was considered to be 1 July 2017, 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 afore-mentioned 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)

26 Investments in subsidiaries and associates (continued)

Acquisition of Banka Intesa Sanpaolo dd – common control transaction (continued)

The carrying values of assets and liabilities of Banka Intesa Sanpaolo dd Slovenia were as follows:

(in HRK million)

	1 January 2016*	31 December 2016*	1 July 2017*
Cash and current accounts with banks	1,665	1,325	1,962
Financial assets at fair value through profit or loss	2	1	1
Derivative financial assets	1	8	25
Loans and advances to banks	1,346	808	437
Loans and advances to customers	11,320	12,292	11,448
Financial assets available for sale	2,520	2,680	2,637
Intangible assets	34	31	28
Property and equipment	164	142	129
Investment property	108	106	144
Deferred tax assets	20	7	7
Other assets	180	183	141
Tax prepayments	8	-	-
Total assets	**17,368**	**17,583**	**16,959**
Current accounts and deposits from banks	174	473	117
Current accounts and deposits from customers	13,565	13,906	13,882
Derivative financial liabilities	1	11	2
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	3	9
Interest-bearing borrowings	1,143	664	574
Other liabilities	158	183	216
Accrued expenses and deferred income	41	55	57
Provisions for liabilities and charges	87	78	75
Deferred tax liabilities	18	12	9
Current tax liability	-	7	1
Total liabilities	**15,187**	**15,392**	**14,942**
Net assets and liabilities	**2,181**	**2,191**	**2,017**
Attributable to non-controlling interests	1,069	1,074	988
Consideration paid and payable			1,071

(*) reported figures not adjusted for intercompany transactions, consolidation and reclassification adjustments.

Notes to the financial statements (continued)

27 Intangible assets

(in HRK million)

	Goodwill	Software	Other intangible assets	Assets acquired but not brought into use	Total
Group					
Acquisition cost					
Balance at 1 January 2016	**69**	**552**	**25**	**19**	**665**
Acquisition of entity under common control	-	127	28	10	**165**
Balance at 1 January 2016	**69**	**679**	**53**	**29**	**830**
Additions	-	-	-	71	**71**
Transfer into use	-	70	4	(74)	-
Disposals and eliminations	-	(6)	(7)	-	**(13)**
Impairment of goodwill	(40)	-	-	-	**(40)**
Balance at 31 December 2016	**29**	**743**	**50**	**26**	**848**
Additions	-	-	-	111	**111**
Transfer into use	-	83	7	(90)	**-**
Disposals and eliminations	-	(3)	(8)	-	**(11)**
Translation differences in respect of foreign operations	-	(1)	-	-	**(1)**
Balance at 31 December 2017	**29**	**822**	**49**	**47**	**947**
Accumulated amortisation					
Balance at 1 January 2016	**-**	**467**	**16**	**-**	**483**
Acquisition of entity under common control	-	107	24	-	**131**
Balance at 1 January 2016	**-**	**574**	**40**	**-**	**614**
Charge for the year	-	53	5	-	**58**
Disposals and eliminations		(6)	(7)		**(13)**
Balance at 31 December 2016	**-**	**621**	**38**	**-**	**659**
Charge for the year	-	65	4	-	**69**
Disposals and eliminations	-	(2)	(6)	-	**(8)**
Balance at 31 December 2017	**-**	**684**	**36**	**-**	**720**
Carrying value					
Balance at 31 December 2016	**29**	**122**	**12**	**26**	**189**
Balance at 31 December 2017	**29**	**138**	**13**	**47**	**227**

Notes to the financial statements (continued)

27 Intangible assets (continued)

Goodwill represents goodwill arising from the acquisition of Međimurska banka in the amount of HRK 15 million (2016: 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 (2016: HRK 14 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% (2016: 9.9%).

Notes to the financial statements (continued)

27 Intangible assets (continued)

(in HRK million)

	Goodwill	Software	Other intangible assets	Assets acquired but not brought into use	Total
Bank					
Acquisition cost					
Balance at 1 January 2016	**14**	**490**	**3**	**14**	**521**
Additions	-	-	-	60	**60**
Transfer into use	-	60	-	(60)	-
Balance at 31 December 2016	**14**	**550**	**3**	**14**	**581**
Additions	-	-	-	92	**92**
Transfer into use	-	71	-	(71)	-
Balance at 31 December 2017	**14**	**621**	**3**	**35**	**673**
Accumulated amortisation					
Balance at 1 January 2016	**-**	**415**	**-**	**-**	**415**
Charge for the year	-	41	1	-	**42**
Balance at 31 December 2016	**-**	**456**	**1**	**-**	**457**
Charge for the year	-	53	1	-	**54**
Balance at 31 December 2017	**-**	**509**	**2**	**-**	**511**
Carrying value					
Balance at 31 December 2016	**14**	**94**	**2**	**14**	**124**
Balance at 31 December 2017	**14**	**112**	**1**	**35**	**162**

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)

28 Property and equipment

(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
Group						
Acquisition cost						
Balance at 1 January 2016	**1,308**	**481**	**129**	**455**	**25**	**2,398**
Acquisition to entity under common control	351	73	27	44	3	**498**
Balance at 1 January 2016	**1,659**	**554**	**156**	**499**	**28**	**2,896**
Additions	-	-	-	-	102	**102**
Transfer to investment property	(98)	-	-	-	-	**(98)**
Disposals	(10)	(14)	(68)	(21)	-	**(113)**
Transfer into use	6	12	45	37	(100)	**-**
Translation differences in respect of foreign operations	(4)	(1)	-	-	-	**(5)**
Balance at 31 December 2016	**1,553**	**551**	**133**	**515**	**30**	**2,782**
Additions	-	-	-	-	174	**174**
Disposals	-	(16)	(129)	(22)	-	**(167)**
Application of revaluation model: Fair value gain	290	-	-	-	-	**290**
Reclassifications		4	-	(4)	-	**-**
Transfer into use	6	15	120	30	(171)	**-**
Reclassified to non-current assets held for sale	(77)	-	-	-	-	**(77)**
Application of revaluation model: Reversal of accumulated depreciation	(614)	-	-	-	-	**(614)**
Balance at 31 December 2017	**1,158**	**554**	**124**	**519**	**33**	**2,388**
Accumulated depreciation						
Balance at 1 January 2016	**387**	**435**	**55**	**389**	**-**	**1,266**
Acquisition to entity under common control	232	67	14	40	-	**353**
Balance at 1 January 2016	**619**	**502**	**69**	**429**	**-**	**1,619**
Charge for the year	45	22	24	46	-	**137**
Disposals	(3)	(14)	(35)	(21)	-	**(73)**
Transfer to investment property	(50)	-	-	-	-	**(50)**
Translation differences in respect of foreign operations	(2)	(1)	-	-	-	**(3)**
Balance at 31 December 2016	**609**	**509**	**58**	**454**	**-**	**1,630**
Charge for the year	45	19	22	30	-	**116**
Impairment	7	-	-	-	-	**7**
Disposals	-	(16)	(28)	(20)	-	**(64)**
Reclassifications	-	2	-	(2)	-	**-**
Reclassified to non-current assets held for sale	(43)	-	-	-	-	**(43)**
Translation differences in respect of foreign operations	(4)	-	-	-	-	**(4)**
Application of revaluation model: Reversal of accumulated depreciation	(614)	-	-	-	-	**(614)**
Balance at 31 December 2017	**-**	**514**	**52**	**462**	**-**	**1,028**
Carrying value						
Balance at 31 December 2016	**944**	**42**	**75**	**61**	**30**	**1,152**
Balance at 31 December 2017	**1,158**	**40**	**72**	**57**	**33**	**1,360**

Notes to the financial statements (continued)

28 Property and equipment (continued)

(in HRK million)

	Land and buildings	Furniture and other equipment	Motor vehicles	Computer equipment	Assets acquired but not brought into use	Total
Bank						
Acquisition cost						
Balance at 1 January 2016	**850**	**416**	**3**	**327**	**25**	**1,621**
Additions	-	-	-	-	38	**38**
Disposals	-	(9)	(1)	(9)	-	**(19)**
Transfer into use	2	7	-	27	(36)	-
Transfer to investment property	(98)	-	-	-	-	**(98)**
Balance at 31 December 2016	**754**	**414**	**2**	**345**	**27**	**1,542**
Additions	-	-	-	-	39	**39**
Transfer into use	3	13	-	20	(36)	-
Disposals	-	(7)	-	(6)	-	**(13)**
Reclassifications	-	4	-	(4)	-	-
Application of revaluation model: Fair value gain	106	-	-	-	-	**106**
Reclassified to non-current assets held for sale	(38)	-	-	-	-	**(38)**
Application of revaluation model: Reversal of accumulated depreciation	(297)	-	-	-	-	**(297)**
Balance at 31 December 2017	**528**	**424**	**2**	**355**	**30**	**1,339**
Accumulated depreciation						
Balance at 1 January 2016	**330**	**379**	**2**	**285**	**-**	**996**
Charge for the year	22	15	-	32	-	69
Disposals	-	(8)	(1)	(9)	-	(18)
Transfer to investment property	(50)	-	-	-	-	(50)
Balance at 31 December 2016	**302**	**386**	**1**	**308**	**-**	**997**
Charge for the year	19	15	1	20	-	**55**
Impairment	7	-	-	-	-	**7**
Disposals	-	(7)	-	(6)	-	**(13)**
Reversal of impairment losses	(12)	-	-	-	-	**(12)**
Reclassification	-	2	-	(2)	-	-
Reclassified to non-current assets held for sale	(19)	-	-	-	-	**(19)**
Application of revaluation model: Reversal of accumulated depreciation	(297)	-	-	-	-	**(297)**
Balance at 31 December 2017	**-**	**396**	**2**	**320**	**-**	**718**
Carrying value						
Balance at 31 December 2016	**452**	**28**	**1**	**37**	**27**	**545**
Balance at 31 December 2017	**528**	**28**	**-**	**35**	**30**	**621**

Notes to the financial statements (continued)

28 Property and equipment (continued)

During the year 2017, the Group has changed the accounting policy for the disclosure and measurement of property held for property (governed by IAS 16 “Property, Plant and Equipment) from cost model to the redetermination of value for measurement subsequent to initial disclosure of property.

As of 31 December 2017, the Group's Land and buildings were valued into their fair value based on the valuation of independent expert. The valuation, which confirms to International Valuation Standards, was performed by independent real estate appraiser CBRE and was determined by reference to model discounted cash flow method. Current market conditions were used as assumptions for the valuations performed.

The carrying amount that would have been recognized had those assets been carried under the cost model amounts to HRK 901 million and HRK 436 for the Group and the Bank, respectively, as of 31 December 2017.

Based on independent appraiser's valuation, following fair value adjustments were performed as of 31 December 2017 (HRK million):

(in HRK million)

	Carrying amount before revaluation	Fair value
Croatia	778	836
Slovenia	88	288
Bosnia and Herzegovina	35	34
	901	**1,158**

Revaluation reserve (accounted for under equity) was formed to account for revaluation differences.

Real estate, furniture and other equipment and motor vehicles of the Group include assets leased under operating leases with a carrying value of HRK 394 million (2016: HRK 379 million).

Notes to the financial statements (continued)

29 Investment property

	GROUP	BANK
	(in HRK million)	
Acquisition cost		
Balance at 1 January 2016	**44**	**30**
Acquisition to entity under common control	127	-
Balance at 1 January 2016	**171**	**30**
Transfer from foreclosed asset	5	-
Disposals	(29)	(25)
Transfer from property and equipment	98	98
Translation differences in respect of foreign operations	(1)	-
Balance at 31 December 2016	**244**	**103**
Additions	1	-
Transfer from foreclosed asset	53	-
Disposals	(29)	(12)
Reclassified to non-current assets held for sale	(256)	(90)
Application of revaluation model: Reversal of accumulated depreciation	(4)	-
Translation differences in respect of foreign operations	(1)	-
Balance at 31 December 2017	**8**	**1**
Accumulated depreciation		
Balance at 1 January 2016	**21**	**20**
Acquisition to entity under common control	19	-
Balance at 1 January 2016	**40**	**20**
Charge for the year	5	2
Impairment	4	-
Disposals and eliminations	(23)	(19)
Transfer from property and equipment	50	50
Balance at 31 December 2016	**76**	**53**
Charge for the year	6	2
Disposals and eliminations	(6)	(4)
Application of revaluation model: Reversal of accumulated depreciation	(4)	-
Reclassified to non-current assets held for sale	(72)	(51)
Balance at 31 December 2017	**-**	**-**
Carrying value		
Balance at 31 December 2016	**168**	**50**
Balance at 31 December 2017	**8**	**1**

Notes to the financial statements (continued)

29 Investment property (continued)

During the year 2017, the PBZ Group has changed the accounting criteria for the disclosure and measurement of property held for investment (governed by IAS 40 "Investment property") from cost model to fair value model. The fair value of Investment property was estimated by the independent appraiser. The independent appraiser will 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 17.2 million (2016: HRK 18.6 million) and HRK 1.8 million (2016: HRK 5.2 million) respectively, and was presented within other operating income (Note 11).

30 Non-current assets held for sale

During the year 2017, the Bank's Management Board resolved to dispose all real estates not needed for core operations of the Group.

In addition, all actions taken to close the deal and management's commitment indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn Therefore, the assets were classified as non-current assets held for sale and are presented separately in the balance sheet. The proceeds of the disposal are estimated to exceed the net carrying amount of the relevant assets and, accordingly, no impairment loss was recognized on the classification of these assets as held for sale.

(in HRK million)

Net carrying amount	**GROUP**	**BANK**
Balance at 1 January 2017	-	-
Transfer from property and equipment	34	19
Transfer from investment property	184	39
Transfer from foreclosed assets	124	32
Balance at 31 December 2017	**342**	**90**

Notes to the financial statements (continued)

31 Other assets

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Receivables from card business	359	298	79	66
Foreclosed assets	126	233	36	68
Prepaid expenses	39	50	22	29
Accrued fees	50	48	56	54
Receivables in course of collection	60	38	5	2
Leasehold improvements	42	44	19	18
Advance payments	13	13	11	9
Receivables from debtors	13	13	1	1
Other assets	114	111	340	76
	816	**848**	**569**	**323**
Impairment	(92)	(113)	(54)	(49)
	724	**735**	**515**	**274**

Movement in impairment

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Balance at 1 January	**113**	**144**	**49**	**87**
Net charge for the year	17	22	13	9
Amounts written off	(38)	(53)	(8)	(47)
Balance at 31 December	**92**	**113**	**54**	**49**

Movement in impairment on other assets is presented as part of Provisions for other items and other assets (Note 14b).

Notes to the financial statements (continued)

32 Current accounts and deposits from banks

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Term deposits	576	640	501	466
Demand deposits	615	955	563	910
	1,191	**1,595**	**1,064**	**1,376**

33 Current accounts and deposits from customers

a) Analysis by term

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Demand deposits	44,368	38,986	29,785	25,619
Term deposits	33,789	35,298	27,388	28,489
	78,157	**74,284**	**57,173**	**54,108**

b) Analysis by source

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Retail deposits	55,568	53,750	40,758	39,444
Corporate deposits	16,515	15,133	11,712	10,800
Public sector and other institutions	6,074	5,401	4,703	3,864
	78,157	**74,284**	**57,173**	**54,108**

Notes to the financial statements (continued)

34 Interest-bearing borrowings

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Foreign borrowings	2,068	2,526	777	1,115
Domestic borrowings	1,720	1,714	1,606	1,638
Accrued fee	(5)	(5)	(6)	(6)
	3,783	**4,235**	**2,377**	**2,747**

a) 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, USD and CHF and with floating interest rates.

b) 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 (2016: 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.

35 Subordinated liabilities

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Ministry of Finance of Bosnia and Herzegovina	1	1	-	-
	1	**1**	**-**	**-**

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.

Notes to the financial statements (continued)

36 Other liabilities

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Credit card payables and other payables	1,359	1,214	39	32
Items in the course of settlement and other liabilities	826	551	506	317
Salaries and other personnel costs	169	167	132	132
	2,354	**1,932**	**677**	**481**

37 Accrued expenses and deferred income

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Accrued expenses	269	227	145	114
Deferred income	93	92	20	23
	362	**319**	**165**	**137**

Notes to the financial statements (continued)

38 Provisions

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Provisions for liabilities and charges	311	324	249	257
Retirement benefit obligations	40	38	-	-
	351	**362**	**249**	**257**

a) Provisions for liabilities and charges

(in HRK million)

Group	Total	Provisions for off-balance-sheet items	Provisions for court cases	Provisions for other items
Balance as at 1 January 2017	**324**	**252**	**67**	**5**
Net (release)/charge in the income statement	-	(2)	4	(2)
Provisions used during the year	(13)	-	(12)	(1)
Balance as at 31 December 2017	**311**	**250**	**59**	**2**
Balance as at 1 January 2016, restated	**363**	**298**	**56**	**9**
Net (release)/charge in the income statement	(34)	(46)	13	(1)
Provisions used during the year	(5)	-	(2)	(3)
Balance as at 31 December 2016, restated	**324**	**252**	**67**	**5**

(in HRK million)

Bank	Total	Provisions for off-balance-sheet items	Provisions for court cases	Provisions for other items
Balance as at 1 January 2017	**257**	**207**	**46**	**4**
Net charge/(release) in the income statement	1	8	(5)	(2)
Provisions used during the year	(9)	-	(9)	-
Balance as at 31 December 2017	**249**	**215**	**32**	**2**
Balance as at 1 January 2016	**288**	**241**	**39**	**8**
Net (release)/charge in the income statement	(27)	(34)	8	(1)
Provisions used during the year	(4)	-	(1)	(3)
Balance as at 31 December 2016	**257**	**207**	**46**	**4**

Notes to the financial statements (continued)

38 Provisions (continued)

Provisions for off-balance-sheet items, court cases and other items are recognised in other impairment losses and provisions in the income statement (Note 14b).

Provision for off-balance-sheet items relates to specific and collective provisions on credit-related contingencies as disclosed in Note 39.

As at 31 December 2017 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 2017 in the amount of HRK 59 million (31 December 2016: HRK 67 million) for the Group and HRK 32 million (31 December 2016: HRK 46 million), for the Bank, respectively.

b) Retirement benefit obligation

(in HRK million)

Group	Retirement benefit obligations
Balance as at 1 January 2017	**38**
Net charge in the income statement	2
Provisions used during the year	-
Balance as at 31 December 2017	**40**
Balance as at 1 January 2016	**37**
Net charge in the income statement	3
Provisions used during the year	(1)
Actuarial gains	(1)
Balance as at 31 December 2016	**38**

The defined benefit scheme liabilities are measured on an actuarial basis using the projected unit credit method, which measures actuarial liabilities in accordance with the expected wage/salary increase from the valuation date until the foreseen retirement of the employed person. The wage/salary increase comprises promotion and inflation-related rise. Calculated current scheme liabilities are discounted using the rates equivalent to market yields on government bonds. For the calculation of actuarial gains and losses, the following assumptions have been used:

- The discount rate of 1.02% (2016: 1.02%), and
- Future salary increases of 0% p.a. for 2017 and 0.9% p.a. from 2018 onwards (2016: 0% p.a. for 2017 and 0.9% p.a. from 2018 onwards).

Notes to the financial statements (continued)

39 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 250 million for the Group and HRK 215 million for the Bank (2016: HRK 252 million and HRK 207 million respectively) is sufficient to cover risks due to the default of the respective counterparties (refer to Note 38a).

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	
	2017	Restated 2016	2017	2016
Undrawn lending commitments	14,214	12,957	11,224	10,094
Performance guarantees	3,081	2,975	2,329	2,256
Kuna payment guarantees	445	342	445	342
Foreign currency payment guarantees	1,529	1,480	583	456
Foreign currency letters of credit	65	211	53	190
Factoring and forfaiting	-	2	-	2
Other contingent liabilities	1	1	1	1
	19,335	**17,968**	**14,635**	**13,341**

Long-term commitments as lessees

On 31 December 2017 the Group and the Bank had long-term commitments as lessees in respect of rent for business premises and equipment lease agreements expiring between 2018 and 2022. The future minimum commitments for each of the next five years are presented below:

(in HRK million)

	2017	2018	2019	2020	2021	2022	Total
Group							
Premises	49	50	50	50	50	50	**250**
Equipment	16	19	18	18	18	17	**90**
	65	**69**	**68**	**68**	**68**	**67**	**340**
Bank							
Premises	70	71	71	71	71	71	**355**
Equipment	14	15	12	11	10	9	**57**
	84	**86**	**83**	**82**	**81**	**80**	**412**

Notes to the financial statements (continued)

40 Share capital

a) Issued share capital

Issued share capital as at 31 December 2017 amounted to HRK 1,907 million (31 December 2016: HRK 1,907 million). The total number of authorised registered shares at 31 December 2017 was 19,074,769 (2016: 19,074,769) with a nominal value of HRK 100 per share (2016: 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.

The ownership structure as at 31 December 2017 and 31 December 2016 was as follows:

	REGISTERED SHARES			
	31 December 2017		31 December 2016	
	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	418,614	2.2%	418,574	2.2%
Treasury shares	64,633	0.3%	64,673	0.3%
	19,074,769	**100.0%**	**19,074,769**	**100.0%**

Each share has an equal proportion in the share capital of the Bank and its participating value in the share capital as well. The proportion of each share in the share capital of the Bank is determined on the basis of the number of the issued shares.

The Bank’s shares are listed on the Zagreb Stock Exchange. As at 31 December 2017 the share price of the Bank’s ordinary shares quoted on the Zagreb Stock Exchange was HRK 755 (31 December 2016: HRK 769).

On 31 December 2017, the President of the Management Board Mr Božo Prka held 361 shares (31 December 2016: 361) of Privredna banka Zagreb dd, and of the other members of the Management Board, Mr Ivan Gerovac held 120 shares (31 December 2016: 120) and Mr Draženko Kopljar held 108 shares (31 December 2016: 108).

b) Share premium

The Bank recognises share premium in an amount of HRK 1,570 million (31 December 2016: HRK 1,570 million) representing the excess of the paid-in amount over the nominal value of the issued shares.

c) Treasury shares

During 2017 the Bank transferred 40 treasury shares to a minority shareholder. No movements of treasury shares were during 2016.

d) Own shares held as collateral

The Bank holds 2,508 (31 December 2016: 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)

40 Share capital (continued)

e) Other reserves (continued)

Treasury share reserve

During 2016 and 2017 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 2017 translation reserve amounted to HRK 18 million (2016: HRK 28 million) for the Group.

Other revaluation reserves

Other revaluation reserves includes valuation reseve of tangible assets due to the change in the accounting criteria for the disclosure and measurement of funcional and investment property in amount of HRK 290 million (net of tax: HRK 239 million) for the PBZ Group and HRK 106 million (net of tax: 87 million) for the Bank.

Other reserves

The amount of other reserves for the Group includes Statutory reserves of Intesa Sanpaolo bank dd Slovenia which the Intesa Sanpaolo Bank dd Slovenia according to its Statute, creates until they achieve an amount which is fifteen times that of the Bank's registered capital stock. In each financial year, a part of the net profit that remained after any losses carried forward, legal reserves and reserves for own shares have been covered is allocated to statutory reserve.

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 2017 in respect of 2016 is HRK 25.33 (2016 in respect of 2015: HRK 10) 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 acquirees.

i) Non-distributable reserves

Management considers that the fair value reserve and other reserves may not be distributed to shareholders. As at 31 December 2017 non-distributable reserves amount to HRK 1,469 million (31 December 2016: HRK 1,352 million) and HRK 345 million (31 December 2016: HRK 321 million), for the Group and the Bank, respectively.

Notes to the financial statements (continued)

41 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)

	Note	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Cash and current accounts with banks	17	18,711	14,292	15,466	12,338
Loans and advances to banks with maturity of up to 90 days		1,581	1,903	1,506	1,678
		20,292	**16,195**	**16,972**	**14,016**

42 Managed funds for and on behalf of third parties

(in HRK million)

	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Assets under custody - investment funds	7,269	11,815	3,723	3,211
Assets under custody	6,126	6,843	6,126	6,843
Assets under portfolio management	1,016	906	819	737
	14,411	**19,564**	**10.668**	**10,791**

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 15,154 million as at 31 December 2017 (31 December 2016: HRK 13,888 million). These funds are held by a custody bank which is not a member of the Group.

Notes to the financial statements (continued)

43 Leases

PBZ Leasing doo and Banka Intesa Sanpaolo dd, both members of the PBZ Group, are 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 2017 amounted to HRK 1,050 million (31 December 2016: HRK 1,116 million) which is included within loans and advances to customers (Note 23) in the Group financial statements.

The carrying value of leased property and equipment under operating lease as at 31 December 2017 amounted to HRK 394 million (31 December 2016: HRK 379 million) and are classified within property and equipment (Note 28).

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 2017	Present value of payments 2017	Minimum payments Restated 2016	Present value of payments Restated 2016
Less than one year	458	419	492	443
Between one and five years	661	587	675	576
More than five years	211	179	308	250
Gross investment in finance lease	**1,330**	**1,185**	**1,475**	**1,269**
Unearned finance income	(145)	-	(206)	-
	1,185	**1,185**	**1,269**	**1,269**
Less: Impairment allowance	(135)	(135)	(153)	(153)
Net investment in finance lease	**1,050**	**1,050**	**1,116**	**1,116**

Future minimum lease payments at undiscounted amounts under non-cancellable operating leases where the Group is the lessor are as follows:

(in HRK million)

	2017	Restated 2016
Less than one year	47	52
Between one and five years	97	110
More than five years	46	61
	190	**223**

The above is for illustrative purposes considering there are no non-cancellable leases.

Notes to the financial statements (continued)

44 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 2017 (97.5% as at 31 December 2016). 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"), 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
Group				
Deposits and loans given				
Balance at 1 January 2017	**11**	**1,529**	**-**	**63**
Changes during the year	-	(1,020)	-	(14)
Balance at 31 December 2017	**11**	**509**	**-**	**49**
Interest income for the year ended 31 December 2017	**-**	**-**	**-**	**-**
Interest income for the year ended 31 December 2016, restated	-	4	-	10
Deposits and loans received				
Balance at 1 January 2017	**43**	**1,561**	**93**	**852**
Changes during the year	(3)	(1,083)	(93)	(527)
Balance at 31 December 2017	**40**	**478**	**-**	**325**
Interest expense for the year ended 31 December 2017	**-**	**-**	**-**	**(1)**
Interest expense for the year ended 31 December 2016, restated	(1)	(14)	(1)	(37)
Contingent liabilities and commitments at 31 December 2017	**1**	**13**	**-**	**151**
Contingent liabilities and commitments at 31 December 2016, restated	1	6	1	150
Fees and other income for the year ended 31 December 2017	**-**	**13**	**-**	**51**
Fees and other income for the year ended 31 December 2016, restated	-	4	1	58
Fees and other expense for the year ended 31 December 2017	**-**	**(4)**	**-**	**(16)**
Fees and other expense for the year ended 31 December 2016, restated	-	(3)	-	(19)

Notes to the financial statements (continued)

44 Related party transactions (continued)

(in HRK million)

	Key management personnel	Bank's subsidiaries	Ultimate controlling party - Intesa Sanpaolo S.p.A	Associates	Other shareholders and their affiliates and affiliates of ultimate controlling party
Bank					
Deposits and loans given					
Balance at 1 January 2017	**11**	**773**	**14**	**-**	**31**
Changes during the year	(2)	(336)	3	-	(13)
Balance at 31 December 2017	**9**	**437**	**17**	**-**	**18**
Interest income for the year ended 31 December 2017	**-**	**18**	**-**	**-**	**-**
Interest income for the year ended 31 December 2016	-	23	-	-	-
Deposits and loans received					
Balance at 1 January 2017	**32**	**517**	**43**	**93**	**654**
Changes during the year	(1)	(57)	(14)	(93)	(629)
Balance at 31 December 2017	**31**	**460**	**29**	**-**	**25**
Interest expense for the year ended 31 December 2017	**-**	**(4)**	**-**	**-**	**(1)**
Interest expense for the year ended 31 December 2016	(1)	(5)	-	(1)	(13)
Contingent liabilities and commitments at 31 December 2017	**1**	**166**	**13**	**-**	**151**
Contingent liabilities and commitments at 31 December 2016	1	44	4	1	142
Lease expense for the year ended 31 December 2017	**-**	**(23)**	**-**	**-**	**-**
Lease expense for the year ended 31 December 2016	-	(5)	-	-	-
Fees and other income for the year ended 31 December 2017	**-**	**529**	**13**	**12**	**51**
Fees and other income for the year ended 31 December 2016	-	296	4	19	45
Fees and other expense for the year ended 31 December 2017	**-**	**(16)**	**(3)**	**-**	**(16)**
Fees and other expense for the year ended 31 December 2016	-	(17)	(1)	-	(9)

No provisions were recognised in respect of deposits and loans given to related parties as at 31 December 2017 (31 December 2016: nil).

Notes to the financial statements (continued)

44 Related party transactions (continued)

Annual key management remuneration:

	GROUP	
	2017	Restated 2016
Short-term benefits	**37**	**37**
- salaries paid for the current year	37	37
Long-term benefits	**20**	**13**
- paid during the current year in respect of earlier years	20	13
	57	**50**

(in HRK million)

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 as at 31 December 2017 was 35 (31 December 2016: 35).

Bonuses in 2017 and 2016 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 3 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 2017	Restated 31 December 2016	31 December 2017	Restated 31 December 2016
Awards granted	327,453	123,624	7	2

Notes to the financial statements (continued)

45 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)

	BANK	
	2017	2016
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)	8,566	7,442
Profit for the period, decreased by proposed dividend	-	1,124
Accumulated other comprehensive income	(3)	9
Other reserves	140	234
Deductions in accordance with EBA regulations	(233)	(197)
Common Equity Tier 1 capital	**11,929**	**12,071**
Additional Tier 1	-	-
Tier 1 capital	**11,929**	**12,071**
Tier 2 capital	-	-
Total regulatory capital (unaudited)	**11,929**	**12,071**
Risk weighted assets and other risk elements (unaudited)	**51,523**	**48,644**
Common Equity Tier 1 capital ratio	23.15%	24.81%
Tier 1	23.15%	24.81%
Total capital ratio	23.15%	24.81%

Regulation prescribes a following 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)

46 Leverage ratio

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	
	2017	2016
Exposure and capital values in December		
Securities Financing Transactions (SFT) exposure	17	27
Derivatives: Market value and Add-on Mark-to-Market Method	10	42
Other off-balance sheet items	6,497	5,756
Other assets	75,579	71,956
Exposure values	**82,103**	**77,781**
Common Equity Tier 1 capital	11,929	12,071
Tier 1 capital	-	-
Regulatory adjustments of Tier 1 capital	-	-
Capital	**11,929**	**12,071**
Leverage ratio (unaudited)	**14.5%**	**15.1%**

Notes to the financial statements (continued)

47 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, equity securities and derivatives 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)

47 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	2017				Restated 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative financial assets	-	22	-	**22**	-	33	-	**33**
Financial assets held for trading	550	-	-	**550**	518	-	-	**518**
Financial assets initially designated at fair value through profit or loss	4	1,659	-	**1,663**	100	5,475	11	**5,586**
Financial assets available for sale*	3,958	3,439	73	**7,470**	3,821	98	52	**3,971**
Financial assets	**4,512**	**5,120**	**73**	**9,705**	**4,439**	**5,606**	**63**	**10,108**
Derivative financial liabilities	-	13	-	**13**	-	22	-	**22**
Financial liabilities	**-**	**13**	**-**	**13**	**-**	**22**	**-**	**22**

* unlisted equity securities carried at cost are not included.

(in HRK million)

Bank	2017				2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative financial assets	-	2	-	**2**	-	19	-	**19**
Financial assets held for trading	550	-	-	**550**	518	-	-	**518**
Financial assets initially designated at fair value through profit or loss	1	1,659	-	**1,660**	6	5,440	11	**5,457**
Financial assets available for sale*	707	3,374	44	**4,125**	302	-	34	**336**
Financial assets	**1,258**	**5,035**	**44**	**6,337**	**826**	**5,459**	**45**	**6,330**
Derivative financial liabilities	-	7	-	**7**	-	5	-	**5**
Financial liabilities	**-**	**7**	**-**	**7**	**-**	**5**	**-**	**5**

* unlisted equity securities carried at cost are not included.

Notes to the financial statements (continued)

47 Fair values of financial assets and liabilities (continued)

a) Financial instruments measured at fair value and fair value hierarchy (continued)

During 2017, 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 2.1% to 5.6% (2016: 2.7% to 6.7%) with weighted average used of 2.8% (2016: 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.

(in HRK million)

	Group		**Bank**	
	Financial assets initially designated at fair value through profit or loss	Financial instruments available for sale	Financial assets initially designated at fair value through profit or loss	Financial instruments available for sale
Balance at 1 January 2017	**11**	**52**	**11**	**34**
Total gains/(losses):	-	12	-	10
in other comprehensive income	-	*12*	-	*10*
Purchases	-	13	-	-
Settlements	(11)	(4)	(11)	-
Balance at 31 December 2017	**-**	**73**	**-**	**44**

Notes to the financial statements (continued)

47 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 assets held for trading	Financial assets initially designated at fair value through profit or loss	Financial instruments available for sale	Financial assets held for trading	Financial assets initially designated at fair value through profit or loss	Financial instruments available for sale
Balance at 1 January 2016, restated	**28**	**61**	**171**	**28**	**61**	**103**
Total gains/(losses):	-	1	47	-	1	47
in profit or loss	-	*1*	*45*	-	*1*	*45*
in other comprehensive income	-	-	*2*	-	-	*2*
Purchases	-	-	34	-	-	34
Sale	-	-	(213)	-	-	(150)
Settlements	(28)	(51)	-	(28)	(51)	-
Transfers to Level 3	-	-	13	-	-	-
Balance at 31 December 2016, restated	**-**	**11**	**52**	**-**	**11**	**34**

Notes to the financial statements (continued)

47 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
31 December 2017					
Assets					
Cash and current accounts with banks	-	-	18,711	18,711	18,711
Balances with CNB	-	-	4,185	4,185	4,185
Loans and advances to banks	-	-	2,414	2,414	2,414
Loans and advances to customers	-	751	64,513	65,264	64,900
Held to maturity investments	16	-	-	16	16
Liabilities					
Current accounts and deposits from banks	-	1,191	-	1,191	1,191
Current accounts and deposits from customers	-	78,288	-	78,288	78,157
Interest-bearing borrowings and subordinated liabilities	-	3,765	-	3,765	3,784

Group	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
31 December 2016, restated					
Assets					
Cash and current accounts with banks	-	-	14,292	14,292	14,292
Balances with CNB	-	-	3,916	3,916	3,916
Loans and advances to banks	-	-	3,614	3,614	3,614
Loans and advances to customers	-	1,387	64,494	65,881	65,177
Held to maturity investments	13	-	-	13	17
Liabilities					
Current accounts and deposits from banks	-	1,578	-	1,578	1,595
Current accounts and deposits from customers	-	74,725	-	74,725	74,284
Interest-bearing borrowings and subordinated liabilities	-	4,274	-	4,274	4,236

Notes to the financial statements (continued)

47 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
31 December 2017					
Assets					
Cash and current accounts with banks	-	-	15,466	15,466	15,466
Balances with CNB	-	-	4,185	4,185	4,185
Loans and advances to banks	-	-	1,493	1,493	1,493
Loans and advances to customers	-	724	44,265	44,989	44,562
Liabilities					
Current accounts and deposits from banks	-	1,064	-	1,064	1,064
Current accounts and deposits from customers	-	57,379	-	57,379	57,173
Interest-bearing borrowings	-	2,391	-	2,391	2,377

Bank	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
31 December 2016					
Assets					
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	-	1,328	45,122	46,450	45,667
Liabilities					
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

Notes to the financial statements (continued)

47 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 performing and non-performing loans includes estimation and is therefore classified as Level 3 in fair value hierarchy. 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)

47 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.

(in HRK million)

Group **As at 31 December 2017**	Trading	Designated at fair value	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total
Assets							
Cash and current accounts with banks	-	-	-	18,711	-	-	**18,711**
Balances with the Croatian National Bank	-	-	-	4,185	-	-	**4,185**
Financial assets at fair value through profit or loss	550	1,663	-	-	-	-	**2,213**
Derivative financial assets	22	-	-	-	-	-	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	-	-	-	-	-	**1**
Loans and advances to banks	-	-	-	2,414	-	-	**2,414**
Loans and advances to customers	-	-	-	64,900	-	-	**64,900**
Financial assets available for sale	-	-	-	-	7,573	-	**7,573**
Held-to-maturity investments	-	-	16	-	-	-	**16**
Total assets	**573**	**1,663**	**16**	**90,210**	**7,573**	**-**	**100,035**
Liabilities							
Current accounts and deposits from banks	-	-	-	-	-	1,191	**1,191**
Current accounts and deposits from customers	-	-	-	-	-	78,157	**78,157**
Derivative financial liabilities	13	-	-	-	-	-	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	-	-	-	-	-	**9**
Interest-bearing borrowings	-	-	-	-	-	3,783	**3,783**
Subordinated liabilities	-	-	-	-	-	1	**1**
Total liabilities	**22**	**-**	**-**	**-**	**-**	**83,132**	**83,154**

Notes to the financial statements (continued)

47 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 2016, re-stated**	Trading	Designated at fair value	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total
Assets							
Cash and current accounts with banks	-	-	-	14,292	-	-	**14,292**
Balances with the Croatian National Bank	-	-	-	3,916	-	-	**3,916**
Financial assets at fair value through profit or loss	520	5,584	-	-	-	-	**6,104**
Derivative financial assets	33	-	-	-	-	-	**33**
Loans and advances to banks	-	-	-	3,614	-	-	**3,614**
Loans and advances to customers	-	-	-	65,177	-	-	**65,177**
Financial assets available for sale	-	-	-	-	4,085	-	**4,085**
Held-to-maturity investments	-	-	17	-	-	-	**17**
Total assets	**553**	**5,584**	**17**	**86,999**	**4,085**	**-**	**97,238**
Liabilities							
Current accounts and deposits from banks	-	-	-	-	-	1,595	**1,595**
Current accounts and deposits from customers	-	-	-	-	-	74,284	**74,284**
Derivative financial liabilities	22	-	-	-	-	-	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	3	-	-	-	-	-	**3**
Interest-bearing borrowings	-		-	-	-	4,235	**4,235**
Subordinated liabilities	-	-	-	-	-	1	**1**
Total liabilities	**25**	**-**	**-**	**-**	**-**	**80,115**	**80,140**

Notes to the financial statements (continued)

47 Fair values of financial assets and liabilities (continued)

c) Classification of financial assets and financial liabilities (continued)

(in HRK million)

Bank **As at 31 December 2017**	Trading	Designated at fair value	Loans and receivables	Available-for-sale	Other amortised cost	Total
Assets						
Cash and current accounts with banks	-	-	15,466	-	-	**15,466**
Balances with the Croatian National Bank	-	-	4,185	-	-	**4,185**
Financial assets at fair value through profit or loss	550	1,660	-	-	-	**2,210**
Derivative financial assets	2	-	-	-	-	**2**
Loans and advances to banks	-	-	1,493	-	-	**1,493**
Loans and advances to customers	-	-	44,562	-	-	**44,562**
Financial assets available for sale	-	-	-	4,145	-	**4,145**
Total assets	**552**	**1,660**	**65,706**	**4,145**	**-**	**72,063**
Liabilities						
Current accounts and deposits from banks	-	-	-	-	1,064	**1,064**
Current accounts and deposits from customers	-	-	-	-	57,173	**57,173**
Derivative financial liabilities	7	-	-	-	-	**7**
Interest-bearing borrowings	-	-	-	-	2,377	**2,377**
Total liabilities	**7**	**-**	**-**	**-**	**60,614**	**60,621**

Notes to the financial statements (continued)

47 Fair values of financial assets and liabilities (continued)

c) Classification of financial assets and financial liabilities (continued)

(in HRK million)

Bank **As at 31 December 2016**	Trading	Designated at fair value	Loans and receivables	Available-for-sale	Other amortised cost	Total
Assets						
Cash and current accounts with banks	-	-	12,338	-	-	**12,338**
Balances with the Croatian National Bank	-	-	3,916	-	-	**3,916**
Financial assets at fair value through profit or loss	518	5,457	-	-	-	**5,975**
Derivative financial assets	19	-	-	-	-	**19**
Loans and advances to banks	-	-	1,731	-	-	**1,731**
Loans and advances to customers	-	-	45,667	-	-	**45,667**
Financial assets available for sale	-	-	-	370	-	**370**
Total assets	**537**	**5,457**	**63,652**	**370**	**-**	**70,016**
Liabilities						
Current accounts and deposits from banks	-	-	-	-	1,376	**1,376**
Current accounts and deposits from customers	-	-	-	-	54,108	**54,108**
Derivative financial liabilities	5	-	-	-	-	**5**
Interest-bearing borrowings	-	-	-	-	2,747	**2,747**
Total liabilities	**5**	**-**	**-**	**-**	**58,231**	**58,236**

Notes to the financial statements (continued)

47 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 reclassified in 2009	Carrying amount	Fair value	Amounts reclassified in 2009	Carrying amount	Fair value
31 December 2017						
Financial assets reclassified from held for trading to loans and receivables	1,903	12	13	1,903	12	13
Financial assets reclassified from available for sale to loans and receivables	1,418	26	29	381	-	-
31 December 2016						
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

Notes to the financial statements (continued)

47 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 2017 and 2016 on assets reclassified to the loans and receivables category:

(in HRK million)

	GROUP		BANK	
	2017	2016	2017	2016
Financial assets reclassified from held for trading to loans and receivables				
Interest income	5	34	5	34
Amortisation of discount	-	10	-	10
Financial assets reclassified from available for sale to loans and receivables				
Interest income	2	3	-	1
Amortisation of discount	5	6	-	4
Amortisation of fair value reserve	(2)	(2)	(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	
	2017	2016	2017	2016
Financial assets reclassified from held for trading to loans and receivables				
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	(13)	(7)	-	(13)
Financial assets reclassified from available for sale to loans and receivables				
Fair value losses which would have been recognised in other comprehensive income	(4)	(11)	-	(14)

Notes to the financial statements (continued)

48 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.

Retail banking: Individual customers' savings and deposits, current accounts and overdrafts, all types of consumer loans, credit cards facilities and other facilities to individual customers

Corporate banking: 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

Finance banking: Treasury operations as well as investment banking services including corporate finance, merger and acquisition services and trading

Central structure: 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)

48 Financial information by segment (continued)

a) Information about business segments

(in HRK million)

Group **As of and for the year ended 31 December 2017**	Corporate banking	Retail banking	Finance banking	Central Structure	PBZ Card	Other subsidiaries	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	944	1,583	(116)	509	22	32	**2,974**	-	**2,974**
Net commission income/(expense)	394	531	11	6	546	13	**1,501**	-	**1,501**
Net profit/(loss) from trading and dividend and other operating income	43	57	100	34	(171)	77	**140**	307	**447**
Operating income	**1,381**	**2,171**	**(5)**	**549**	**397**	**122**	**4,615**	**307**	**4,922**
Operating expenses	(289)	(866)	(39)	(585)	(143)	(65)	**(1,987)**	(456)	**(2,443)**
Operating profit	**1,092**	**1,305**	**(44)**	**(36)**	**254**	**57**	**2,628**	**(149)**	**2,479**
Impairments and provisions	(857)	7	2	38	(25)	(1)	**(836)**	7	**(829)**
Profit before tax	**235**	**1,312**	**(42)**	**2**	**229**	**56**	**1,792**	**(142)**	**1,650**
Segment assets	29,944	31,607	31,865	10,671	2,626	2,564	**109,277**	(6,434)	**102,843**
Investments in associates	-	-	-	69	-	-	**69**	-	**69**
Total segment assets	**29,944**	**31,607**	**31,865**	**10,740**	**2,626**	**2,564**	**109,346**	**(6,434)**	**102,912**
Total segment liabilities	**21,059**	**58,348**	**2,941**	**6,579**	**1,623**	**2,157**	**92,707**	**(6,394)**	**86,313**
Capital expenditure	10	41	-	87	-	33	**171**	-	**171**

Notes to the financial statements (continued)

48 Financial information by segment (continued)

a) Information about business segments (continued)

(in HRK million)

Group **As of and for the year ended 31 December 2016, restated**	Corporate banking	Retail banking	Finance banking	Central Structure	PBZ Card	Other subsidiaries	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	919	1,675	375	(68)	25	24	2,950	-	2,950
Net commission income/(expense)	384	509	-	-	534	13	1,440	-	1,440
Net profit/(loss) from trading and dividend and other operating income	91	214	(76)	129	(175)	93	**276**	582	858
Operating income	**1,394**	**2,398**	**297**	**63**	**384**	**130**	**4,666**	**582**	**5,248**
Operating expenses	(467)	(1,246)	(61)	(7)	(153)	(66)	**(2,000)**	(483)	(2,483)
Operating profit	**927**	**1,152**	**236**	**56**	**231**	**64**	**2,666**	**99**	**2,765**
Impairments and provisions	(335)	(144)	-	(18)	(52)	(11)	**(560)**	-	(560)
Profit before tax	**592**	**1,008**	**236**	**38**	**179**	**53**	**2,106**	**99**	**2,205**
Segment assets	35,594	30,833	31,159	5,345	2,774	3,085	**108,790**	**(9,149)**	**99,641**
Investments in associates	-	-	-	67	-	-	**67**	-	**67**
Total segment assets	**35,594**	**30,833**	**31,159**	**5,412**	**2,774**	**3,085**	**108,857**	**(9,149)**	**99,708**
Total segment liabilities	25,189	53,861	3,014	4,186	1,553	2,646	**90,449**	**(7,491)**	**82,958**
Capital expenditure	3	24	1	87	2	-	**117**	-	**117**

Notes to the financial statements (continued)

48 Financial information by segment (continued)

a) Information about business segments (continued)

(in HRK million)

Bank **As of and for the year ended 31 December 2017**	Corporate banking	Retail banking	Finance banking	Central Structure	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	701	1,277	(113)	509	**2,374**	-	**2,374**
Net commission income	330	355	-	-	**685**		**685**
Net profit/(loss) from trading and dividend and other operating income	72	514	57	7	**650**	106	**756**
Operating income	**1,103**	**2,146**	**(56)**	**516**	**3,709**	**106**	**3,815**
Operating expenses	(269)	(660)	(29)	(354)	**(1,312)**	(220)	**(1,532)**
Operating profit	**834**	**1,486**	**(85)**	**162**	**2,397**	**(114)**	**2,283**
Impairments and provisions	(691)	34	-	55	**(602)**	(7)	**(609)**
Profit before tax	**143**	**1,520**	**(85)**	**217**	**1,795**	**(121)**	**1,674**
Total segment assets	**23,807**	**24,345**	**27,418**	**4,515**	**80,085**	**(4,588)**	**75,497**
Total segment liabilities	**21,315**	**40,526**	**1,018**	**3,472**	**66,330**	**(4,588)**	**61,742**
Capital expenditure	10	41	-	87	**138**	-	**138**

Notes to the financial statements (continued)

48 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	197	51	129	439	431	870
Operating income	**1,069**	**1,857**	**421**	**61**	**3,408**	**431**	**3,839**
Operating expenses	(400)	(855)	(44)	(7)	(1,306)	(213)	(1,519)
Operating profit	**669**	**1,002**	**377**	**54**	**2,102**	**218**	**2,320**
Impairments and provisions	(323)	(4)	-	(8)	(335)	-	(335)
Profit before tax	**346**	**998**	**377**	**46**	**1,767**	**218**	**1,985**
Total segment assets	25,712	23,456	24,434	3,641	**77,243**	**(5,193)**	**72,050**
Total segment liabilities	20,151	39,724	979	3,617	**64,471**	**(5,190)**	**59,281**
Capital expenditure	2	21	-	79	**102**	**-**	**102**

Notes to the financial statements (continued)

48 Financial information by segment (continued)

b) Geographical segment information

(in HRK million)

	GROUP	
	2017	Restated 2016
Operating income	**4,908**	**5,224**
Croatia	4,014	4,194
Slovenia	565	706
Bosnia and Herzegovina	329	324
Non-current assets*	**1,595**	**1,529**
Croatia	1,305	1,174
Slovenia	225	279
Bosnia and Herzegovina	65	76
Capital expenditure	**171**	**113**
Croatia	158	104
Slovenia	9	9
Bosnia and Herzegovina	4	4

* 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)

49 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 39.

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 Credit Risk Governance 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)

49 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)

	Notes	GROUP 2017	GROUP Restated 2016	BANK 2017	BANK 2016
Cash and current accounts with banks (excluding cash in hand)	17	16,113	12,156	13,850	10,818
Balances with the Croatian National bank	18	4,185	3,916	4,185	3,916
Financial assets at fair value through profit or loss (excluding equity securities and units in investment funds)	19	2,189	5,983	2,189	5,949
Derivative financial assets	20	22	33	2	19
Fair value changes of the hedged items in portfolio hedge of interest rate risk	20c	1	-	-	-
Loans and advances to banks	22	2,414	3,614	1,493	1,731
Loans and advances to customers	23	64,900	65,177	44,562	45,667
Financial assets available for sale (excluding equity securities)	24	7,362	3,881	4,053	276
Held-to-maturity investments	25	16	17	-	-
Other assets (excluding foreclosed assets, prepaid expenses and leaseholds improvements)	31	517	408	438	159
Total		**97,719**	**95,185**	**70,772**	**68,535**
Contingent liabilities and commitments	39	19,335	17,968	14,635	13,341
Total credit risk exposure		**117,054**	**113,153**	**85,407**	**81,876**

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)

49 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

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 5,202 million (2016: HRK 6,135 million). Exposure to Croatian municipalities is included in the above analysis.

Analysis by type of collateral

(in HRK million)

	2017		**2016**	
Group	Net loans	Appraised value of collateral	Net loans	Appraised value of collateral
Residential Real Estate	10,743	28,471	10,063	28,296
Commercial Real Estate	9,350	27,779	8,977	30,304
Other Real Estate	219	544	280	656
Real Estate	**20,312**	**56,794**	**19,320**	**59,257**
First Rate Guarantees	5,979	6,323	7,203	7,646
Central Government	*5,720*	*5,756*	*6,891*	*7,005*
Local Government	*116*	*120*	*149*	*153*
Banks	*143*	*447*	*163*	*488*
Other Guarantees	4,026	5,792	4,193	6,368
Guarantees	**10,005**	**12,115**	**11,396**	**14,014**
Loan Insurance	1,573	1,988	1,760	2,155
Life Insurance	452	528	433	530
Deposits	318	403	347	540
Shares	114	272	198	402
Bonds	146	158	183	229
Funds	21	26	37	58
Other	1,350	3,696	1,282	3,934
Other Collaterals	**3,974**	**7,071**	**4,240**	**7,848**
Total	**34,291**	**75,980**	**34,956**	**81,120**
Unsecured loans	30,609	-	30,221	-
Total	**64,900**	**75,980**	**65,177**	**81,120**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

(in HRK million)

	2017		2016	
Bank	Net loans	Appraised value of collateral	Net loans	Appraised value of collateral
Residential Real Estate	8,402	20,035	7,886	20,260
Commercial Real Estate	6,333	16,605	6,083	17,915
Other Real Estate	-	22	-	25
Real Estate	**14,735**	**36,662**	**13,969**	**38,200**
First Rate Guarantees	3,905	3,943	4,919	4,970
Central Government	*3,762*	*3,796*	*4,742*	*4,789*
Local Government	*116*	*120*	*149*	*153*
Banks	*27*	*27*	*28*	*28*
Other Guarantees	488	539	497	543
Guarantees	**4,393**	**4,482**	**5,416**	**5,514**
Loan Insurance	790	819	924	968
Life Insurance	379	381	345	347
Deposits	257	337	257	368
Shares	114	272	197	402
Bonds	110	121	146	165
Funds	21	24	22	27
Other	953	2,296	876	2,160
Other Collaterals	**2,624**	**4,250**	**2,767**	**4,437**
Total	**21,752**	**45,394**	**22,152**	**48,151**
Unsecured loans	22,810	-	23,515	-
Total	**44,562**	**45,394**	**45,667**	**48,151**

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 2016, forborne portfolio exposure of the Group has declined in volume by 7.2% in 2017, amounting to HRK 4,292 million (2016: HRK 4,623 million). Provisions coverage of forborne portfolio as of 31 December 2017 was 20.8% (2016: 24.0%). Forborne performing portfolio exposure has declined in volume by 5.6% (amounting to HRK 1,792 million, 2016: HRK 1,899 million), while forborne NPL portfolio exposure has declined in volume by 8.2% (amounting to HRK 2,500 million, 2016: HRK 2,724 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)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of forborne portfolio exposures of the Group

(in HRK million)

	Gross exposure				Impairment allowance				
Group 2017	Performing	Performing under probation period	Non-performing	**Total**	Performing	Performing under probation period	Non-performing	**Total**	Net of impairment allowance
Government and municipalities	-	1	4	**5**	-	-	2	**2**	3
Enterprises	135	80	1,087	**1,302**	9	3	425	**437**	865
of which:									
Micro enterprises	*17*	*5*	*161*	***183***	*1*	-	*95*	***96***	*87*
Small enterprises	*91*	*1*	*127*	***219***	*5*	-	*48*	***53***	*166*
Mid enterprises	*20*	*52*	*206*	***278***	*2*	*2*	*29*	***33***	*245*
Large corporate	*7*	*22*	*593*	***622***	*1*	*1*	*253*	***255***	*367*
Others	480	2	246	**728**	27	-	64	**91**	637
of which									
Special finance	*290*	-	*141*	***431***	*24*	-	*38*	***62***	*369*
Loans and advances to corporate customers	**615**	**83**	**1,337**	**2,035**	**36**	**3**	**491**	**530**	**1,505**
Craftsmen	7	2	20	**29**	-	-	10	**10**	19
Housing loans	13	13	23	**49**	-	-	9	**9**	40
Mortgage loans	11	-	2	**13**	-	-	1	**1**	12
Non-purpose loans	8	-	29	**37**	-	-	21	**21**	16
Refinancing	601	440	1,088	2,129	18	9	296	**323**	1,806
Loans and advances to retail customers	**640**	**455**	**1,162**	**2,257**	**18**	**9**	**337**	**364**	**1,893**
Total	**1,255**	**538**	**2,499**	**4,292**	**54**	**12**	**828**	**894**	**3,398**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of forborne portfolio exposures of the Group

(in HRK million)

	Gross exposure				Impairment allowance				
Group 2016 restated	Perform-ing	Perform-ing under probation period	Non-per-forming	**Total**	Perform-ing	Perform-ing under probation period	Non-per-forming	**Total**	Net of im-pairment allowance
Government and municipalities	-	17	4	**21**	-	-	2	**2**	**19**
Enterprises	329	345	1,262	**1,936**	35	20	543	**598**	**1,338**
of which:									
Micro enterprises	*25*	*7*	*168*	***200***	*1*	-	*79*	***80***	***120***
Small enterprises	*43*	*1*	*159*	***203***	*4*	-	*56*	***60***	***143***
Mid enterprises	*134*	-	*473*	***607***	*12*	-	*153*	***165***	***442***
Large corporate	*127*	*337*	*462*	***926***	*18*	*20*	*255*	***293***	***633***
Others	264	-	164	**428**	21	-	45	**66**	**362**
of which									
Special finance	*262*	-	*142*	***404***	*21*	-	*40*	***61***	***343***
Loans and advances to corporate customers	**593**	**362**	**1,430**	**2,385**	**56**	**20**	**590**	**666**	**1,719**
Craftsmen	8	5	11	**24**	1	-	6	**7**	**17**
Housing loans	22	18	22	**62**	0	-	6	**6**	**56**
Mortgage loans	-	-	2	**2**	1	-	-	**1**	**1**
Non-purpose loans	5	-	23	**28**	1	-	16	**17**	**11**
Refinancing	377	509	1,236	**2,122**	11	12	390	**413**	**1,709**
Loans and advances to retail customers	**412**	**532**	**1,294**	**2,238**	**14**	**12**	**418**	**444**	**1,794**
Total	**1,005**	**894**	**2,724**	**4,623**	**70**	**32**	**1,008**	**1,110**	**3,513**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of forborne portfolio exposures of the Bank

(in HRK million)

	Gross exposure				Impairment allowance				
Bank 2017	Performing	Performing under probation period	Non-performing	**Total**	Performing	Performing under probation period	Non-performing	**Total**	Net of impairment allowance
Government and municipalities	-	1	5	**6**	-	-	2	**2**	**4**
Enterprises	71	79	402	**552**	4	3	139	**146**	**406**
of which:									
Micro enterprises	*9*	*4*	*48*	***61***	-	-	*23*	***23***	***38***
Small enterprises	*46*	*1*	*32*	***79***	*2*	-	*14*	***16***	***63***
Mid enterprises	*16*	*52*	*46*	***114***	*2*	*2*	*9*	***13***	***101***
Large corporate	-	*22*	*276*	***298***	-	*1*	*93*	***94***	***204***
Others	482	-	162	**644**	27	-	51	**78**	**566**
of which									
Special finance	*290*	-	*141*	***431***	*24*	-	*38*	***62***	***369***
Loans and advances to corporate customers	**553**	**80**	**569**	**1,202**	**31**	**3**	**192**	**226**	**976**
Craftsmen	7	2	9	**18**	-	-	4	**4**	**14**
Housing loans	10	13	14	**37**	-	-	3	**3**	**34**
Mortgage loans	11	-	-	**11**	-	-	-	-	**11**
Non-purpose loans	-	-	-	-	-	-	-	-	-
Refinancing	601	440	1,088	**2,129**	17	8	297	**322**	**1,807**
Loans and advances to retail customers	**629**	**455**	**1,111**	**2,195**	**17**	**8**	**304**	**329**	**1,866**
Total	**1,182**	**535**	**1,680**	**3,397**	**48**	**11**	**496**	**555**	**2,842**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of forborne portfolio exposures of the Bank

(in HRK million)

Bank 2016	Gross exposure				Impairment allowance				
	Performing	Performing under probation period	Non-performing	**Total**	Performing	Performing under probation period	Non-performing	**Total**	Net of impairment allowance
Government and municipalities	-	17	4	**21**	-	-	2	**2**	**19**
Enterprises	148	147	676	**971**	11	5	313	**329**	**642**
of which:									
Micro enterprises	*13*	*7*	*61*	***81***	-	-	*27*	***27***	***54***
Small enterprises	*27*	*1*	*40*	***68***	*2*	-	*17*	***19***	***49***
Mid enterprises	*108*	-	*266*	***374***	*9*	-	*125*	***134***	***240***
Large corporate	-	*139*	*309*	***448***	-	*5*	*144*	***149***	***299***
Others	262	-	156	**418**	21	-	44	**65**	**353**
of which									
Special finance	*262*	-	*142*	***404***	*21*	-	*40*	***61***	***343***
Loans and advances to corporate customers	**410**	**164**	**836**	**1,410**	**32**	**5**	**359**	**396**	**1,014**
Craftsmen	7	5	-	**12**	1	-	-	**1**	**11**
Housing loans	17	18	14	**49**	-	-	4	**4**	**45**
Mortgage loans	-	-	1	**1**	-	-	-	-	**1**
Non-purpose loans	-	-	-	-	-	-	-	-	-
Refinancing	377	509	1,236	**2,122**	11	11	390	**412**	**1,710**
Loans and advances to retail customers	**401**	**532**	**1,251**	**2,184**	**12**	**11**	**394**	**417**	**1,767**
Total	**811**	**696**	**2,087**	**3,594**	**44**	**16**	**753**	**813**	**2,781**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers: analysis by performance

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Loans and advances to customers				
Neither past due nor impaired	59,988	60,321	41,186	42,267
Past due but not impaired	2,795	2,600	1,912	1,929
Impaired	6,157	6,732	4,269	4,568
Gross	**68,940**	**69,653**	**47,367**	**48,764**
Specific impairment allowance	(3,201)	(3,552)	(2,142)	(2,369)
IBNR	(629)	(671)	(490)	(508)
Net of impairment allowance	**65,110**	**65,430**	**44,735**	**45,887**

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 Management (PCEM) office 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 addition to corporate clients, Bank adopted monitoring of retail clients on portfolio level within PCEM office.

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Loans and advances to corporate customers				
Standard monitoring	27,727	29,823	18,654	21,313
Special monitoring	1,874	1,509	1,588	826
Loans and advances to retail customers				
Standard monitoring	30,387	28,989	20,944	20,128
Total	**59,988**	**60,321**	**41,186**	**42,267**

Notes to the financial statements (continued)

49 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.

(in HRK million)

Group 2017	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	-	-	3	-	-	**3**
Enterprises	**301**	**52**	**126**	**-**	**-**	**479**
of which:						
Micro enterprises	*15*	*1*	*50*	-	-	***66***
Small enterprises	*44*	*1*	*54*	-	-	***99***
Mid enterprises	*216*	*50*	*22*	-	-	***288***
Large corporate	*26*	-	-	-	-	***26***
Others	223	-	285	-	-	**508**
Loans and advances to corporate customers	**524**	**52**	**414**	**-**	**-**	**990**
Housing loans	330	135	229	33	-	**727**
Mortgage loans	8	19	19	3	-	**49**
Car loans	4	-	1	-	-	**5**
Non-purpose loans	128	140	128	17	-	**413**
Quick loans	25	6	25	1	-	**57**
Overdrafts	14	4	7	1	-	**26**
Refinancing	52	53	72	17	-	**194**
Credit cards	111	106	36	-	-	**253**
Others	14	27	11	1	-	**53**
Craftsmen	10	1	16	1	-	**28**
Loans and advances to retail customers	**696**	**491**	**544**	**74**	**-**	**1,805**
Total	**1,220**	**543**	**958**	**74**	**-**	**2,795**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers past due but not impaired (continued)

(in HRK million)

Group 2016, restated	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	**271**	**104**	**179**	**-**	**-**	**554**
of which:						
Micro enterprises	*26*	*4*	*53*	-	-	***83***
Small enterprises	*51*	*23*	*39*	-	-	***113***
Mid enterprises	*98*	*77*	*87*	-	-	***262***
Large corporate	*96*	-	-	-	-	***96***
Others	218	-	16	-	-	**234**
Loans and advances to corporate customers	**653**	**105**	**196**	**-**	**-**	**954**
Housing loans	118	108	262	40	-	**528**
Mortgage loans	9	35	27	3	-	**74**
Car loans	5	1	2	-	-	**8**
Non-purpose loans	151	154	144	14	-	**463**
Quick loans	27	7	29	1	-	**64**
Overdrafts	16	4	8	1	-	**29**
Refinancing	38	43	70	19	-	**170**
Credit cards	95	87	39	-	-	**221**
Others	12	23	12	-	-	**47**
Craftsmen	15	6	21	-	-	**42**
Loans and advances to retail customers	**486**	**468**	**614**	**78**	**-**	**1,646**
Total	**1,139**	**573**	**810**	**78**	**-**	**2,600**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers past due but not impaired (continued)

(in HRK million)

Bank 2017	up to 15 days	16 to 30 days	31 to 90 days	91 to 180 days	more than 180 days	Total
Government and municipalities	-	-	3	-	-	**3**
Enterprises	146	1	95	-	-	**242**
of which:						
Micro enterprises	*2*	-	*36*	-	-	***38***
Small enterprises	*28*	*1*	*53*	-	-	***82***
Mid enterprises	*90*	-	*6*	-	-	***96***
Large corporate	*26*	-	-	-	-	***26***
Others	223	-	285	-	-	**508**
Loans and advances to corporate customers	**369**	**1**	**383**	**-**	**-**	**753**
Housing loans	101	100	222	33	-	**456**
Mortgage loans	4	9	17	3	-	**33**
Car loans	-	-	-	-	-	**-**
Non-purpose loans	112	106	116	16	-	**350**
Quick loans	25	6	25	1	-	**57**
Overdrafts	9	3	6	1	-	**19**
Refinancing	52	53	72	17	-	**194**
Credit cards	4	7	3	-	-	**14**
Others	6	9	6	1	-	**22**
Craftsmen	-	1	12	1	-	**14**
Loans and advances to retail customers	**313**	**294**	**479**	**73**	**-**	**1,159**
Total	**682**	**295**	**862**	**73**	**-**	**1,912**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers past due but not impaired (continued)

(in HRK million)

Bank 2016	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**
of which:						
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**
Loans and advances to corporate customers	**518**	**34**	**144**	**-**	**-**	**696**
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**
Credit cards	5	7	3	-	-	**15**
Others	2	4	3	1	-	**10**
Craftsmen	-	2	12	-	-	**14**
Loans and advances to retail customers	**322**	**298**	**534**	**79**	**-**	**1,233**
Total	**840**	**332**	**678**	**79**	**-**	**1,929**

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)

49 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**	
	2017	2016	2017	2016
Loans and advances to corporate customers				
Government and municipalities	5	6	5	6
Enterprises	3,340	3,250	1,887	1,574
of which:				
Micro enterprises	*663*	*921*	*268*	*352*
Small enterprises	*466*	*648*	*277*	*385*
Mid enterprises	*497*	*973*	*106*	*399*
Large corporate	*1,714*	*708*	*1,236*	*438*
Others	252	365	252	364
Total gross amount	**3,597**	**3,621**	**2,144**	**1,944**
Specific impairment allowance	(2,071)	(2,006)	(1,291)	(1,137)
Net amount	**1,526**	**1,615**	**853**	**807**
Loans and advances to retail customers				
Housing loans	573	734	507	655
Mortgage loans	92	126	75	105
Car loans	13	17	9	11
Non-purpose loans	250	332	158	225
Quick loans	31	42	31	42
Overdrafts	81	83	68	67
Refinancing	1,192	1,369	1,170	1,369
Credit cards	158	195	14	19
Others	14	2	4	4
Craftsmen	156	211	89	127
Total gross amount	**2,560**	**3,111**	**2,125**	**2,624**
Specific impairment allowance	(1,130)	(1,546)	(851)	(1,232)
Net amount	**1,430**	**1,565**	**1,274**	**1,392**
Total gross amount	**6,157**	**6,732**	**4,269**	**4,568**
Specific impairment allowance	(3,201)	(3,552)	(2,142)	(2,369)
Net amount	**2,956**	**3,180**	**2,127**	**2,199**

The fair value of collateral hold in respect of loans determined to be impaired as of 31 December 2017 amounts to HRK 5,100 million for the Group and 4,013 million for the Bank (31 December 2016: HRK 6,382 million for the Group and HRK 4,860 million for the Bank).

Notes to the financial statements (continued)

49 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)

Group	Financial assets at fair value through profit or loss	Loans and advances to banks	Financial assets available for sale	Held-to-maturity investments
As at 31 December 2017				
Neither past due nor impaired	2,189	2,433	7,362	16
Past due but not impaired	-	-	-	-
Impaired	-	4	-	-
Gross	**2,189**	**2,437**	**7,362**	**16**
Specific impairment allowance	-	(4)	-	-
IBNR	-	(19)	-	-
Net of impairment allowance	**2,189**	**2,414**	**7,362**	**16**
As at 31 December 2016, restated				
Neither past due nor impaired	5,983	3,647	3,881	17
Past due but not impaired	-	-	-	-
Impaired	-	8	-	-
Gross	**5,983**	**3,655**	**3,881**	**17**
Specific impairment allowance	-	(8)	-	-
IBNR	-	(33)	-	-
Net of impairment allowance	**5,983**	**3,614**	**3,881**	**17**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of performance of other financial assets (continued)

(in HRK million)

Bank **As at 31 December 2017**	Financial assets at fair value through profit or loss	Loans and advances to banks	Financial assets available for sale
Neither past due nor impaired	2,189	1,512	4,053
Past due but not impaired	-	-	-
Impaired	-	4	-
Gross	**2,189**	**1,516**	**4,053**
Specific impairment allowance	-	(4)	-
IBNR	-	(19)	-
Net of impairment allowance	**2,189**	**1,493**	**4,053**
As at 31 December 2016			
Neither past due nor impaired	5,949	1,764	276
Past due but not impaired	-	-	-
Impaired	-	8	-
Gross	**5,949**	**1,772**	**276**
Specific impairment allowance	-	(8)	-
IBNR	-	(33)	-
Net of impairment allowance	**5,949**	**1,731**	**276**

Notes to the financial statements (continued)

49 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 2017 and 31 December 2016. The amounts provided are gross of specific or collective provisions.

(in HRK million)

Group	**2017**		**Restated 2016**	
	Loans and advances to customers	Impairment allowance	Loans and advances to customers	Impairment allowance
Performing loans	62,783	629	62,921	671
Non-performing loans	6,157	3,201	6,732	3,552
Doubtful loans	*2,568*	*1,850*	*3,591*	*2,474*
Unlikely to pay	*3,475*	*1,312*	*3,059*	*1,049*
Past due impaired	*114*	*39*	*82*	*29*
	68,940	**3,830**	**69,653**	**4,223**

(in HRK million)

Bank	**2017**		**2016**	
	Loans and advances to customers	Impairment allowance	Loans and advances to customers	Impairment allowance
Performing loans	43,098	490	44,196	508
Non-performing loans	4,269	2,142	4,568	2,369
Doubtful loans	*1,559*	*1,113*	*2,140*	*1,545*
Unlikely to pay	*2,656*	*1,015*	*2,374*	*807*
Past due impaired	*54*	*14*	*54*	*17*
	47,367	**2,632**	**48,764**	**2,877**

Notes to the financial statements (continued)

49 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**	
	2017	2016	2017	2016
Government bonds and treasury bills	**2,189**	**5,972**	**2,189**	**5,938**
BB+	-	4,418	-	4,409
BB	355	244	355	219
B	1,559	1,310	1,559	1,310
no rating	275		275	
Domestic corporate bonds	**-**	**6**	**-**	**6**
no rating	-	6	-	6
Municipal bonds	**-**	**5**	**-**	**5**
no rating	-	5	-	5
Total	**2,189**	**5,983**	**2,189**	**5,949**

Notes to the financial statements (continued)

49 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 2017 derivative financial instruments with positive fair value amounted to HRK 4 million (31 December 2016: HRK 25 million) for the Group and HRK 2 million (31 December 2016: HRK 19 million) for the Bank, while derivative financial instruments with negative fair value amounted to HRK 8 million (31 December 2016: HRK 11 million) for the Group and HRK 7 million (31 December 2016: HRK 5 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)

49 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**	
	2017	2016	2017	2016
Receivables from reverse sale and repurchase agreements related to:	**228**	**314**	**232**	**351**
- loans and advances to banks	97	*165*	101	*202*
- loans and advances to customers	131	*149*	131	*149*
Fair value of collateral accepted in respect of the above	185	342	189	382
Payables under sale and repurchase agreements	-	-	-	-
- 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)

49 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 analysis of the Bank's funding structure;
- 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;
- T*hreshold 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% (2016: 17%) of foreign currency liabilities in short-term assets. The actual figures were as follows:

2017	%	2016	%
"17% ratio" (at year end)	32.6	"17% ratio" (at year end)	28.6
Average	26.7	Average	26.6
Maximum	37.8	Maximum	36.6
Minimum	19.3	Minimum	19.1

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 52 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)

49 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&ALM Department, 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)

49 Financial risk management policies (continued)

c) Market risk (continued)

(in HRK thousand)

Group	Equity VaR	Interest rate VaR	Foreign exchange VaR	Effects of correlation	Total
2017 – 2 January	238	3,422	877	(1,158)	**3,379**
2017 – 31 December	284	1,770	5,582	(2,376)	**5,260**
2017 – Average daily	275	2,241	1,349	(1,066)	**2,799**
2017 – Lowest	206	1,373	267	(99)	**1,747**
2017 – Highest	323	3,402	5,582	(4,047)	**5,260**

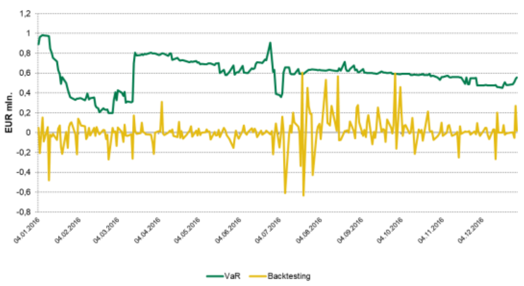
Note: historical simulation used for VaR calculations

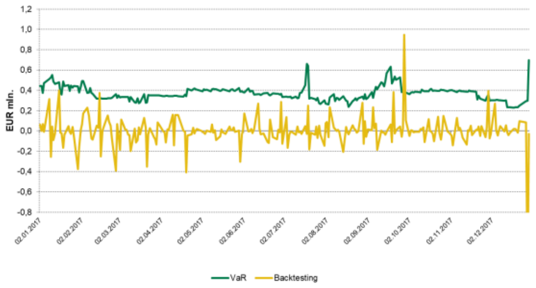
(in HRK thousand)

	Equity VaR	Interest rate VaR	Foreign exchange VaR	Effects of correlation	Total
Restated 2016 – 4 January	273	934	5,304	290	**6,801**
Restated 2016 – 31 December	236	3,448	1,714	(1,147)	**4,251**
Restated 2016 – Average daily	255	3,891	2,090	(1,769)	**4,467**
Restated 2016 – Lowest	213	645	234	449	**1,541**
Restated 2016 – Highest	285	6,149	7,161	(6,144)	**7,451**

Note: historical simulation used for VaR calculations

Chart below presents Bank’s Total VaR movements in 2016 and 2017 and corresponding backtest values:





In accordance with confidence level of VaR model, in period of one year at least 2 backtest breaches are expected, while in 2017 four backtest breaches were observed, two of them due to change in interest rate and other due to significant change of exchange rate.

Notes to the financial statements (continued)

49 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 2017 and 31 December 2016 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

(in HRK million)

Currency	FX Open position 31 December 2017*	Scenario 2017		FX Open position 31 December 2016*	Scenario 2016 restated	
		10% Move Up	10% Move Down		10% Move Up	10% Move Down
EUR	**(125)**	(12.5)	12.5	**472**	47	(47)
CHF	**6**	0.6	(0.6)	**1**	0.1	(0.1)
USD	**7**	0.7	(0.7)	**5**	0,5	(0.5)
Other	**1,947**	195	(195)	**1,798**	180	(180)

* Positive amounts represent long FX position while negative amounts represent short FX Position.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

c) Market risk (continued)

Bank

(in HRK million)

Currency	FX Open position 31 December 2017*	Scenario 2017 10% Move Up	Scenario 2017 10% Move Down	FX Open position 31 December 2016*	Scenario 2016 10% Move Up	Scenario 2016 10% Move Down
EUR	**627**	63	(63)	**489**	49	(49)
CHF	**8**	0.8	(0.8)	**1**	0.1	(0.1)
USD	**15**	1.5	(1.5)	**4**	0.4	(0.4)
Other	**89**	9	(9)	**79**	8	(8)

* Positive amounts represent long FX position while negative amounts represent short FX Position.

Currency risk is further analysed in Note 52.

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)

49 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 2017. Items with floating interest rate are distributed according to next repricing date, while items with fixed interest rate according to their original maturity.

		Change at 31 December 2017			Change at 31 December 2016, restated		
	Increase in basis points	interest income	interest expenses	net interest income	interest income	interest expenses	net interest income
Group	+25	129.0	(46.9)	82.1	150.4	(94.8)	55.6
	+50	259.4	(98.9)	160.5	300.8	(189.6)	111.2
Bank	+25	97.7	(40.0)	57.7	116.8	(77.6)	39.2
	+50	196.8	(85.2)	111.6	233.5	(155.3)	78.2

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 50.

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.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

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)

50 Interest rate risk

Interest risk is calculated through change in the net present value of the portfolio in case of a shift in the reference curves.

The tables below show the sensitivity based on the change of the interest rate for one basis point through the interest rate periods which are defined by the remaining contracted maturity or the contracted interest rate period, whichever is shorter, and does not include held for trading portfolio. In the tables below, increases in the net present value of all future cash flows are shown as positive values, while decreases are shown as a negative value, shown over the different currencies and interest rate periods.

The basis for the sensitivity analysis of the individual position are the contracted interest rate periods. For positions which do not have interest rate periods contracted (a vista position) the Group uses assumptions which reflect the real interest sensitivity of the position.

(in HRK thousands)

Group **Assets**	Up to 3 months	From 3 months to 1 year	From 1 to 3 years	From 3 to 10 years	Over 10 years	**Total**
As at 31 December 2017						
HRK	(77)	(162)	33	(2,240)	(299)	**(2,745)**
EUR	(166)	295	990	(643)	(1,014)	**(538)**
USD	(9)	35	50	(2)	1	**75**
CHF	1	7	6	(9)	(13)	**(8)**
Other	(69)	(2,014)	1,024	(52)	21	**(1,090)**
Total	**(320)**	**(1,839)**	**2,103**	**(2,946)**	**(1,304)**	**(4,306)**
As at 31 December 2016						
HRK	(79)	(161)	84	(1,258)	(187)	**(1,601)**
EUR	(180)	107	1,277	(519)	(1,173)	**(488)**
USD	(13)	50	68	10	1	**116**
CHF	1	9	12	(2)	(14)	**6**
Other	(248)	(2,006)	11	195	16	**(2,032)**
Total	**(519)**	**(2,001)**	**1,452**	**(1,574)**	**(1,357)**	**(3,999)**

Notes to the financial statements (continued)

50 Interest rate risk (continued)

(in HRK thousands)

Bank **Assets**	Up to 3 months	From 3 months to 1 year	From 1 to 3 years	From 3 to 10 years	Over 10 years	**Total**
As at 31 December 2017						
HRK	(78)	(157)	53	(2,207)	(215)	(2,604)
EUR	(79)	394	688	(1,080)	(873)	(950)
USD	(8)	35	49	(3)	1	74
CHF	-	7	5	(7)	(13)	(8)
Other	(4)	4	1	-	-	1
Total	**(169)**	**283**	**796**	**(3,297)**	**(1,100)**	**(3,487)**
As at 31 December 2016						
HRK	(79)	(158)	98	(1,209)	(138)	**(1,486)**
EUR	(166)	257	971	(919)	(1,111)	**(968)**
USD	(12)	43	65	(4)	2	**94**
CHF	-	7	6	(9)	(14)	**(10)**
Other	(14)	4	1	-	-	**(9)**
Total	**(271)**	**153**	**1,141**	**(2,141)**	**(1,261)**	**(2,379)**

Notes to the financial statements (continued)

51 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	
	2017	Restated 2016	2017	2016
	%	%	%	%
Current accounts with banks	(0.12)	(0.14)	(0.07)	(0.09)
Balances with the Croatian National Bank	0.00	0.00	0.00	0.00
Financial assets at fair value through profit or loss	0.96	1.59	0.96	1.48
Loans and advances to banks	(0.14)	0.05	(0.18)	0.05
Loans and advances to customers	4.72	5.12	5.34	5.72
Current accounts and deposits from customers	0.54	0.84	0.54	0.91
Current accounts and deposits from banks and interest-bearing borrowings	0.99	1.63	1.06	1.83

Notes to the financial statements (continued)

52 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.

(in HRK million)

Group **As at 31 December 2017**	EUR and EUR linked	CHF and CHF linked	USD and USD linked	BAM and BAM linked	Other curren-cies	HRK	Total
Assets							
Cash and current accounts with banks	9,448	680	284	834	386	7,079	**18,711**
Balances with the Croatian National Bank	-	-	-	-	-	4,185	**4,185**
Financial assets at fair value through profit or loss	99	-	56	-	-	2,058	**2,213**
Derivative financial assets	17	-	2	1	-	2	**22**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	1	-	-	-	-	-	**1**
Loans and advances to banks	570	-	1,094	566	184	-	**2,414**
Loans and advances to customers	39,196	87	750	2,148	-	22,719	**64,900**
Financial assets available for sale	4,500	-	357	253	-	2,463	**7,573**
Held-to-maturity investments	16	-	-	-	-	-	**16**
Investments in subsidiaries and associates	-	-	-	-	-	69	**69**
Intangible assets	26	-	-	25	-	176	**227**
Property and equipment	199	-	-	50	-	1,111	**1,360**
Investment property	-	-	-	-	-	8	**8**
Non-current assets held for sale	147	-	-	3	-	192	**342**
Deferred tax assets	7	-	-	1	-	117	**125**
Other assets	213	-	16	40	-	455	**724**
Tax prepayments	4	-	-	11	-	7	**22**
Total assets	**54,443**	**767**	**2,559**	**3,932**	**570**	**40,641**	**102,912**
Liabilities							
Current accounts and deposits from banks	577	14	9	53	45	493	**1,191**
Current accounts and deposits from customers	48,060	741	2,970	2,731	519	23,136	**78,157**
Derivative financial liabilities	5	-	-	1	-	7	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	-	-	-	-	-	**9**
Interest-bearing borrowings	2,748	-	103	-	-	932	**3,783**
Subordinated liabilities	-	-	-	1	-	-	**1**
Other liabilities	356	2	11	100	2	1,883	**2,354**
Accrued expenses and deferred income	66	-	-	-	-	296	**362**
Provisions for liabilities and charges	126	-	12	17	25	171	**351**
Deferred tax liabilities	29	-	1	8	-	48	**86**
Current tax liability	-	-	-	1	-	5	**6**
Total liabilities	**51,976**	**757**	**3,106**	**2,912**	**591**	**26,971**	**86,313**
Net position	**2,467**	**10**	**(547)**	**1,020**	**(21)**	**13,670**	**16,599**

Notes to the financial statements (continued)

52 Currency risk (continued)

(in HRK million)

Group As at 31 December 2016, restated	EUR and EUR linked	CHF and CHF linked	USD and USD linked	BAM and BAM linked	Other currencies	HRK	Total
Assets							
Cash and current accounts with banks	7,006	717	125	467	254	5,723	**14,292**
Balances with the Croatian National Bank	-	-	-	-	-	3,916	**3,916**
Financial assets at fair value through profit or loss	1,988	-	32	-	-	4,084	**6,104**
Derivative financial assets	12	-	2	-	-	19	**33**
Loans and advances to banks	693	-	1,628	965	274	54	**3,614**
Loans and advances to customers	42,216	102	916	1,822	11	20,110	**65,177**
Financial assets available for sale	2,977	-	383	342	2	381	**4,085**
Held-to-maturity investments	17	-	-	-	-	-	**17**
Investments in subsidiaries and associates	-	-	-	-	-	67	**67**
Intangible assets	31	-	-	25	-	133	**189**
Property and equipment	122	-	-	50	-	980	**1,152**
Investment property	106	-	-	-	-	62	**168**
Deferred tax assets	7	-	-	1	-	129	**137**
Other assets	244	-	12	38	-	441	**735**
Tax prepayments	-	-	-	8	1	13	**22**
Total assets	**55,419**	**819**	**3,098**	**3,718**	**542**	**36,112**	**99,708**
Liabilities							
Current accounts and deposits from banks	815	43	133	13	42	549	**1,595**
Current accounts and deposits from customers	47,413	854	3,437	2,411	455	19,714	**74,284**
Derivative financial liabilities	10	-	1	6	-	5	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	3	-	-	-	-	-	**3**
Interest-bearing borrowings	2,197	179	411	193	2	1,253	**4,235**
Subordinated liabilities	-	-	-	1	-	-	**1**
Other liabilities	308	2	16	61	3	1,542	**1,932**
Accrued expenses and deferred income	56	-	-	-	-	263	**319**
Provisions for liabilities and charges	107	-	14	18	12	211	**362**
Deferred tax liabilities	12	-	-	7	-	14	**33**
Current tax liability	7	-	-	-	-	165	**172**
Total liabilities	**50,928**	**1,078**	**4,012**	**2,710**	**514**	**23,716**	**82,958**
Net position	**4,491**	**(259)**	**(914)**	**1,008**	**28**	**12,396**	**16,750**

Notes to the financial statements (continued)

52 Currency risk (continued)

(in HRK million)

Bank **As at 31 December 2017**	EUR and EUR linked	CHF and CHF linked	USD and USD linked	BAM and BAM linked	Other curren-cies	HRK	Total
Assets							
Cash and current accounts with banks	7,257	580	224	5	323	7,077	**15,466**
Balances with the Croatian National Bank	-	-	-	-	-	4,185	**4,185**
Financial assets at fair value through profit or loss	97	-	56	-	-	2,057	**2,210**
Derivative financial assets	-	-	-	-	-	2	**2**
Loans and advances to banks	367	-	980	-	143	3	**1,493**
Loans and advances to customers	23,526	56	648	81	-	20,251	**44,562**
Financial assets available for sale	1,695	-	44	-	-	2,406	**4,145**
Investments in subsidiaries and associates	-	-	-	-	-	1,962	**1,962**
Intangible assets	-	-	-	-	-	162	**162**
Property and equipment	-	-	-	-	-	621	**621**
Investment property	-	-	-	-	-	1	**1**
Non-current assets held for sale	-	-	-	-	-	90	**90**
Deferred tax assets	-	-	-	-	-	79	**79**
Other assets	26	-	15	-	-	474	**515**
Tax prepayments	-	-	-	-	-	4	**4**
Total assets	**32,968**	**636**	**1,967**	**86**	**466**	**39,374**	**75,497**
Current accounts and deposits from banks	440	14	9	-	42	559	**1,064**
Current accounts and deposits from customers	30,528	609	2,476	2	419	23,139	**57,173**
Derivative financial liabilities	-	-	-	-	-	7	**7**
Interest-bearing borrowings	1,558	-	3	-	-	816	**2,377**
Other liabilities	89	2	8	-	1	577	**677**
Accrued expenses and deferred income	1	-	-	-	-	164	**165**
Provisions for liabilities and charges	47	-	12	-	25	165	**249**
Deferred tax liabilities	-	-	-	-	-	30	**30**
Current tax liability	-	-	-	-	-	-	-
Total liabilities	**32,663**	**625**	**2,508**	**2**	**487**	**25,457**	**61,742**
Net position	**305**	**11**	**(541)**	**84**	**(21)**	**13,917**	**13,755**

Notes to the financial statements (continued)

52 Currency risk (continued)

(in HRK million)

Bank **As at 31 December 2016**	EUR and EUR linked	CHF and CHF linked	USD and USD linked	BAM and BAM linked	Other currencies	HRK	Total
Assets							
Cash and current accounts with banks	5,718	608	80	3	204	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**
Total assets	**34,554**	**671**	**2,337**	**84**	**418**	**33,986**	**72,050**
Liabilities							
Current accounts and deposits from banks	616	43	77	-	24	616	**1,376**
Current accounts and deposits from customers	30,373	707	2,890	1	353	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**
Total liabilities	**32,986**	**752**	**2,993**	**1**	**391**	**22,158**	**59,281**
Net position	**1,568**	**(81)**	**(656)**	**83**	**27**	**11,828**	**12,769**

Notes to the financial statements (continued)

53 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 2017 and 31 December 2016.

(in HRK million)

Group **As at 31 December 2017**	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 carry-ing amou nt
Liabilities							
Current accounts and deposits from banks	831	231	72	61	-	**1,195**	**1,191**
Current accounts and deposits from custom-ers	47,575	5,258	15,168	10,444	239	**78,684**	**78,157**
Derivative financial liabilities	5	2	1	3	2	**13**	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	1	9	-	**10**	**9**
Interest-bearing borrowings	105	89	742	2,028	945	**3,909**	**3,783**
Other liabilities*	2,616	135	253	116	41	**3,161**	**3,160**
Total undiscounted financial liabilities	**51,132**	**5,716**	**16,236**	**12,661**	**1,227**	**86,972**	**86,313**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	3,417	791	5,190	2,139	2,677	**14,214**	**14,214**
Other contingent liabilities	633	811	2,250	1,181	247	**5,122**	**5,121**
Total undiscounted off-balance sheet con-tingent liabilities and commitments	**4,050**	**1,602**	**7,440**	**3,320**	**2,924**	**19,336**	**19,335**
As at 31 December 2016, restated							
Liabilities							
Current accounts and deposits from banks	1,066	81	379	77	1	**1,604**	**1,595**
Current accounts and deposits from custom-ers	42,205	6,507	17,619	10,624	400	**77,355**	**74,284**
Derivative financial liabilities	2	1	12	3	8	**26**	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	3	**3**	**3**
Interest-bearing borrowings	681	114	785	2,806	1,092	**5,478**	**4,235**
Other liabilities*	2,412	115	156	104	55	**2,842**	**2,819**
Total undiscounted financial liabilities	**46,366**	**6,818**	**18,951**	**13,614**	**1,559**	**87,308**	**82,958**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	1,768	1,316	7,911	1,935	27	**12,957**	**12,957**
Other contingent liabilities	291	984	1,693	1,694	349	**5,011**	**5,011**
Total undiscounted off-balance sheet con-tingent liabilities and commitments	**2,059**	**2,300**	**9,604**	**3,629**	**376**	**17,968**	**17,968**

* 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)

53 Liquidity risk (continued)

Analysis of financial liabilities by remaining contractual maturities (continued)

(in HRK million)

Bank **As at 31 December 2017**	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
Liabilities							
Current accounts and deposits from banks	762	3	37	271	-	**1,073**	**1.064**
Current accounts and deposits from customers	32,645	4,396	12,691	7,645	156	**57,533**	**57,173**
Derivative financial liabilities	5	1	1	-	-	**7**	**7**
Interest-bearing borrowings	76	55	349	1,287	693	**2,460**	**2,377**
Other liabilities*	795	22	226	42	29	**1,114**	**1,121**
Total undiscounted financial liabilities	**34,283**	**4,477**	**13,304**	**9,245**	**878**	**62,187**	**61,742**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	2,529	553	3,946	1,519	2,677	**11,224**	**11,224**
Other contingent liabilities	232	616	1,742	728	93	**3,411**	**3,411**
Total undiscounted off-balance sheet contingent liabilities and commitments	**2,761**	**1,169**	**5,688**	**2,247**	**2,770**	**14,635**	**14,635**

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
Liabilities							
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**
Total undiscounted financial liabilities	**30,919**	**4,649**	**14,029**	**9,718**	**725**	**60,040**	**59,281**
Off-balance sheet contingent liabilities and commitments							
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**
Total undiscounted off-balance sheet contingent liabilities and commitments	**902**	**1,474**	**7,818**	**2,923**	**224**	**13,341**	**13,341**

* 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)

53 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 2017 and 31 December 2016. 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.

Notes to the financial statements (continued)

53 Liquidity risk (continued)

Maturity analysis of assets and liabilities (continued)

(in HRK million)

Group **As at 31 December 2017**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	18,711	-	**18,711**
Balances with the Croatian National Bank	-	4,185	**4,185**
Financial assets at fair value through profit or loss	1,686	527	**2,213**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	22	-	**22**
Derivative financial assets	-	1	**1**
Loans and advances to banks	2,050	364	**2,414**
Loans and advances to customers	19,816	45,084	**64,900**
Financial assets available for sale	2,761	4,812	**7,573**
Held-to-maturity investments	-	16	**16**
Investments in subsidiaries and associates	-	69	**69**
Intangible assets	-	227	**227**
Property and equipment	-	1,360	**1,360**
Investment property	-	8	**8**
Non-current assets held for sale	342	-	**342**
Deferred tax assets	18	107	**125**
Other assets	643	81	**724**
Tax prepayments	22	-	**22**
Total assets	**46,071**	**56,841**	**102,912**
Liabilities			
Current accounts and deposits from banks	1,131	60	**1,191**
Current accounts and deposits from customers	53,639	24,518	**78,157**
Derivative financial liabilities	13	-	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	9	**9**
Interest-bearing borrowings	935	2,848	**3,783**
Subordinated liabilities	1	-	**1**
Other liabilities	2,354	-	**2,354**
Accrued expenses and deferred income	351	11	**362**
Provisions for liabilities and charges	-	351	**351**
Deferred tax liabilities	-	86	**86**
Current tax liability	6	-	**6**
Total liabilities	**58,430**	**27,883**	**86,313**
Net expected maturity gap	**(12,359)**	**28,958**	**16,599**

Notes to the financial statements (continued)

53 Liquidity risk (continued)

Maturity analysis of assets and liabilities (continued)

(in HRK million)

Group **As at 31 December 2016, restated**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	14,292	-	**14,292**
Balances with the Croatian National Bank	-	3,916	**3,916**
Financial assets at fair value through profit or loss	5,687	417	**6,104**
Derivative financial assets	25	8	**33**
Loans and advances to banks	3,482	132	**3,614**
Loans and advances to customers	20,806	44,371	**65,177**
Financial assets available for sale	998	3,087	**4,085**
Held-to-maturity investments	-	17	**17**
Investments in subsidiaries and associates	-	67	**67**
Intangible assets	-	189	**189**
Property and equipment	-	1,152	**1,152**
Investment property	-	168	**168**
Deferred tax assets	-	137	**137**
Other assets	618	117	**735**
Tax prepayments	22	-	**22**
Total assets	**45,930**	**53,778**	**99,708**
Liabilities			
Current accounts and deposits from banks	1,515	80	**1,595**
Current accounts and deposits from customers	47,857	26,427	**74,284**
Derivative financial liabilities	11	11	**22**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	3	**3**
Interest-bearing borrowings	1,532	2,703	**4,235**
Subordinated liabilities	-	1	**1**
Other liabilities	1,932	-	**1,932**
Accrued expenses and deferred income	305	14	**319**
Provisions for liabilities and charges	9	353	**362**
Deferred tax liabilities	-	33	**33**
Current tax liability	172	-	**172**
Total liabilities	**53,333**	**29,625**	**82,958**
Net expected maturity gap	**(7,403)**	**24,153**	**16,750**

Notes to the financial statements (continued)

53 Liquidity risk (continued)

Maturity analysis of assets and liabilities (continued)

(in HRK million)

Bank **As at 31 December 2017**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	15,466	-	**15,466**
Balances with the Croatian National Bank	-	4,185	**4,185**
Financial assets at fair value through profit or loss	1,685	525	**2,210**
Derivative financial assets	2	-	**2**
Loans and advances to banks	1,493	-	**1,493**
Loans and advances to customers	12,271	32,291	**44,562**
Financial assets available for sale	1,791	2,354	**4,145**
Investments in subsidiaries and associates	-	1,962	**1,962**
Intangible assets	-	162	**162**
Property and equipment	-	621	**621**
Investment property	-	1	**1**
Non-current assets held for sale	90	-	**90**
Deferred tax assets	-	79	**79**
Other assets	455	60	**515**
Tax prepayments	4	-	**4**
Total assets	**33,257**	**42,240**	**75,497**
Liabilities			
Current accounts and deposits from banks	802	262	**1,064**
Current accounts and deposits from customers	35,388	21,785	**57,173**
Derivative financial liabilities	7	-	**7**
Interest-bearing borrowings	477	1,900	**2,377**
Other liabilities	677	-	**677**
Accrued expenses and deferred income	153	12	**165**
Provisions for liabilities and charges	-	249	**249**
Deferred tax liabilities	-	30	**30**
Current tax liability	-	-	-
Total liabilities	**37,504**	**24,238**	**61,742**
Net expected maturity gap	**(4,247)**	**18,002**	**13,755**

Notes to the financial statements (continued)

53 Liquidity risk (continued)

Maturity analysis of assets and liabilities (continued)

(in HRK million)

Bank **As at 31 December 2016**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	12,338	-	**12,338**
Balances with the Croatian National Bank	-	3,916	**3,916**
Financial assets at fair value through profit or loss	5,560	415	**5,975**
Derivative financial assets	19	-	**19**
Loans and advances to banks	1,731	-	**1,731**
Loans and advances to customers	13,917	31,750	**45,667**
Financial assets available for sale	96	274	**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	181	93	**274**
Total assets	**33,842**	**38,208**	**72,050**
Liabilities			
Current accounts and deposits from banks	1,111	265	**1,376**
Current accounts and deposits from customers	46,410	7,698	**54,108**
Derivative financial liabilities	5	-	**5**
Interest-bearing borrowings	1,100	1,647	**2,747**
Other liabilities	481	-	**481**
Accrued expenses and deferred income	123	14	**137**
Provisions for liabilities and charges	-	257	**257**
Deferred tax liabilities	-	5	**5**
Current tax liability	165	-	**165**
Total liabilities	**49,395**	**9,886**	**59,281**
Net expected maturity gap	**(15,553)**	**28,322**	**12,769**

Notes to the financial statements (continued)

54 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 2017	GROUP Assets	GROUP Liabilities	GROUP Off balance sheet liabilities	BANK Assets	BANK Liabilities	BANK Off balance sheet liabilities
Geographic region						
Republic of Croatia	72,231	61,319	12,685	69,616	58,244	12,844
Other European Union members	20,438	18,198	5,145	2,885	1,833	1,488
Other countries	10,243	6,796	1,505	2,996	1,665	303
	102,912	**86,313**	**19,335**	**75,497**	**61,742**	**14,635**
Industry sector						
Citizens	34,000	55,568	7,377	23,813	40,758	5,983
Finance	22,440	7,779	1,279	22,294	5,167	1,110
Government	18,644	2,971	104	13,041	2,230	102
Commerce	3,787	3,101	2,657	1,975	2,167	1,295
Tourism	2,426	1,209	151	2,102	1,010	118
Agriculture	978	360	160	901	323	151
Other sectors	20,637	15,325	7,607	11,371	10,087	5,876
	102,912	**86,313**	**19,335**	**75,497**	**61,742**	**14,635**

(in HRK million)

As at 31 December 2016, restated	GROUP Assets	GROUP Liabilities	GROUP Off balance sheet items	BANK Assets	BANK Liabilities	BANK Off balance sheet items
Geographic region						
Republic of Croatia	68,158	57,637	12,231	64,906	55,077	12,260
Other European Union members	21,968	18,345	4,467	4,592	2,447	990
Other countries	9,582	6,976	1,270	2,552	1,757	91
	99,708	**82,958**	**17,968**	**72,050**	**59,281**	**13,341**
Industry sector						
Citizens	31,854	53,750	6,926	22,430	39,444	5,595
Finance	21,859	10,939	894	18,433	5,573	564
Government	20,776	3,770	207	15,140	1,816	136
Commerce	4,639	2,464	2,029	2,784	1,725	963
Tourism	2,123	883	265	1,551	596	196
Agriculture	835	236	98	716	196	84
Other sectors	17,622	10,916	7,549	10,996	9,931	5,803
	99,708	**82,958**	**17,968**	**72,050**	**59,281**	**13,341**

Notes to the financial statements (continued)

55 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 19,010,136 (2016: 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.

	GROUP		**BANK**	
	2017	Restated 2016	2017	2016
Profit attributable to equity holders of the Bank (in HRK million)	1,331	1,660	1,443	1,605
Weighted average number of ordinary shares	19,010,136	19,010,096	19,010,136	19,010,096
Basic and diluted earnings per share (in HRK per share)	**70.0**	**87.3**	**75.9**	**84.4**

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 30/2017) and Corrections of the Decision on the Structure and Content of Annual Financial Statements (Official Gazette 44/2017) are presented below:

Form "Balance sheet"

(in HRK million)

	GROUP		BANK	
	31 December 2017	Restated 31 December 2016	31 December 2017	31 December 2016
Assets				
Cash and deposits with the Croatian National Bank	18,479	12,653	17,497	12,037
Cash	*2,600*	*2,137*	*1,618*	*1,521*
Deposits with the Croatian National Bank	*15,879*	*10,516*	*15,879*	*10,516*
Deposits with banking institutions	6,699	9,031	3,530	5,773
Ministry of Finance treasury bills and the Croatian National Bank bills	5,021	5,453	5,021	5,418
Securities and other financial instruments held for trading	544	513	544	513
Securities and other financial instruments available for sale	4,169	4,048	766	368
Securities and other financial instruments held to maturity	16	17	-	-
Securities and other financial instruments at fair value through profit or loss which are not actively traded	4	111	1	17
Derivative financial assets	23	33	2	19
Loans to financial institutions	132	138	117	174
Loans to other clients	64,808	65,065	44,516	45,600
Investments in subsidiaries, associates and joint ventures	69	67	1,962	953
Foreclosed assets	126	233	36	68
Tangible assets (net of depreciation)	1,360	1,152	621	545
Interest, fees and other assets	1,581	1,323	1,004	695
Total assets	**103,031**	**99,837**	**75,617**	**72,180**

Appendix 1 - Supplementary forms required by local regulation (continued)

Form "Balance sheet" (continued)

(in HRK million)

	GROUP		BANK	
	31 December 2017	Restated 31 December 2016	31 December 2017	31 December 2016
Liabilities				
Loans from financial institutions	3,773	4,225	2,369	2,739
Short-term loans	*80*	*154*	*48*	*154*
Long-term loans	*3,693*	*4,071*	*2,321*	*2,585*
Deposits	79,104	75,541	58,026	55,188
Giro account and current account deposits	*29,821*	*26,307*	*17,080*	*14,778*
Savings deposits	*15,127*	*13,596*	*13,261*	*11,744*
Term deposits	*34,156*	*35,638*	*27,685*	*28,666*
Other loans	-	-	-	-
Short-term loans	-	-	-	-
Long-term loans	-	-	-	-
Derivative financial liabilities and other financial liabilities held for trading	22	25	7	5
Debt securities issued	-	-	-	-
Short-term debt securities issued	-	-	-	-
Long-term debt securities issued	-	-		-
Subordinated instruments issued	1	1	-	-
Hybrid instruments issued	-	-	-	-
Interest, fees and other liabilities	3,532	3,295	1,460	1,479
Total liabilities	**86,432**	**83,087**	**61,862**	**59,411**
Equity				
Share capital	1,907	1,907	1,907	1,907
Current year profit/(loss)	1,346	1,739	1,443	1,605
Retained earnings/(loss)	11,615	10,512	8,566	7,442
Legal reserves	201	198	134	134
Statutory reserves and other capital reserves	1,431	2,313	1,656	1,662
Unrealised gains/(losses) on value adjustments of financial assets available for sale	99	81	49	19
Total equity	**16,599**	**16,750**	**13,755**	**12,769**
Total liabilities and equity	**103,031**	**99,837**	**75,617**	**72,180**
Total equity	**16,599**	**16,750**	**13,755**	**12,769**
Equity holders of the Bank	15,548	15,626	13,755	12,769
Non-controlling interests	1,051	1,124	-	-

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 2017

Assets

(in HRK million)

	per IFRS																	
GROUP CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets at fair value through profit or loss	Derivative financial assets	Fair value changes of the hedged items in portfolio hedge	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	Non-current assets held for sale	Deferred tax assets	Other assets	Tax prepayments	**Total assets**
Cash and deposits with the Croatian National Bank	14,294	4,185	-	-	-	-	-	-	-	-	-	-	-	-	-	-		**18,479**
Cash	2,600	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-		**2,600**
Deposits with the Croatian National Bank	11,694	4,185	-	-	-	-	-	-	-	-	-	-	-	-	-	-		**15,879**
Deposits with banking institutions	4,417	-	-	-	-	2,282	-	-	-	-	-	-	-	-	-	-		**6,699**
Ministry of Finance treasury bills and the Croatian National Bank bills	-	-	1,652	-	-	-	-	3,369	-	-	-	-	-	-	-	-		**5,021**
Securities and other financial instruments held for trading	-	-	544	-	-	-	-	-	-	-	-	-	-	-	-	-		**544**
Securities and other financial instruments available for sale	-	-	-	-	-	-	-	4,169	-	-	-	-	-	-	-	-		**4,169**
Securities and other financial instruments held to maturity	-	-	-	-	-	-	-		16	-	-	-	-	-	-	-		**16**

Appendix 1 - Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Assets (continued)

(in HRK million)

	per IFRS																	
GROUP CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets at fair value through profit or loss	Derivative financial assets	Fair value changes of the hedged items in portfolio hedge of interest rate risk	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	Non-current assets held for sale	Deferred tax assets	Other assets	Tax prepayments	**Total assets**
Securities and other financial instruments at fair value through profit or loss which are not actively traded	-	-	4	-	-	-	-	-	-	-	-	-	-	-	-	-		**4**
Derivative financial assets	-	-	-	22	1	-	-	-	-	-	-	-	-	-	-	-		**23**
Loans to financial institutions	-	-	-	-	-	132	-	-	-	-	-	-	-	-	-	-		**132**
Loans to other clients	-	-	-	-	-	-	64,808	-	-	-	-	-	-	-	-	-		**64,808**
Investments in subsidiaries, associates and joint ventures	-	--	-	-	-	-		-	-	69	-	-	-	-	-	-		**69**
Foreclosed assets	-	-	-	-	-	-		-	-	-	-	-	-	-	-	126		**126**
Tangible assets (net of depreciation)	-	-	-	-	-	-		-	-	-	-	1,360	-	-	-	-		**1,360**
Interest, fees and other assets	-	-	13	-	-	-	211	35	-	-	227	-	8	342	125	598	22	**1,581**
Transfer to interest, fees and other liabilities	-	-	-	-	-	-	(119)	-	-	-	-	-	-	-	-	-		**(119)**
Total assets	**18,711**	**4,185**	**2,213**	**22**	**1**	**2,414**	**64,900**	**7,573**	**16**	**69**	**227**	**1,360**	**8**	**342**	**125**	**724**	**22**	**102,912**

Appendix 1 – Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Liabilities

(in HRK million)

	Per IFRS												
GROUP **CNB schedules**	Current accounts and deposits from banks	Current accounts and deposits from customers	Derivative financial liabilities	Fair value changes of the hedged items in portfolio hedge	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	**Total liabilities**
Loans from financial institutions	-	-	-	-	3,773	-	-	-	-	-	-	-	**3,773**
Short-term loans	-	-	-	-	80	-	-	-	-	-	-	-	**80**
Long-term loans	-	-	-	-	3,693	-	-	-	-	-	-	-	**3,693**
Deposits	1,186	77,918	-	-	-	-	-	-	-	-	-	-	**79,104**
Giro account and current account deposits	610	29,211	-	-	-	-	-	-	-	-	-	-	**29,821**
Savings deposits	-	15,127	-	-	-	-	-	-	-	-	-	-	**15,127**
Term deposits	576	33,580	-	-	-	-	-	-	-	-	-	-	**34,156**
Other loans	-	-	-	-	-	-	-	-	-	-	-	-	-
Short-term loans	-	-	-	-	-	-	-	-	-	-	-	-	-
Long-term loans	-	-	-	-	-	-	-	-	-	-	-	-	-
Derivative financial liabilities and other financial liabilities held for trading	-	-	13	9	-	-	-	-	-	-	-	-	**22**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Short-term debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Long-term debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Subordinated instruments issued	-	-	-	-	-	1	-	-	-	-	-	-	**1**
Hybrid instruments issued	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest, fees and other liabilities	5	239	-	-	10	-	2,354	362	351	86	6	-	**3,413**
Total liabilities	**1,191**	**78,157**	**13**	**9**	**3,783**	**1**	**2,354**	**362**	**351**	**86**	**6**	**-**	**86,313**

Appendix 1 - Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Equity

(in HRK million)

	Per IFRS								
GROUP **CNB schedules**	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	Merger reserve	Non-controlling interests	**Total equity**
Share capital	1,907	-	-	-	-	-	-	-	**1,907**
Current year profit/(loss)	-	-	-	-	-	1,331	-	15	**1,346**
Retained earnings/(loss)	-	-	-	-	-	10,579	-	1,036	**11,615**
Legal reserves	-	-	-	201	-	-	-	-	**201**
Statutory reserves and other capital reserves	-	1,570	(76)	1,168	-	(1,231)	-	-	**1,431**
Unrealised gains/(losses) on value adjustments of financial assets available for sale	-	-	-	-	99	-	-	-	**99**
Total equity	**1,907**	**1,570**	**(76)**	**1,369**	**99**	**10,679**	**-**	**1,051**	**16,599**

Appendix 1 - Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Assets

(in HRK million)

	per IFRS															
BANK CNB schedules	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	Non current asset held for sale	Deferred tax assets	Other assets	Tax prepayments	**Total assets**
Cash and deposits with the Croatian National Bank	13,312	4,185	-	-	-	-	-	-	-	-	-	-	-	-	-	**17,497**
Cash	1,618	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**1,618**
Deposits with the Croatian National Bank	11,694	4,185	-	-	-	-	-	-	-	-	-	-	-	-	-	**15,879**
Deposits with banking institutions	2,154	-	-	-	1,376	-	-	-	-	-	-	-	-	-	-	**3,530**
Ministry of Finance treasury bills and the Croatian National Bank bills	-	-	1,652	-	-	-	3,369	-	-	-	-	-	-	-	-	**5,021**
Securities and other financial instruments held for trading	-	-	544	-	-	-	-	-	-	-	-	-	-	-	-	**544**
Securities and other financial instruments available for sale	-	-	-	-	-	-	766	-	-	-	-	-	-	-	-	**766**
Securities and other financial instruments held to maturity	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**

Appendix 1 - Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Assets (continued)

(in HRK million)

	per IFRS															
BANK CNB schedules	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	Non-current asset held for sale	Deferred tax assets	Other assets	Tax prepayments	**Total assets**
Securities and other financial instruments at fair value through profit or loss which are not actively traded	-	-	1	-	-	-	-	-	-	-	-	-	-	-	-	**1**
Derivative financial assets	-	-	-	2	-	-	-	-	-	-	-	-	-	-	-	**2**
Loans to financial institutions	-	-	-	-	117	-	-	-	-	-	-	-	-	-	-	**117**
Loans to other clients	-	-	-	-	-	44,516	-	-	-	-	-	-	-	-	-	**44,516**
Investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	1,962	-	-	-	-	-	-	-	**1,962**
Foreclosed assets	-	-	-	-	-	-	-	-	-	-	-	-	-	36	-	**36**
Tangible assets (net of depreciation)	-	-	-	-	-	-	-	-	-	621	-	-	-	-	-	**621**
Interest, fees and other assets	-	-	13	-	-	166	10	-	162	-	1	90	79	479	4	**1,003**
Transfer to interest, fees and other liabilities	-	-	-	-	-	(120)	-	-	-	-	-	-	-	-	-	**(120)**
Total assets	**15,466**	**4,185**	**2,210**	**2**	**1,493**	**44,562**	**4,145**	**1,962**	**162**	**621**	**1**	**90**	**79**	**515**	**4**	**75,497**

Appendix 1 – Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Liabilities

(in HRK million)

	Per IFRS										
BANK CNB schedules	Current accounts and deposits from banks	Current accounts and deposits from customers	Derivative financial liabilities	Interest-bearing borrowings	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	**Total liabilities**
Loans from financial institutions	-	-	-	**2,369**	-	-	-	-	-	-	**2,369**
Short-term loans	-	-	-	48	-	-	-	-	-	-	**48**
Long-term loans	-	-	-	2,321	-	-	-	-	-	-	**2,321**
Deposits	**1,056**	**56,970**	-	-	-	-	-	-	-	-	**58,026**
Giro account and current account deposits	557	16,523	-	-	-	-	-	-	-	-	**17,080**
Savings deposits	-	13,261	-	-	-	-	-	-	-	-	**13,261**
Term deposits	499	27,186	-	-	-	-	-	-	-	-	**27,685**
Other loans	-	-	-	-	-	-	-	-	-	-	-
Short-term loans	-	-	-	-	-	-	-	-	-	-	-
Long-term loans	-	-	-	-	-	-	-	-	-	-	-
Derivative financial liabilities and other financial liabilities held for trading	-	-	7	-	-	-	-	-	-	-	**7**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-
Short-term debt securities issued	-	-	-	-	-	-	-	-	-	-	-
Long-term debt securities issued	-	-	-	-	-	-	-	-	-	-	-
Subordinated instruments issued	-	-	-	-	-	-	-	-	-	-	-
Hybrid instruments issued	-	-	-	-	-	-	-	-	-	-	-
Interest, fees and other liabilities	8	203	-	8	677	165	249	30	-	120	**1,460**
Total liabilities	**1,064**	**57,173**	**7**	**2,377**	**677**	**165**	**249**	**30**	**-**	**120**	**61,742**

Appendix 1 - Supplementary forms required by local regulation (continued)

Balance sheet reconciliation as at 31 December 2017 (continued)

Equity

(in HRK million)

	Per IFRS						
BANK **CNB schedules**	Share capital	Share premium	Treasury shares	Other reserves	Fair value reserve	Retained earnings	**Total equity**
Share capital	1,907	-	-	-	-	-	**1,907**
Current year profit/(loss)	-	-	-	-	-	1,443	**1,443**
Retained earnings/(loss)	-	-	-	-	-	8,566	**8,566**
Legal reserves	-	-	-	134	-	-	**134**
Statutory reserves and other capital reserves	-	1,570	(76)	162	-	-	**1,656**
Unrealised gains/(losses) on value adjustments of financial assets available for sale	-	-	-	-	49	-	**49**
Total equity	**1,907**	**1,570**	**(76)**	**296**	**49**	**10,009**	**13,755**

Appendix 1 - Supplementary forms required by local regulation (continued)

Form "Income statement"

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Interest income	3,435	3,645	2,691	2,888
(Interest expenses)	(526)	(736)	(374)	(573)
Net interest income	**2,909**	**2,909**	**2,317**	**2,315**
Income from fees and commissions	1,848	1,774	811	754
(Expenses on fees and commissions)	(347)	(334)	(126)	(120)
Net income from fees and commissions	**1,501**	**1,440**	**685**	**634**
Gains/(losses) from investments in subsidiaries, associates and joint ventures	14	24	-	-
Gains/(losses) from trading activities	21	22	21	22
Gains/(losses) from embedded derivatives	-	-	-	-
Gains/(losses) from financial assets at fair value through profit or loss and not traded	(13)	(8)	(12)	(8)
Gains/(losses) from activities related to assets available for sale	53	274	16	125
Gains/(losses) from activities related to assets held to maturity	-	-	-	-
Gains/(losses) from hedging transactions	(1)	1	-	-
Income from equity investments in subsidiaries, associates and joint ventures	-	-	443	218
Income from other equity investments	6	14	2	9
Gains/(losses) from exchange differences	232	216	206	199
Other income	135	315	68	305
Other expenses	(673)	(674)	(310)	(322)
General administrative expenses and depreciation	(1,770)	(1,809)	(1,222)	(1,197)
Net operating income before value adjustments and loss provisions	**2,414**	**2,724**	**2,226**	**2,300**
Impairment expenses	(764)	(519)	(552)	(315)
Profit/(loss) before taxes	**1,650**	**2,205**	**1,674**	**1,985**
Income tax	(304)	(466)	(231)	(380)
Current year profit/(loss)	**1,346**	**1,739**	**1,443**	**1,605**
Attributable to:				
Equity holders of the Bank	1,331	1,660	1,443	1,605
Non-controlling interests	15	79	**0**	-
	1,346	1,739	**1,443**	**1,605**

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)

Form "Income statement" (continued)

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Net profit for the year	**1,346**	**1,739**	**1,443**	**1,605**
Other comprehensive income	**249**	**(116)**	**117**	**(67)**
Items that will not be reclassified to profit or loss	**239**	**1**	**87**	**-**
Tangible assets	290	-	106	-
Intangible assets	-	-	-	-
Actuarial gains (losses) on defined benefit pensions plans	-	1	-	-
Non-current assets and disposal groups classified as held for sale	-	-	-	-
Share of other recognized revenues and costs from entities accounted by equity method	-	-	-	-
Income tax related to items which will not be reclassified to profit or loss	(51)	-	(19)	-
Items that are or may be reclassified to profit or loss	**10**	**(117)**	**30**	**(67)**
Protection of net investment in foreign operations (effective share)	**-**	**-**	**-**	**-**
Gain/(Loss) in equity	-	-	-	-
Transferred to the income statement	-	-	-	-
Other reclassifications	-	-	-	-
Foreign exchange differences	**(9)**	**(29)**	**-**	**-**
Gain/(Loss) in equity	(9)	(29)	-	-
Transferred to the income statement	-	-	-	-
Other reclassifications	-	-	-	-
Protection of cash flows (effective share)	**-**	**-**	**-**	**-**
Gain/(Loss) in equity	-	-	-	-
Transferred to the income statement	-	-	-	-
Transferred to initial carrying value of hedged items	-	-	-	-
Other reclassifications	-	-	-	-
Available-for-sale financial assets	**21**	**(107)**	**36**	**(84)**
Gain/(Loss) in equity	58	32	51	11
Transferred to the income statement	(37)	(139)	(15)	(95)
Other reclassifications	-	-	-	-
Non-current assets and disposal groups classified as held for sale	**-**	**-**	**-**	**-**
Gain/(Loss) in equity	-	-	-	-
Transferred to the income statement	-	-	-	-
Other reclassifications	-	-	-	-
Share of other recognized revenues and costs from investments in subsidiaries, joint ventures and associates	-	-	-	-
Income tax related to items which are or may be reclassified to profit or loss	(2)	19	(6)	17
Total comprehensive income for the year	**1,595**	**1,623**	**1,560**	**1,538**
Attributable to:				
Equity holders of the Bank	**1,541**	**1,572**	**1,560**	**1,538**
Non-controlling interests	**54**	**51**	**-**	**-**
	1,595	**1,623**	**1,560**	**1,538**

Appendix 1 - Supplementary forms required by local regulation (continued)

Income statement reconciliation for the year ended 31 December 2017

(in HRK million)

	Per IFRS																
GROUP CNB schedules	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	Fair value adjustments in hedge accounting	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	3,435	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**3,435**
(Interest expenses)	-	(526)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**(526)**
Income from fees and commissions	-	-	1,848	-	-	-	-	-	-	-	-	-	-	-	-	-	**1,848**
(Expenses on fees and commissions)	-	-	-	(347)	-	-	-	-	-	-	-	-	-	-	-	-	**(347)**
Gains/(losses) from investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	14	-	**14**
Gains/(losses) from trading activities	-	-	-	-	-	21	-	-	-	-	-	-	-	-	-	-	**21**
Gains/(losses) from embedded derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Gains/(losses) from financial assets at fair value through profit or loss and not traded	-	-	-	-	-	(13)	-	-	-	-	-	-	-	-	-	-	**(13)**
Gains/(losses) from activities related to assets available for sale	-	-	-	-	-	-	-	53	-	-	-	-	-	-	-	-	**53**
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 2017 (continued)

(in HRK million)

	Per IFRS																
GROUP CNB schedules	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	Fair value adjustments in hedge accounting	Other operating income	Personnel expenses	Impairment losses on loans and advances to customers	Release/(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		-	-	-	-	-	(1)	-	-	-	-	-	-	-	-	-	**(1)**
Income from equity investments in subsidiaries, associates and joint ventures		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Income from other equity investments		-	-	-	6	-	-	-	-	-	-	-	-	-	-	-	**6**
Gains/(losses) from exchange differences		-	-	-	-	232	-	-	-	-	-	-	-	-	-	-	**232**
Other income		-	-	-	-	-	-	135	-	-	-	-	-	-	-	-	**135**
Other expenses		-	-	-	-	-	-	-	-	-	-	-	-	(673)	-	-	**(673)**
General administrative expenses and depreciation		-	-	-	-	-	-	-	(1,102)	-	-	-	(198)	(470)	-	-	**(1,771)**
Impairment expenses	65	-	-	-	-	-	-	-	-	(823)	-	(6)	-	-	-	-	**(764)**
Income tax		-	-	-	-		-	-	-	-	-	-	-	-	-	(304)	**(304)**
Current year profit/(loss)	**3,500**	**(526)**	**1,848**	**(347)**	**6**	**240**	**(1)**	**188**	**(1,102)**	**(823)**	**-**	**(6)**	**(198)**	**(1,143)**	**14**	**(304)**	**1,346**

Appendix 1 - Supplementary forms required by local regulation (continued)

Income statement reconciliation for the year ended 31 December 2017 (continued)

(in HRK million)

	Per IFRS															
BANK CNB schedules	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) recognised on CHF conversion	Other impairment losses and provisions	Depreciation and amortisation	Other operating expenses	Net value adjustment from valuation of tangible assets (IAS 16)	Income tax expense	**Profit for the year**
Interest income	2,691	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**2,691**
(Interest expenses)	-	(374)	-	-	-	-	-	-	-	-	-	-	-	-	-	**(374)**
Income from fees and commissions	-	-	811	-	-	-	-	-	-	-	-	-	-	-	-	**811**
(Expenses on fees and commissions)	-	-	-	(126)	-	-	-	-	-	-	-	-	-	-	-	**(126)**
Gains/(losses) from investments in subsidiaries, associates and joint ventures	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Gains/(losses) from trading activities	-	-	-	-	-	21	-	-	-	-	-	-	-	-	-	**21**
Gains/(losses) from embedded derivatives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Gains/(losses) from financial assets at fair value through profit or loss and not traded	-	-	-	-	-	(12)	-	-	-	-	-	-	-	-	-	**(12)**
Gains/(losses) from activities related to assets available for sale	-	-	-	-	-	-	16	-	-	-	-	-	-	-	-	**16**
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 2017 (continued)

(in HRK million)

	Per IFRS														
BANK CNB schedules	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) recognised on CHF conversion	Other impairment losses and provisions	Depreciation and amortisation	Other operating expenses	Income tax expense	**Profit for the year**
Gains/(losses) from hedging transactions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income from equity investments in subsidiaries, associates and joint ventures	-	-	-	-	443	-	-	-	-	-	-	-	-	-	**443**
Income from other equity investments	-	-	-	-	2	-	-	-	-	-	-	-	-	-	**2**
Gains/(losses) from exchange differences	-	-	-	-	-	206	-	-	-	-	-	-	-	-	**206**
Other income	-	-	-	-	-	-	80	-	-	-	-	-	-	-	**80**
Other expenses	-	-	-	-	-	-	-	-	-	-	-	-	(310)	-	**(310)**
General administrative expenses and depreciation	-	-	-	-	-	-	-	(730)	-	-	-	(118)	(374)	-	**(1.222)**
Impairment expenses	57	-	-	-	-	-	-	-	(608)		(1)	-	-	-	**(552)**
Income tax	-	-	-	-	-	-	-	-	-	-	-	-	-	(231)	**(231)**
Current year profit/(loss)	**2,748**	**(374)**	**811**	**(126)**	**445**	**215**	**96**	**(730)**	**(608)**	**-**	**(1)**	**(118)**	**(684)**	**(231)**	**1,443**

Appendix 1 - Supplementary forms required by local regulation (continued)

Form "Cash flow statement"

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Cash flow from operating activities				
Profit/(loss) before tax	1,650	2,205	1,674	1,985
Impairment losses	764	518	552	315
Depreciation and amortization	198	244	119	113
(Gains)/losses from sale of tangible assets	(8)	(14)	(8)	(14)
Unrealised (gains)/losses on securities at fair value through profit or loss	(6)	(29)	(3)	(5)
Other (gains)/losses	-	162	-	(241)
Cash flow from operating activities before changes in operating assets	**2,598**	**3,086**	**2,334**	**2,153**
(Increase)/decrease in operating assets				
Deposits with the Croatian National Bank	(269)	634	(269)	634
Ministry of Finance treasury bills and Croatian National Bank bills	432	224	397	200
Deposits with banking institutions and loans to financial institutions	911	(224)	99	46
Loans to other clients	(390)	(3,222)	580	(1,726)
Securities and other financial instruments held for trading	(8)	(418)	(10)	(418)
Securities and other financial instruments available for sale	(102)	(527)	(368)	(151)
Securities and other financial instruments at fair value through profit or loss which are not actively traded	93	46	2	46
Other operating assets	24	(279)	(318)	(79)
Net (increase)/decrease in operating assets	**691**	**(3,766)**	**113**	**(1,448)**
Increase/(decrease) in operating liabilities				
Demand deposits	3,515	3,468	2,302	1,458
Savings and term deposits	48	(429)	536	(24)
Derivative financial liabilities and other liabilities held for trading	(3)	9	2	(10)
Other liabilities	(46)	(343)	(309)	(285)
Net increase/(decrease) in operating liabilities	**3,514**	**2,705**	**2,531**	**1,139**
Net cash flow from operating activities	**6,803**	**2,025**	**4,978**	**1,844**
(Income tax paid)	(458)	(137)	(389)	(58)
Net inflow/(outflow) of cash from operating activities	**6,345**	**1,888**	**4,589**	**1,786**

Appendix 1 - Supplementary forms required by local regulation (continued)

Form "Cash flow statement" (continued)

(in HRK million)

	GROUP		BANK	
	2017	Restated 2016	2017	2016
Investing activities				
Cash receipts from/(payments to acquire) tangible and intangible assets	(199)	46	(104)	15
Cash receipts from the disposal of/(payments for the investment in) subsidiaries, associates and joint ventures	(1,103)	251	(1,103)	251
Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity	-	-	-	-
Dividends received	6	14	446	227
Other receipts from/(payments for) investments	-	-	-	-
Net cash flow from investing activities	**(1,296)**	**311**	**(761)**	**493**
Financing activities				
Net increase/(decrease) in received loans	(450)	(793)	(370)	(94)
Net increase/(decrease) in issued debt securities	-	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-	-
Proceeds from issue of share capital	-	-	-	-
(Dividends paid)	(482)	(193)	(482)	(193)
Other proceeds/(payments) from financing activities	-	-	-	-
Net cash flow from financing activities	**(932)**	**(986)**	**(852)**	**(287)**
Net increase/(decrease) in cash and cash equivalents	**4,117**	**1,213**	**2,976**	**1,992**
Effect of foreign exchange differences on cash and cash equivalents	(20)	1	(20)	5
Net increase/(decrease) in cash and cash equivalents	**4,097**	**1,214**	**2,956**	**1,997**
Cash and cash equivalents at the beginning of the year	16,195	14,981	14,016	12,019
Cash and cash equivalents at the end of the year	**20,292**	**16,195**	**16,972**	**14,016**

Appendix 1 - Supplementary forms required by local regulation (continued)

Cash flow statement reconciliation for the year ended 31 December 2017

(in HRK million)

	GROUP			BANK		
	CNB schedules	per IFRS	Differences	CNB schedules	per IFRS	Differences
Cash flow from operating activities						
Profit (loss) before tax	1,650	1,650	-	1,674	1,674	-
Impairment losses	764	-	764	552	-	552
Impairment losses on loans and advances to customers	-	823	(823)	-	608	(608)
Other impairment losses and provisions	-	6	(6)	-	1	(1)
Depreciation and amortization	198	198	-	119	118	1
Loss recognised on CHF conversion	-	-	-	-	-	-
(Gains)/losses from sale of tangible assets	(6)	(6)	-	(4)	(3)	(1)
Unrealised (gains)/losses on securities at fair value through profit or loss	(8)	(8)	-	(8)	(9)	1
Other (gains)/losses	-	-	-	-	-	-
Share of profit from associates	-	(14)	14	-	-	-
Net interest income	-	(2,974)	2,974	-	(2,374)	2,374
Gain on disposal of associate	-	-	-	-	-	-
Net gain from disposal of available-for-sale securities	-	(53)	53	-	(16)	16
Dividend income	-	(6)	6	-	(445)	445
Cash flow from operating activities before changes in operating assets	**2,598**	**(384)**	**2,982**	**2,333**	**(446)**	**2,779**
(Increase)/decrease in operating assets						
Deposits with the Croatian National Bank	(269)	(269)	-	(269)	(269)	-
Ministry of Finance treasury bills and Croatian National Bank bills	432	-	432	397	-	397
Deposits with banking institutions and loans to financial institutions	911	-	911	99	-	99
Loans and advances to banks	-	910	(910)	-	99	(99)
Loans to other clients	(390)	(166)	(224)	581	542	39
Securities and other financial instruments held for trading	(8)	-	(8)	(10)	-	(10)
Securities and other financial instruments available for sale	(102)	-	(102)	(368)	-	(368)
Securities and other financial instruments at fair value through profit or loss which are not actively traded	93	-	93	2	-	2
Financial assets held for trading and financial assets available for sale	-	466	(466)	-	63	(63)
Other operating assets	24	-	24	(317)	-	(317)
Other assets		(310)	310	-	(291)	291
Net (increase)/decrease in operating assets	**691**	**631**	**60**	**115**	**144**	**(29)**
Increase/(decrease) in operating liabilities						
Demand deposits	3,515	-	3,515	2,302	-	2,302
Savings and time deposits	48	-	48	536	-	536
Current accounts and deposits from banks	-	(403)	403	-	(313)	313
Current accounts and deposits from customers	-	3,987	(3,987)	-	3,215	(3,215)
Derivative financial liabilities and other liabilities held for trading	(3)	-	(3)	2	-	2
Other liabilities	(46)	452	(498)	(308)	217	(525)

Appendix 1 - Supplementary forms required by local regulation (continued)

Cash flow statement reconciliation for the year ended 31 December 2017 (continued)

(in HRK million)

	GROUP			BANK		
	CNB schedules	per IFRS	Differences	CNB schedules	per IFRS	Differences
Net increase/(decrease) in operating liabilities	**3,514**	**4,036**	**(522)**	**2,532**	**3,119**	**(587)**
Interest received	-	3,136	(3,136)	-	2,710	(2,710)
Interest paid	-	(643)	643	-	(524)	524
Dividends received	-	6	(6)	-	445	(445)
Net cash flow from operating activities	**6,803**	**6,782**	**21**	**4,980**	**5,448**	**(468)**
(Income tax paid)	(458)	(458)	-	(391)	(391)	-
Net inflow/(outflow) of cash from operating activities	**6,345**	**6,324**	**21**	**4,589**	**5,057**	**(468)**
Investing activities						
Cash receipts from/(payments to acquire) tangible and intangible assets	(199)	-	(199)	(104)	-	(104)
Purchase of property and equipment and intangible assets	-	(285)	285	-	(131)	131
Cash receipts from the disposal of/ (payments for the investment in) subsidiaries, associates and joint ventures	(1,103)	-	(1,103)	(1,103)	-	(1,103)
Disposal of property and equipment and intangible assets	-	112	(112)	-	3	(3)
Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity	-	-	-	-	-	-
Cash paid for the aquisition of Intesa Sanpaolo Bank dd		(1,071)	1,071		(1,071)	1,071
Dividends received	6	-	6	446	-	446
Other receipts from/(payments for) investments	-	(32)	32	-	(32)	32
Net cash flow from investing activities	**(1,296)**	**(1,276)**	**(20)**	**(761)**	**(1,231)**	**470**
Financing activities						
Net increase/(decrease) in received loans	(450)	(450)	-	(370)	(369)	(1)
Net increase/(decrease) in issued debt securities	-	-	-	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-	-	-	-
Proceeds from issue of share capital	-	-	-	-	-	-
(Dividends paid)	(482)	(481)	(1)	(482)	(481)	(1)
Other proceeds/(payments) from financing activities	-	-	-	-	-	-
Net cash flow from financing activities	**(932)**	**(931)**	**(1)**	**(852)**	**(850)**	**(2)**
Net increase/(decrease) in cash and cash equivalents	**4,117**	**4,117**	**-**	**2,976**	**2,976**	**-**
Effect of foreign exchange differences on cash and cash equivalents	(20)	(20)	-	(20)	(20)	-
Net increase/(decrease) in cash and cash equivalents	**4,097**	**4,097**	**-**	**2,956**	**2,956**	**-**
Cash and cash equivalents at the beginning of the year	**16,195**	**16,195**	**-**	**14,016**	**14,016**	**-**
Cash and cash equivalents at the end of the year	**20,292**	**20,292**	**-**	**16,972**	**16,972**	**-**

Appendix 1 - Supplementary forms required by local regulation (continued)

Cash flow statement reconciliation for the year ended 31 December 2017 (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
Group								
Balance as at 1 January 2017	**1,907**	**(76)**	**2,587**	**9,467**	**1,660**	**81**	**1,124**	**16,750**
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-	-
Closing balance as at 1 January 2017	**1,907**	**(76)**	**2,587**	**9,467**	**1,660**	**81**	**1,124**	**16,750**
Sale of available-for-sale financial assets	-	-	-	-	-	(28)	(10)	**(38)**
Changes in fair value of the portfolio of available-for sale financial assets	-	-	-	-	-	48	7	**55**
Tax on items recognised directly or transferred from equity	-	-	(42)	-	-	(3)	(9)	**(54)**
Other gains and losses recognised directly in equity	-	-	234	-	-	1	50	**285**
Net gains/losses recognised directly in equity	-	-	**192**	-	-	**18**	**38**	**248**
Current year profit/(loss)	-	-	-	-	1.331	-	15	**1.346**
Total current year income and expenses	-	-	**192**	-	**1.331**	**18**	**53**	**1.594**
Increase/(decrease) of share capital	-	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-	-
Other changes	-	-	(1.071)	12	(78)	-	(126)	**(1.263)**
Transfer to reserves	-	-		1.100	(1.100)	-	-	-
Dividend payments	-	-	-	-	(482)	-	-	**(482)**
Profit distribution	-	-	-	**1,100**	**(1,582)**	-	-	**(482)**
Closing balance as at 31 December 2017	**1,907**	**(76)**	**1,708**	**10,579**	**1,331**	**99**	**1,051**	**16,599**

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
Group								
Balance as at 1 January 2016, restated	**1,907**	**(76)**	**1,644**	**9,231**	**365**	**108**	**45**	**13,224**
Changes in accounting policies and correction of errors	-	-	1,024	-	46	43	1,069	**2,182**
Closing balance as at 1 January 2016, restated	**1,907**	**(76)**	**2,668**	**9,231**	**411**	**151**	**1,114**	**15,406**
Sale of available-for-sale financial assets	-	-	-	-	-	(127)	(22)	**(149)**
Changes in fair value of the portfolio of available-for-sale financial assets	-	-	-	-	-	30	1	**31**
Tax on items recognised directly or transferred from equity	-	-	-	-	-	16	3	**19**
Other gains and losses recognised directly in equity	-	-	(19)	-	-	11	(11)	**(19)**
Net gains/losses recognised directly in equity	**-**	**-**	**(19)**	**-**	**-**	**(70)**	**(29)**	**(118)**
Current year profit/(loss)	-	-	-	-	1,660	-	80	**1,740**
Total current year income and expenses	**-**	**-**	**(19)**	**-**	**1,660**	**(70)**	**51**	**1,622**
Increase/(decrease) of share capital	-	-	-	-	-	-	-	**-**
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-	**-**
Other changes	-	-	(62)	65	(46)	-	(41)	**(84)**
Transfer to reserves	-	-	-	171	(172)	-	-	**(1)**
Dividend payments	-	-	-	-	(193)	-	-	**(193)**
Profit distribution	**-**	**-**	**-**	**171**	**(365)**	**-**	**-**	**(194)**
Closing balance as at 31 December 2016	**1,907**	**(76)**	**2,587**	**9,467**	**1,660**	**81**	**1,124**	**16,750**

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	Total equity
Bank							
Balance as at 1 January 2017	**1,907**	**(76)**	**1,872**	**7,442**	**1,605**	**19**	**12,769**
Changes in accounting policies and correction of errors	-	-	-	-	-	-	**-**
Closing balance as at 1 January 2017	**1,907**	**(76)**	**1,872**	**7,442**	**1,605**	**19**	**12,769**
Sale of available-for-sale financial assets	-	-	-	-	-	(15)	**(15)**
Changes in fair value of the portfolio of available-for sale financial assets	-	-	-	-	-	51	**51**
Tax on items recognised directly or transferred from equity	-	-	(19)	-	-	(6)	**(25)**
Other gains and losses recognised directly in equity	-	-	106	-	-	1	**107**
Net gains/losses recognised directly in equity	**-**	**-**	**87**	**-**	**-**	**31**	**118**
Current year profit/(loss)	-	-	-	-	1,443	-	**1,443**
Total current year income and expenses	**-**	**-**	**87**	**-**	**1,443**	**31**	**1,561**
Increase/(decrease) of share capital	-	-	-	-	-	-	**-**
(Purchase)/sale of treasury shares	-	-	-	-	-	-	**-**
Other changes	-	-	(94)	-	-	-	**(94)**
Transfer to reserves	-	-	-	1,124	(1,124)	-	**-**
Dividend payments	-	-	-	-	(481)	-	**(481)**
Profit distribution	**-**	**-**	**-**	**1,124**	**(1,605)**	**-**	**(481)**
Closing balance as at 31 December 2017	**1,907**	**(76)**	**1,865**	**8,566**	**1,443**	**50**	**13,755**

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	Total equity
Bank							
Balance as at 1 January 2016	**1,907**	**(76)**	**1,872**	**7,442**	**193**	**86**	**11,424**
Changes in accounting policies and correction of errors	-	-	-	-	-	-	-
Closing balance as at 1 January 2016	**1,907**	**(76)**	**1,872**	**7,442**	**193**	**86**	**11,424**
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	-	-	-	-	-	-	-
Net gains/losses recognised directly in equity	-	-	-	-	-	**(67)**	**(67)**
Current year profit/(loss)					1,605		**1,605**
Total current year income and expenses	-	-	-	-	**1,605**	**(67)**	**1,538**
Increase/(decrease) of share capital	-	-	-	-	-	-	-
(Purchase)/sale of treasury shares	-	-	-	-	-	-	-
Other changes	-	-	-	-	-	-	-
Transfer to reserves	-	-	-	-	-	-	-
Dividend payments	-	-	-	-	(193)	-	**(193)**
Profit distribution	-	-	-	-	**(193)**	-	**(193)**
Closing balance as at 31 December 2016	**1,907**	**(76)**	**1,872**	**7,442**	**1,605**	**19**	**12,769**

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	
	2017	Restated 2016	2017	2016
Interest income	469	490	368	386
Interest expense	(71)	(98)	(50)	(76)
Net interest income	**398**	**392**	**318**	**310**
Fee and commission income	248	235	109	100
Fee and commission expense	(47)	(44)	(17)	(16)
Net fee and commission income	**201**	**191**	**92**	**84**
Dividend income	1	2	60	30
Net trading income and net loss on translation of monetary assets and liabilities	32	31	29	28
Other operating income	25	78	11	57
Total operating income	**657**	**694**	**510**	**509**
Impairment losses on loans and advances to customers	(110)	(80)	(82)	(52)
Losses recognized in CHF conversion	-	4	-	4
Other impairment losses and provisions	(1)	2	-	3
Personnel expenses	(148)	(144)	(98)	(95)
Depreciation and amortisation	(27)	(32)	(16)	(15)
Other operating expenses	(153)	(154)	(92)	(91)
Net value adjustment from valuation of tangible assets (IAS 16)	-	-	1	-
Share of profits from associates	2	3	-	-
Profit before income tax	**220**	**293**	**223**	**263**
Income tax expense	(41)	(62)	(31)	(50)
Profit for the year	**179**	**231**	**192**	**213**
Attributable to:				
Equity holders of the Bank	177	221	192	213
Non-controlling interests	2	10	-	-
	179	**231**	**192**	**213**

The income statement items were translated from the measurement currency (HRK) to the Euro at the average exchange rate in 2017 (1 EUR = 7.4601 HRK) and in 2016 (1 EUR = 7.529383 HRK).

Appendix 2 - Supplementary financial statements in EUR (unaudited) (continued)

Statement of financial position

As at 31 December

(in EUR million)

	GROUP			BANK	
	2017	Restated 2016	Restated 2015	2017	2016
Assets					
Cash and current accounts with banks	2,490	1,772	1,468	2,058	1,632
Balances with the Croatian National Bank	557	518	596	557	518
Financial assets at fair value through profit or loss	294	808	782	294	791
Derivative financial assets	3	4	1	1	3
Loans and advances to banks	321	597	687	198	229
Loans and advances to customers	8,638	8,624	8,160	5,931	6,042
Financial assets available for sale	1,008	541	476	551	49
Held-to-maturity investments	2	2	2	-	-
Investments in subsidiaries and associates	9	9	20	261	126
Intangible assets	30	25	28	21	16
Property and equipment	181	153	168	83	72
Investment property	1	22	17	1	7
Non-current assets held for sale	45			12	
Deferred tax assets	16	18	21	10	12
Other assets	96	97	98	68	37
Tax prepayments	3	3	22	1	-
Total assets	**13,694**	**13,193**	**12,546**	**10,047**	**9,534**

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 2017 (1 EUR = 7.513648 HRK), 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	
	2017	Restated 2016	Restated 2015	2017	2016
Liabilities					
Current accounts and deposits from banks	159	211	165	142	182
Current accounts and deposits from customers	10,403	9,829	9,397	7,609	7,159
Derivative financial liabilities	2	3	2	1	1
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1				
Interest-bearing borrowings	504	560	658	317	363
Subordinated liabilities	-	-	-	-	-
Other liabilities	313	256	209	90	64
Accrued expenses and deferred income	48	42	37	22	18
Provisions for liabilities and charges	47	48	52	33	34
Deferred tax liabilities	12	4	7	4	1
Current tax liability	1	23	1	-	22
Total liabilities	**11,490**	**10,976**	**10,528**	**8,218**	**7,844**
Equity attributable to equity holders of the parent					
Share capital	250	250	250	250	250
Share premium	206	206	206	206	206
Treasury shares	(10)	(10)	(10)	(10)	(10)
Other reserves	184	168	180	40	40
Fair value reserve	14	11	20	7	3
Retained earnings	1,584	1,477	1,259	1,336	1,201
Merger reserve	(164)	(34)	(33)	-	-
Total equity attributable to equity holders of the Bank	**2,064**	**2,068**	**1,872**	**1,829**	**1,690**
Non-controlling interests	**140**	**149**	**146**	**-**	**-**
Total equity	**2,204**	**2,217**	**2,018**	**1,829**	**1,690**
Total liabilities and equity	**13,694**	**13,193**	**12,546**	**10,047**	**9,534**

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 2017 (1 EUR = 7.513648 HRK), as at 31 December 2016 (1 EUR = 7.557787 HRK) and as at 31 December 2015 (1 EUR = 7.635047 HRK).