Privredna banka Zagreb d.d.

Annual report

31 December 2018

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Introduction

The Management Board of Privredna banka Zagreb d.d. 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 d.d. for the year ended 31 December 2018 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 d.d. is referred to as “the Bank” or “PBZ” or as “Privredna banka Zagreb”, and Privredna banka Zagreb d.d., 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 2018 have been used to translate balances in foreign currency on that date:

CHF 1	=	6.588 HRK
USD 1	=	6.469 HRK
EUR 1	=	7.418 HRK
BAM 1	=	3.792 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 1,102 thousand CURRENT ACCOUNTS	HRK 112 billion TOTAL CUSTOMERS' FUNDS* HRK 16 billion ASSETS UNDER CUSTODY	673,602 INTERNET BANKING USERS 295 TOTAL BRANCHES
1,394 ATM MACHINES 1,261 DAY AND NIGHT VAULTS	HRK 76 billion TOTAL GROSS LOANS HRK 14.7 billion TOTAL HOUSING LOANS	2,864 thousand TOTAL CARDS ISSUED 43,200 EFT POS

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

Introduction (continued)

Five year summary and financial highlights

(in HRK million)

	2018	2017	2016**	2015**	2014*
Group					
Income statement and statement of financial position					
Total gross revenue	5,687	5,796	6,294	6,047	5,355
Net interest income	2,813	2,979	2,950	2,895	2,454
Net operating income	4,880	4,919	5,224	4,625	3,938
Net profit for the year	1,720	1,295	1,739	461	989
Total assets	112,013	104,054	99,708	95,791	78,328
Loans and advances to customers	66,688	65,169	65,177	62,305	51,187
Due to customers	85,938	78,827	74,284	71,745	55,346
Shareholders' equity attributable to equity holders of the Bank	16,036	15,725	15,626	14,292	13,983
Other data (as per management accounts)					
Return on average equity	10.21%	8.10%**	10.83%	2.90%	7.19%
Return on average assets	1.47%	1.20%**	1.68%	0.44%	1.17%
Assets per employee	21.2	20.4**	20.1	20.4	18.9
Cost income ratio	44.20%	42.70%**	38.66%	43.79%	46.72%

** 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.*

***Presented information does not include Veneto banka dd (subsidiary acquired and merged in 2018)*

(in HRK million)

	2018	2017	2016	2015	2014
Bank					
Income statement and statement of financial position					
Total gross revenue	3,761	4,315	4,532	4,087	4,052
Net interest income	2,207	2,374	2,335	2,193	2,132
Net operating income	3,342	3,815	3,839	3,161	2,944
Net profit for the year	1,380	1,443	1,605	193	643
Total assets	82,894	75,497	72,050	69,214	68,876
Loans and advances to customers	45,457	44,562	45,667	44,186	44,543
Due to customers	63,042	57,173	54,108	52,815	50,387
Shareholders' equity attributable to equity holders of the Bank	14,151	13,755	12,769	11,424	11,660
Other data (as per management accounts)					
Return on average equity	10.10%	11.10%	13.44%	1.67%	5.57%
Return on average assets	1.65%	1.80%	2.13%	0.26%	0.88%
Assets per employee	22.8	21.8	21.3	21.7	20.4
Cost income ratio	41.50%	35.30%	38.36%	43.73%	48.01%

Report from the President of the Supervisory Board

On behalf of the Supervisory Board of Privredna banka Zagreb d.d., I am honored to present you the business results of the Bank and Group for the year 2018.

Although marginally lower than in 2017, the remaining risks related to a successful completion of the settlement of the Agrokor Concern creditors were finally overcome in mid-2018. However, in the past year, the economy has faced some temblors, where the most significant is related to the business difficulties of the Uljanik Group and the consequential risks, mainly fiscal, but, to a lesser extent, economic as well. Irrespective of the above, the economic growth rate in 2018 stayed at almost the same level as in 2017 (approximately 3%), bringing the level of the gross domestic product close to the pre-crisis level of 2008.

Contribution to further economic recovery came from the still present positive trends in the environment and their impact on the exports of goods and services. However, during the year, the signals of the upcoming slowdown of the economic growth in the Eurozone countries became more evident, following an unusually strong growth recorded in 2017, mainly due to a series of potential risks tied to the increase in trade protectionism, the forthcoming Brexit and fiscal challenges in some member states. The awakening of other tourism destinations, our competitors, has pointed towards a mild downward trend in the two-digit growth rates of the tourism sector, emphasising the problem that the tourism season is still rather short and the offer in tourism is of limited quality. Personal consumption increased, owing to positive movements in the labour market during the year, whereas investment activity remained lower compared with the expectations.

Amid the continued favourable financing conditions and monetary policy relaxation, but accompanied by a series of the mentioned risks, we expect a moderate slowdown of the economic growth. We anticipate domestic demand as the main growth driver: personal consumption and investment activity. While personal consumption will be supported by a further growth of household net disposable income and employment growth, we expect that the beginning of construction of The Pelješac Bridge and better withdrawal from the EU funds will give further impetus to investment growth. At the same time, the contribution of net foreign demand will be negative, due to a mild slowdown of the export component and increase in the import component. While the risks of achieving expectations in 2019 have been mostly balanced, challenges will become more tangible in the medium term, particularly concerning gradual normalisation of the interest rate level, the beginning of which is expected in late 2019. In addition, the growing problem of labour force will be a limiting factor to the economic growth. It is, therefore, that a strategic goal of the entry in the Euro zone is also a unique opportunity to intensify and accelerate reform measures in order to further strengthen the macroeconomic picture and increase the GDP growth rate and accelerate the convergence to the EU countries.

In an environment where macroeconomic trends are still 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 5.7 billion. Consolidated net operating income equaled HRK 4.9 billion, whereas net profit recorded HRK 1.720 billion. Our cost/income ratio, an efficiency key measure, equals 44.2 percent, while the return on average equity reached 10.2 percent. These are all very satisfactory figures consistently representing strong performance throughout the years.

In 2018, 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.

Report from the President of the Supervisory Board (continued)

Report on the performed supervision in the year 2018

In 2018 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. In the course of 2018 the Supervisory Board held 22 meetings with either physical presence of members or by letter. Meetings were held by letter in cases of utmost urgency or in the case when calling a meeting with physical presence of members was not possible for objective reasons. Four regular meetings that considered financial reports were held within the deadlines prescribed by law and the Articles of Association. 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 2018, the Audit Committee held five meetings where it discussed the processes within its competence. In accordance with its legal responsibility, the Supervisory Board of the Bank has examined the Annual Financial Statements and Consolidated Annual Financial Statements of the Bank for 2018, Report on the Operation of the Bank and its Subsidiaries and Draft Decision on the Allocation of the Bank's Profit Earned in 2018, that were all submitted by the Management Board of the Bank. The Supervisory Board made no remarks on the submitted reports. In that respect, the Supervisory Board established that the Annual Financial Statements and Consolidated Annual Financial Statements were prepared in accordance with the balances recorded in the business books and that they impartially disclosed the assets and financial status of the Bank and the PBZ Group, which was also confirmed by the external auditor KPMG d.o.o., Zagreb, the company that had audited the financial statements for 2018. Since the Supervisory Board has given its consent regarding the Annual Financial Statements and Consolidated Annual Financial Statements of the Bank for 2018, 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 1,379,755,670.88 of the Bank's net profit totaling HRK 1,379,820,597.56, earned in the year that ended on 31 December 2018, should be distributed by pay-out of dividends (or HRK 72.58 per share) whereas the remaining amount should be allocated to retained earnings.

Yours faithfully

19 February 2019

Giovanni Boccolini

Management Board report of the Bank

Distinguished shareholders,

I am honoured to present you the Annual Report and Financial Statements of Privredna banka Zagreb d.d. and PBZ Group for the year ended on 31 December 2018.

The positive macroeconomic upturn experienced in the last couple of years was not hindered by many challenges the economy was facing. Although immeasurably lower than in 2017, the still present risks related to the successful completion of the Agrokor Group creditor's settlement were finally overcome in mid 2018. However, the new turmoil materialized in the face of business problems of Uljanik Group and, consequently, primarily fiscal and to a lesser extent economic risks. Nevertheless, the economic growth rate in 2018 in its scale was aligned with the one evidenced in the previous year, approaching the level of gross domestic product from pre-crisis year 2008. This fact allows us to nurture cautious optimism in the forthcoming period and to tailor our business strategy accordingly. As we have consistently been proving our operations to be resilient and sound, we remained strong and agile and readily welcomed continuation of these positive tendencies. Therefore, Privredna banka Zagreb d.d. and its subsidiaries, supported by our strategic partner Intesa Sanpaolo, managed to substantially outperform our peers in most relevant business aspects. We continued executing our predetermined business strategy built around customer relations and well-diversified source of income, thus keeping a steady course and reflecting the ability to strengthen our earnings power. All our business segments managed to cope extremely well with the surrounding conditions. Supplementary to this, we have been investing significant effort into shaping ourselves into well-capacited, experienced and agile entity able to conduct exceptional management of non-performing loans. Our proactive credit risk management and execution of well-defined collection strategies are showing continuous downward trends in non-performing loans stock and share.

Outlook

The growth of the global economy kept pace even in 2018, similar to the levels experienced in 2017. The financial markets in the last year were marked by further tightening of the monetary policy in the United States of America, but also by the continued gradual reduction of the European Central Bank's quantitative ease. In the forthcoming period and in line with the normalization of the monetary policy, a gradual strengthening of the common European currency is expected.

The economic developments in the major Croatian foreign trade partners during 2018 were still favourable, although the slowdown of growth dynamics can be noticed compared to the peak of the cycle recorded in 2017.

The still present positive trends in the environment and their impact on the export of both goods and services contributed to the continuation of economic recovery. However, during the year the signals of the upcoming slowdown of growth of Eurozone countries have also become increasingly evident following the unusually strong growth during 2017, primarily due to a series of potential risks related to the strengthening of trade protectionism and the upcoming Brexit fiscal challenges which some of the member countries are facing. The recovery of competitive tourist destinations raised the awareness about the fact that double-digit growth rates in the tourism sector are slightly declining, at the same time emphasizing the problem of the still relatively short tourist season and qualitatively limited offer. The positive trends in the labour market recorded during the year strengthened personal consumption, while investment activity remained limited by comparison with expectations.

In an environment of continued favourable financing conditions and relaxed monetary policy, but with a series of above quoted risks, we expect the economic growth in 2019 to slightly slow down. And, while risks of achieving expectations in 2019 are mainly balanced, in the medium-term challenges will become more tangible, especially related to the gradual normalisation of the level of interest rates, which should start at the end of 2019. In addition, the growing problem of workforce will have a limiting impact on the economic growth. For this reason, the strategic goal of joining the Eurozone also represents a unique opportunity to strengthen and accelerate reform measures in order to strengthen the macroeconomic picture prior to accession to the European Exchange rate Mechanism and to strengthen the growth rate of gross domestic product and accelerate convergence to European Union.

Management Board report of the Bank (continued)

Consolidated financial results

The consolidated net profits for 2018 amounted to HRK 1.720 million, representing a momentous increase compared to 2017. This encouraging result came from carefully planned and precisely executed business strategy that encompasses execution of conservative and systematic approach towards all risks arising from the business transactions, especially credit risk as well as already proven dedication to client orientation and diversification of income sources.

Backed by the present positive macroeconomic signals and in spite of direct and indirect omni-present adverse economic shocks, like predicaments with Agrokor Group and Uljanik Group, 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 8.9 to 7.3 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.

As of January 2018, the Group adopted new International Financial Reporting Standard 9 revising and upgrading its methodologies for classification, measurement and impairment of financial instruments. In this endeavour, the Group relied on already proven internal risk measurement tools (namely internal rating systems, probability of default and loss given default models) and further developed them into short term and lifetime expected loss models, which resulted in first time adoption impact of HRK 889 million, serving as additional prudential layer embedded in our financial statements for year 2018.

Additionally, the Group's earnings per share amounted HRK 88.4. Based on the methodology used for management reporting, the Group's return on average equity in 2018 soared to 10.2 percent, while return on average assets stood at 1.47 percent. Assets per employee equalled 21.2 million, whereas the cost to income ratio, according to the consolidated financial statements, was maintained at 44.2 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 stable influence on net interest income and net fee and commission income. Equally important, despite still risky macroeconomic 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 decreased by 5.6 percent compared to 2017, being more strongly affected by a decrease in interest income than what it was compensated by a decrease in interest expense. These effects were caused by high liquidity on the market and by still shy and defensive nature of the economic community towards consumption and investments. Net fee and commission income increased by 4.7 percent, showing continuation of transformation in becoming a more service-oriented enterprise. Compelling decrease in costs of provisions by 56.3 percent compared to the previous year are direct evidence of the quality of our non-performing loans management and strategy.

The balance sheet of the PBZ Group increased notably by 7.6 percent, amounting to HRK 112 billion. The most significant portion of our assets are loans and advances to customers which we managed to keep stable although faced with the negative shocks in the economical environment, notable sales of NPL portfolio and still prevailing lack of demand for loans caused by the erratic economic situation that affected our clients, both corporate and retail. We continue practicing a well-diversified loan portfolio policy, having remotely higher volume of placements to retail customers on one side than placements to public and corporate clients on the other. Given our firm commitment to apply a prudent approach in risk identification and measurement, non-performing loans fell below 10 percent threshold, additionally indicating the quality of our non-performing loans management. From the liabilities perspective, customer deposits mainly fund our balance sheet, where the retail segment plays the most significant role. In 2018, once again we experienced an upsurge in customer deposits by 9 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.

Management Board report of the Bank (continued)

Unconsolidated financial results of the Bank

The Bank's net result in 2018 was HRK 1.380 million, representing a slight decrease compared to the preceding year. Again, this favourable result is stemming from careful planning and enduring execution of our business strategy. Defying the fact that there were significant risks present in the economy (although in its upward phase), net interest income decreased by shy 7 percent. It is noticeable that interest income declined, caused mostly by the presence of excessive liquidity pushing downwards reference market rates. On the other hand, clients continued placing their unfaltering trust in the Bank as a reliable partner and allocating funds to both a-vista and term deposits. Although, in most cases, the Bank offers lower interest rates compared to the competition, our market share continues to grow at a steady pace, reaching, according to the latest data, as much as 21.64 percent, additionally corroborating the high quality of the business relationships between clients and the Bank. Therefore, we were not able to fully compensate for the negative trend experienced in relation to interest income. However, as we are widely recognized as steady and low-risk partner to all our clients, this further affirmed us to continue practicing our dedication to fulfilment of overall client requirements. This strategy was accompanied by efficient and omnipresent cost management enterprise carried within all organizational units enabling us to successfully control the expense side of our business. Hence, we were able to maintain our cost to income ratio at 41.5 percent.

The overall Bank’s balance sheet eminently increased by 9.8 percent, reaching a level of HRK 82.9 billion. Although the market shows sluggishness in demand for loans, loans and advances to customers increased by 2 percent, amounting to HRK 45.5 billion. Current accounts and deposits from customers increased for staggering 10.3 percent, reaching the level of HRK 63 billion. Considering the total structure of the balance sheet, the relative portion of customer deposits amounts to 76.1 percent. The total loan to deposit ratio of the Bank equals 72.1 percent emphasizing the stability and conservative nature of our ventures.

Business segments

Despite still sluggish recovery of demand for loans on the market, I'm proud to report that we managed to increase our portfolio in Retail business segment where, among other initiatives, we ventured ourselves into becoming an important provider in the affluent sub-segment of the market as well. We have invested a considerable effort in transforming ourselves into becoming fully packed digital service enterprise. Therefore, we have thoroughly redesigned and significantly upgraded the content and availability of our digital services on all available platforms. This endeavour has been carefully aligned with an adoption of new group distribution model where we promote execution of cash related and simpler transactions on digital channels whilst we modify our branch network to perform more complexed operations and to improve personal relationship with the clients. By doing so we shall ease the clients' daily banking experience and offer them a wider range of the products thus fully satisfying all their requirements.

Facing uneasy market conditions, SME business segment managed to increase size of its portfolio, both loans and deposits, while earnings stemming from the net interest income very slightly lessened. Corporate business segment was facing harsh market conditions arising from the fact that large clients are offered more financing possibilities than ever, outside banking industry and/or local markets. However, our dedication to successfully serve this portion of the market encouraged us to seek new opportunities. We are especially recognized in Croatian market for our excellence in providing technologically advanced and reliable transaction banking, as the leading equity and debt issue agent and book-runner, as market leader in arranging syndicated loans in Croatia and as top ranked custodian. Therefore, we can proudly state that 75% of all domestic large companies and 64% of large international companies are our clients

Extraordinary business events

In the beginning of 2018 American Express Company made a decision to leave the licencing business model on the EU market. The decision was made due to changes introduced by the European regulatory framework for payment operations which significantly impacts the sustainability of the licencing business model of issuing and accepting American Express cards. This had a profound influence on American Express Company to cancel such models of cooperation in EU countries and not to grant licence rights for issuing and accepting cards to third persons. In accordance with this decision, American Express cards, whose issuer is PBZ Card, can be used till 31 December 2019.

In view of the many years of successful business and the leading position of PBZ Card on the Croatian card market as well as the strategic direction of PBZ Group in providing premium card services and benefits, during the year we launched a series of activities in order to secure continuation of high-quality card products. This also implies a creation of a new credit card business model, its implementation as well as the selection of a new strategic partner to whose brand American Express cards will be migrated – Visa, one of the strongest card brands worldwide.

Management Board report of the Bank (continued)

Extraordinary business events (continued)

In 2017 by a Decree-Law of the Republic of Italy initiation and course of proceeding of compulsory administrative liquidation of Veneto banca S.p.A, as well as state aids, were defined. As a direct consequence of this act, at the end of 2017 Intesa Sanpaolo became sole owner of Veneto banka d.d., situated in Croatia. Based on the Intesa Sanpaolo Group's decision on process of reorganization of business activities on the territory of the Republic of Croatia, in July 2018 Privredna Banka Zagreb acquired Veneto banka d.d. thus making it one of the members of PBZ Group. In October 2018 Veneto banka d.d. migrated into Privredna banka Zagreb d.d. Considering the relative sizes of Veneto banka d.d. and Privredna banka Zagreb d.d., this business combination did not have any significant effect on consolidated financial reports of the PBZ Group nor on the unconsolidated financial reports of the Bank.

Briefly on the Bank's subsidiaries

In 2018, 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 136.5 million, PBZ Leasing HRK 24.3 million, PBZ Stambena štedionica HRK 9.4 million, PBZ Nekretnine HRK 5 million, whereas PBZ Croatia osiguranje, our jointly owned pension fund management company, earned a profit of HRK 27 million.

Intesa Sanpaolo Banka dd Bosna i Hercegovina, our subsidiary established in Bosnia and Herzegovina, earned HRK 135.9 million attributable to PBZ Group. Intesa Sanpaolo Bank, our subsidiary in Slovenia, earned HRK 40.5 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.

Additionally, in order to achieve further operational harmonization on the level of all three Banks in the Group leading to a unique operational model, increase of effectiveness and efficiency of business operations and savings in general, a new multi-year initiative was launched in 2018.

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 dedication and true professionalism that enabled us safely to sail through these restless times. Furthermore, I would like to thank all our acclaimed clients and business partners for putting their trust in our hands. Also, I would like to express my most sincere gratitude to all the members of the Supervisory Board for their encouragement in conducting our business affairs.

Dinko Lucić
President of the Management Board

19 February 2019

Management Board report for the Group

Financial Highlights of the Group

Based on the Intesa Sanpaolo Group's decision on process of reorganization of business activities on the territory of the Republic of Croatia, in July 2018 Privredna Banka Zagreb acquired Veneto banka d.d. thus making it one of the members of PBZ Group. In October 2018 Veneto banka d.d. migrated into Privredna banka Zagreb d.d. Considering the relative sizes of Veneto banka d.d. and Privredna banka Zagreb d.d., this business combination did not have any significant effect on consolidated financial reports of the PBZ Group nor on the unconsolidated financial reports of the Bank. The consolidated net profits for 2018 amounted to HRK 1,720 million, representing an increase of 33 percent compared to 2017. 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 and in spite of direct and indirect omni-present adverse economic shocks, like predicaments with Agrokor Group and Uljanik Group, 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 further decrease of non-performing loans ratio from 8.9 to 6.8 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 88.4. Based on the methodology used for management reporting, the Group's return on average equity in 2018 was 10.21 percent, while return on average assets was 1.47 percent. Assets per employee equalled 21.2 million, whereas the cost to income ratio, according to the consolidated financial statements, was 44.2 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 stable influence on net interest income and net fee and commission income. Equally important, despite still risky macroeconomic 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.

Our net interest income declined by 5.6 percent compared to 2017, being more strongly affected by a decrease in interest income than what it was compensated by a decrease in interest expense. These effects were caused by high liquidity on the market and by still shy and defensive nature of the economic community towards consumption and investments. On the other hand, net fee and commission income increased by 4.7 percent, showing continuation of transformation in becoming a more service-oriented enterprise. Compelling decrease in costs of provisions by 57.7 percent compared to the previous year are direct evidence of the quality of our non-performing loans management and strategy.

The balance sheet of the PBZ Group increased notably by 7.6 percent, amounting to HRK 112.0 billion. The most significant portion of our assets are loans and advances to customers which experienced an increase in the outstanding amount by 2.33 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 6.3 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 significantly 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 2018, we experienced an upsurge in customer deposits by 9.0 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.

Management Board report for the Group (continued)

Financial Highlights of the Group (continued)

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.

PBZ Card

The results of PBZ Card reflect the continuation of a stable and growing business in 2018, which confirms the leading position in the domestic card market.

The total net operating income of the Company in 2018 amount to HRK 602.6 million, which is by 1.1 percent higher compared to the result recorded for the year 2017. Net fee and commission based income amounts to HRK 560.2 million that is 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 million, which is by 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 and 2018, 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 taxation amounted to HRK 170.2 million, and after taxation HRK 136.5 million. The financial result for 2018 was significantly affected by goodwill value adjustment of amounting to HRK 13.9 million and provisions for rebranding costs in the amount of HRK 20.7 million. Goodwill value adjustment is the result of American Express's decision to abandon the current licensing model as of December 31, 2019, about which the details are given in the Business Description section, which also results in changes to the previous business model of PBZ Card.

The total operating costs for the year 2018 amount to HRK 380.9 million, while the total assets as of December 31, 2018 amount to HRK 2,597 million.

The above mentioned results make PBZ Card the second most profitable segment of PBZ Group, thus fulfilling all the Company's objectives. 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 merchants. An important step on this path is rebranding the existing portfolio to a unique and new Visa card on the Croatian market. By expanding cooperation with Visa, one of the most powerful and innovative card brands in the world, PBZ Card will retain its leading position in the market, which will further strengthen PBZ Group's position in card business.

Intesa Sanpaolo banka Bosna i Hercegovina

The 2018's net profit of HRK 136 million shows a 43.0 percent increase compared to the previous year.

Net Interest Margin is higher by 5.6 percent compared to last year as result of significant increase of loans to customers and decrease of cost of funding from customers, banks and international financial organizations, which effect offset the decrease of lending rates. Total operating income increased by 5.0 percent year on year due to extraordinary increase of commission income with increase of 6.5 percent compared to the previous year.

Total operating costs recorded a yearly decrease by 0.2 percent where significant infrastructural, technological and organizational investments strategically implemented in previous years prepared the Bank in facing the stricter and more demanding domestic and international regulatory framework and in sustaining the expansion of the business activities with stable, even lower costs than in previous periods.

Significantly (-64.0 percent) lower net impairment costs on portfolio exposed to credit risk mainly is the result of decrease of non-performing positions and release of provisions for securities portfolio due to maturity. Due to collection and write-off of non-performing positions and significant increase of high quality portfolio compared to previous year resulted in decrease of the NPL ratio, reaching a level of 3.9 percent, which is significantly lower than the banking sector average, while maintaining a prudent coverage ratio for defaulted exposures (76 percent).

Total assets increased by 8.9 percent at HRK 7,816 million with net loans in the amount of HRK 5,418 million and customer deposits in the amount of HRK 4,893 million. In 2018 it is recorded a significant loan portfolio growth, where lending to private customers increased by 6.6 percent and lending to legal entities increased by 13.4 percent. Positive performance was confirmed also by improvement in collection of deposits, where private customer's deposits increased by 3.3 percent and legal entities deposits increased by 1.0 percent. The Bank's position in terms of available liquidity remains comfortable and safe, even if we were to assume worsening macro-economic scenarios, thus ready to sustain expected further expansion of credit.

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 15.7 percent taking into consideration that Net Profit for first six months of the year is audited and allocated to Reserves by General Assembly, but also taking into consideration that net profit of the second half of the year is not included in calculation of capital adequacy ratio.

Strategic objectives of the Bank for 2019 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 2018, Intesa Sanpaolo Bank’s results indicate the continuation of stable business operations with net profit of HRK 79,4 million.

Lending activity in Slovenian economy has continued to show a positive 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 286,3 million (5.4 per cent yearly decrease). On the other hand, the Bank recorded lower cost of risk which ensured from the improvement of the quality of its credit portfolio.

Total operating costs recorded a yearly decrease of 2.6 percent. Net impairment costs on loans portfolio were 40.4 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 9.4 percent in 2017 to 5.5 percent in 2018.

Total net assets increased by 8.3 percent to HRK 19,260 million with net customer loans in the amount of HRK 13,033 million and customer deposits in the amount of HRK 16,376 million. The Bank’s position in terms of available liquidity remains safe and ready to sustain planned further expansion of lending activity.

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 16 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 24.3 million. In 2018, the Company signed new lease contracts in the total value of HRK 452 million, thus retaining positions in the Croatian leasing industry in terms of the number of realized placements.

At the end of 2018, the Company's total portfolio included net fixed assets under operating leases in the amount of HRK 363 million (2017: HRK 387 million) and net receivables under finance leases in the amount of HRK 778 million (2017: HRK 643 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

PBZ Stambena štedionica has been still doing business successfully and in 2018 it achieved its goals and exceeded its competitors in the most important business aspects, all this with substantial help of its parent company, Privredna banka Zagreb d.d.

Profit before tax amounted to HRK 12,2 million, while net profit amounted to HRK 9.4 million, which is an increase by 5.5 percent in comparison to 2017. Total assets of PBZ Stambena štedionica significantly increased by 7.1 percent reaching the amount of HRK 1,949 million. Net interest income grew by 9.3 percent compared to 2017. In 2018 there was a 9.1 percent growth of customers' deposits which currently amount to HRK 1,673 million. PBZ Stambena štedionica placed HRK 207 million of new housing loans increasing thus the housing loans portfolio to HRK 760 million.

In the 2019 – 2021 period, Štedionica is expecting to continue with stable and high quality business operations. PBZ Stambena štedionica, as member of PBZ Group, will furthermore permanently carry out the defined business strategy based on the relationship with customers, constantly monitor the customers' requirements and adapt its offer of housing savings and housing loans to their needs.

PBZ Nekretnine

The Company had a successful business year and achieved a net profit in the amount of HRK 5.0 million. The total assets at 31 December 2018 was HRK 110.7 million. The business of PBZ Nekretnina in 2018 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 7 thousand property market value appraisals.

During 2019 PBZ Nekretnine will continue to promote its activities with the aim of becoming the centre of excellence for real estate operations not only within the PBZ Group but in the whole country.

PBZ Croatia Osiguranje

PBZ Croatia Osiguranje continues to achieve positive financial results. In 2018 the Company reached net profit of HRK 27.4 million. At the same time, the cost income ratio stands at 51.2 percent. Total assets as of 31 December 2018 were HRK 143.6 million.

Net profit was influenced by the statutory change of management fee from 0.39 percent in 2017 to 0.36 percent in 2018. PBZ Croatia Osiguranje is a well-recognised and highly respectable pension fund management company in Croatia. Development strategy for 2019 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

19 February 2019

Macroeconomic developments in Croatia in 2018

Step closer to pre-crisis GDP level, slowdown on horizon

Although marginally lower than in 2017, the remaining risks related to a successful completion of the settlement of the Agrokor Concern creditors were finally overcome in mid-2018, since the Council of Creditors reached an agreement and the settlement was confirmed by the ruling of the High Commercial Court in October. However, in the past year, the economy has faced some temblors, where the most significant is related to the business difficulties of the Uljanik Group and the consequential risks, mainly fiscal, but, to a lesser extent, economic as well. Irrespective of the above, the economic growth rate in 2018 stayed at almost the same level as in 2017 (approximately 3 percent), bringing the level of the gross domestic product close to the pre-crisis level of 2008.

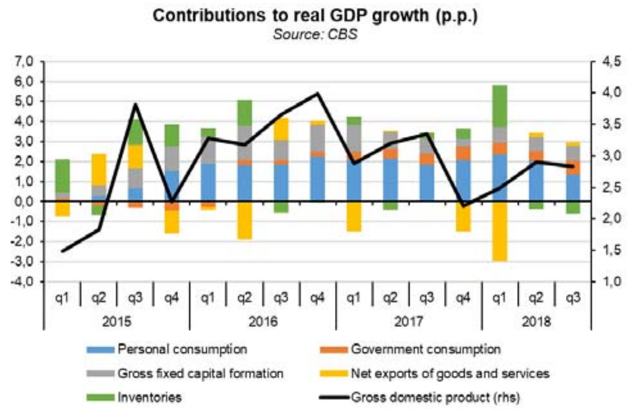
Contribution to further economic recovery came from the still present positive trends in the environment and their impact on the exports of goods and services. However, during the year, the signals of the upcoming slowdown of the economic growth in the Eurozone countries became more evident, following an unusually strong growth recorded in 2017, mainly due to a series of potential risks tied to the increase in trade protectionism, the forthcoming Brexit and fiscal challenges in some member states. The awakening of other tourism destinations, our competitors, has pointed towards a mild downward trend in the two-digit growth rates of the tourism sector, emphasising the problem that the tourism season is still rather short and the offer in tourism is of limited quality. Personal consumption increased, owing to positive movements in the labour market during the year, whereas investment activity remained lower compared with the expectations.

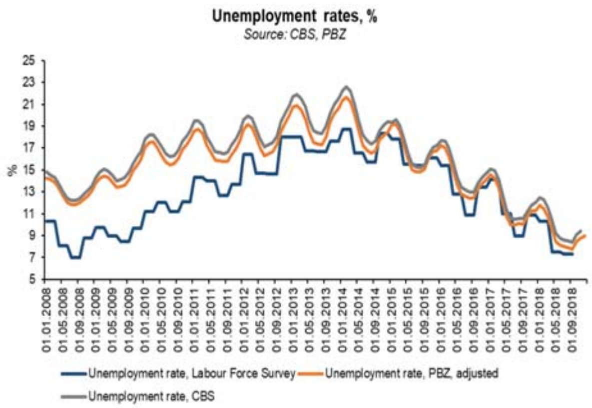
Amid the continued favourable financing conditions and monetary policy relaxation, but accompanied by a series of the mentioned risks, we expect a moderate slowdown of the economic growth to approximately 2.6 percent in 2019. We anticipate domestic demand as the main growth driver: personal consumption and investment activity. While personal consumption will be supported by a further growth of household net disposable income and employment growth, we expect that the beginning of construction of The Pelješac Bridge and better withdrawal from the EU funds will give further impetus to investment growth. At the same time, the contribution of net foreign demand will be negative, due to a mild slowdown of the export component and increase in the import component. While the risks of achieving expectations in 2019 have been mostly balanced, challenges will become more tangible in the medium term, particularly concerning gradual normalisation of the interest rate level, the beginning of which is expected in late 2019. In addition, the growing problem of labour force will be a limiting factor to the economic growth. It is, therefore, that a strategic goal of the entry in the Euro zone is also a unique opportunity to intensify and accelerate reform measures in order to further strengthen the macroeconomic picture and increase the GDP growth rate and accelerate the convergence to the EU countries.

Macroeconomic developments in Croatia in 2018 (continued)

2018 in review

According to our estimate, the 2018 GDP rose by 2.8 percent yoy, where the largest contribution to the growth came from personal consumption and the exports of goods and services.





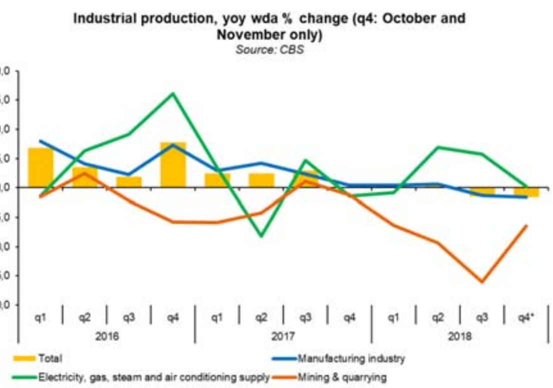
Personal consumption increased by 3.4 percent over the first nine months of 2018 versus the same period of 2017, due to an average 4.5 percent growth of net earnings (data for the first ten months), indicating a somewhat slower increase compared with the first ten months of 2017 (+5.4 percent), which is a result of the absence of impacts of the 2017 tax reform. A similar trend in the wage growth should also continue in 2019, partly driven by changes in tax brackets, the increased basic wage of public and government services by a total of 6 percent and a rise in the minimum wage as well as a faster wage growth in the categories most affected by labour shortage. As regards the labour market, an average of 1.522 million persons were employed in 2018 (Croatian Pension Insurance Institute data), which is an increase of 2.3 percent, compared with an average of 1.488 million persons in employment in 2017. Last year's positive employment trends (growth for the fourth consecutive year) were mainly a result of employment growth in some economic branches, such as Construction with 7.4 thousand of newly employed, followed by Accommodation and food service activities (+4.8 thousand), Manufacturing (+3.8 thousand) and Transportation and storage (+3.6 thousand). Also, last year, employment reached the highest level since 2009, when a total of 1.576 million persons were in employment, which is encouraging, given the substantial outflow of (working-age) citizens, particularly following the entry of Croatia into EU, but also the negative natural population growth during the mentioned period. The number of unemployed persons was also in line with the trend recorded the past years, under the impact of a further growth of the overall economic activity, but also the outflow of citizens, thus reaching a new record low of 154 thousand of unemployed persons in 2018. The decline (registered) in the number of unemployed persons in 2018 thus continued for the fifth consecutive year, where the decline dynamics accelerated (again), amounting to 20.8 percent this time (-19.8 percent in 2017, -15.4 percent in 2016), suggesting a great inconsistency in the labour market, since the decline in the number of unemployed persons does not accompany the increase in the number of employed persons in relatively equal ratios. The adjusted unemployment rate (the share of the number of unemployed persons in active population estimated as the sum of unemployed and employed persons according to the Croatian Pension Insurance Institute) reached 9.2 percent last year, which is down by 2.3 percentage points compared with the average of 2017. In 2019, we expect positive movements in the labour market to continue, albeit at a more moderate pace, taking into account that the level of potential labour force (mainly in terms of the remaining number of unemployed persons) is reduced substantially every year, therefore, one of the options is to import foreign labour force, as it is evident from higher number of total annual quotas of work permits for foreign persons in 2019, which exceeds 65 thousand (26 thousand more yoy).

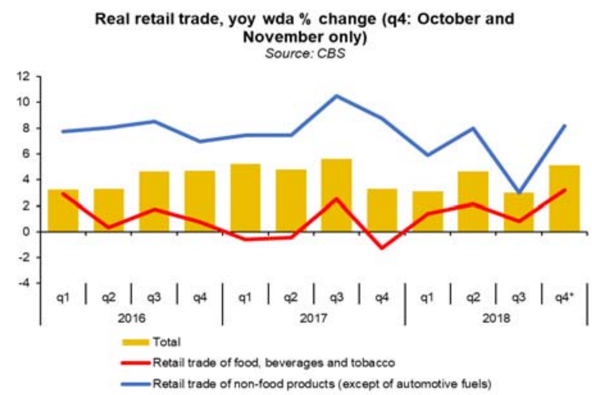
The real turnover growth in retail, supported by wage growth, employment growth, tourist arrivals/nights and consumer optimism as well as (cash) loans to households, advanced by 3,8 percent yoy (+5.4 percent in nominal terms) over the first eleven months of 2018 (wda), where (if gross, non-adjusted data are considered) we may notice that the growth was mostly driven by a larger turnover in the retail trade of automotive fuels and lubricants (+12.5 percent, reflecting partly the increase in oil prices) and non-specialised stores with food, beverages and tobacco predominating (+3.5 percent).

Macroeconomic developments in Croatia in 2018 (continued)

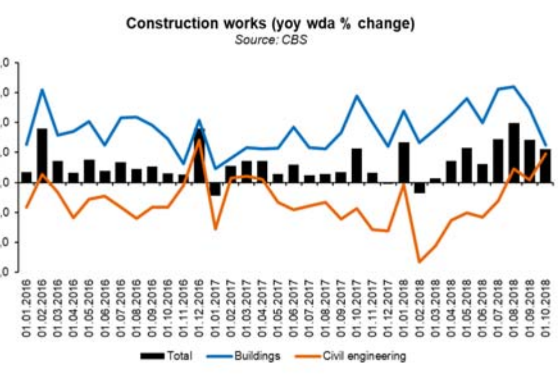
2018 in review (continued)

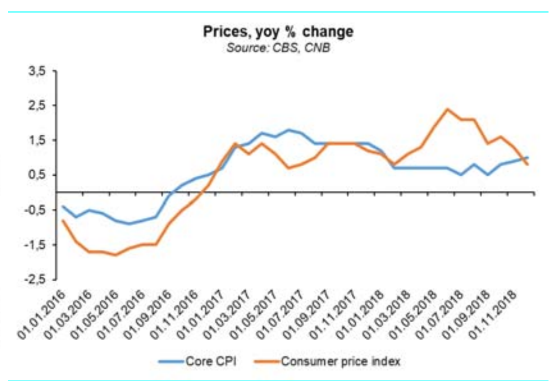
In the first three quarters of 2018, total exports recorded a real-term increase of 3.3 percent yoy, where exports of goods rose by 3.6 percent and exports of services by 2.9 percent. Compared with the previous year, the registered increase in the exports of goods and services indicates a slowdown, which, where it concerns the goods, may be partly explained by business difficulties in the sectors of shipbuilding and chemical industry, and, as far as the services are concerned, by the strengthening of the competitive tourism destinations. Simultaneously, the imports of goods and services rose by 5.1 percent as a result of the recovery of domestic demand, but also of a high dependence of exports on imports. The contribution of net foreign demand to the overall growth during the monitored period of 2018 was consequently negative, amounting to -0.8 p.p. After four years of growth, the total volume of industrial production in the first eleven months of 2018 decreased by 0.5 percent yoy (wda), mostly owing to reduced production in Manufacturing (-0.4 percent), which is for the most part a result of a decline in the manufacture of fabricated metal products (except machinery and equipment) of 10.5 percent, machinery and equipment of 12.3 percent as well as other transport equipment (including the building of ships) of 38.9 percent. A negative contribution to the overall decrease in the activities of Manufacturing also came from lower manufacture of electrical equipment (-8.6 percent), manufacture of chemicals and chemical products (-9.4 percent) and lower manufacture of food products (-1.1 percent).





Gross fixed capital formation investments over the first three quarters of 2018 rose by an average of 3.7 percent yoy, remaining mainly under the influence of the private sector investments and only a mild recovery of public investments. The total volume of construction works over the first ten months of 2018 advanced by 11.2 percent yoy, which is an increase of 4.5 percentage points compared with the same period of 2017, where the total increase was solely generated by a 4.7 percent rise in the activities on buildings, which was partly a result of a further recovery in the labour market and the consequential increased demand for





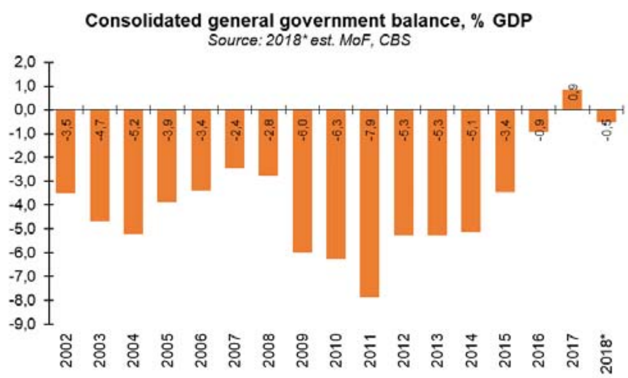
properties (the house price index in the first three quarters last year rose by 6.6 percent yoy, indicating higher demand, equally as a substantial employment growth in the construction sector). On the other hand, the activities on civil engineering works decreased by 3.8 percent yoy in the first ten months (-3.1 percent over the same period of 2017), where a mild increase in the volume of works was recorded in the other half of 2018 and, along with a larger number of issued building permits (+2.9 percent yoy, for the period July - November), imply the awakening of the activities related to infrastructural projects.

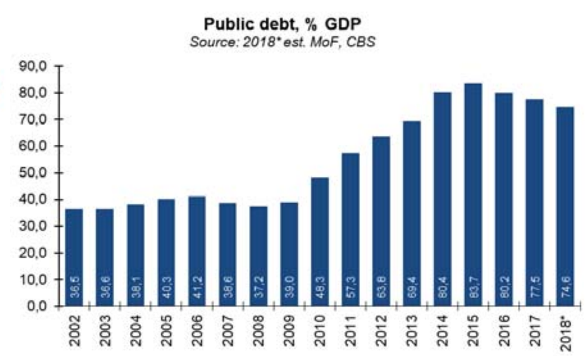
Macroeconomic developments in Croatia in 2018 (continued)

2018 in review (continued)

Following a yoy growth of 1.1 percent in 2017, the average annual inflation rate in 2018 increased to 1.5 percent, which is primarily a result of higher prices in the field of Housing, water, electricity, gas and other fuels, specifically, 4.1 percent higher prices of electricity for households (impact of higher charges to renewable energy sources), also, 9.3 percent higher prices of refuse collection and 2.8 percent of water supply, whereas almost the same impact was recorded by a rise in the price of crude oil in the global markets, resulting in 7.1 percent higher costs of fuels and lubricants for personal transport equipment. Thereby, the prices of food gave a slightly moderate contribution to the overall increase in consumer prices compared with 2017 (+0.3 p.p. versus +0.8 p.p. in 2017), while the only limiting factor to the overall increase in prices last year were 1.3 percent lower prices of clothing and footwear. This year, we expect that the rise of the prices of food will be further subdued, mainly by reduced VAT rates (from 25 percent to 13 percent) for particular items (primarily fresh meat, dairy products and fruits and vegetables), while strong competition in the retail market will be a counterbalance the growing domestic demand.

Positive economic movements and the control of the expenditure side of the budget led in 2018 to a further decrease in the share of public debt in GDP to the estimated 74.6 percent (from 77.5 percent in 2017), whereas, according to the revised budget, the consolidated general government deficit target was set to 0.5 percent of GDP, including the expected one-off fiscal impact of calling the government guarantees issued to the Uljanik Group.



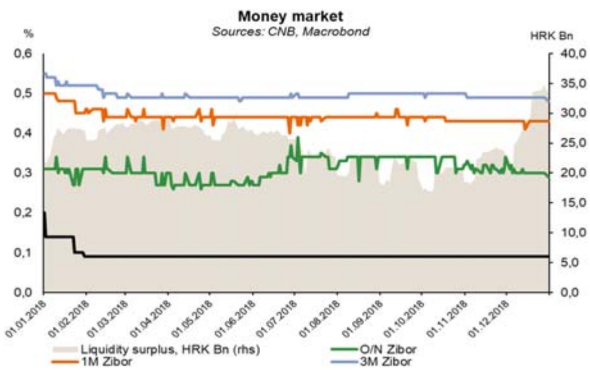


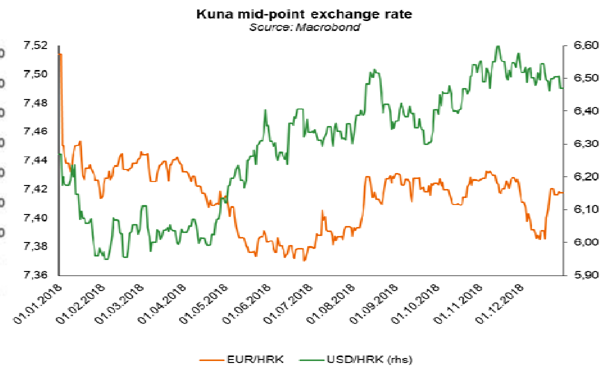
2018 was characterised by record high liquidity, resulting from a strong deposit growth, moderate credit activity and pronounced appreciation pressures that the central bank attempted to reduce by purchasing foreign currency from banks, generating thereby additional 13.4 billion kuna. The average excess liquidity rose to 25 billion kuna, exceeding 30 billion kuna in the last month of the year, due to which no interest was shown at regular reverse repo operations of the Croatian National Bank, while the interbank market saw low demand. Consequently, interest rates mildly decreased. The overnight Zibor and the 1-month and 3-month Zibor fell yoy by an average of 10 b.p. to 0.3, 0.4 and 0.5 percent, respectively, whereas 12M Zibor by 30 b.p. to 0.5 percent. Interest rates on T-bills followed this trend, decreasing by 19 b.p. on six-month kuna T-bills (to 0.06 percent), 5 b.p. on one-year kuna T-bills (to 0.09 percent) and 1 b.p. on one-year kuna T-bills with a currency clause (to 0.00 percent). Owing to substantial excess liquidity, the central bank held only one structural operation where 1.4 billion kuna were injected in the system at the interest rate of 1.2 percent and a five-year maturity. Low interest rates on the domestic money market and the Eurozone market as well as the improved government rating resulted in a drop in the government bond yield as well. The 10-year kuna bond yield decreased by 60 b.p. on average, to 2.1 percent, while the spread versus German government bond narrowed by 70 b.p. to 170 b.p

Macroeconomic developments in Croatia in 2018 (continued)

2018 in review (continued)

The strengthening of the kuna in 2018 was a reflection of a slight growth of the exports of goods, new records in tourism, increased remittances, inflows from EU funds, record positive net foreign positions of banks (27 billion kuna in August and September), improved rating and fiscal outlooks and growing expectations of Croatia's entry into ERM2 in the forthcoming period. Due to the appreciation pressures and the fall of the exchange rate below 7.4, even 1.8 billion euro was purchased from banks through five FX interventions. The average kuna to euro exchange rate decreased by 0.6 percent yoy, to 7.41 kuna to the euro (2017: 7.46), while the kuna against the US dollar increased by 5.2 percent on average and the exchange rate fell to 6.28 kuna to the dollar (2017: 6.62).



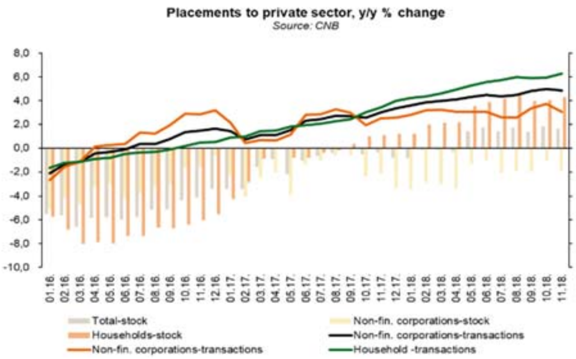


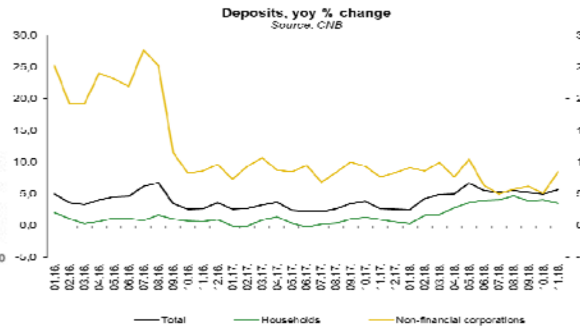
The downward trend in balance sheets of banks ended in 2018, as a result of a solid deposit growth and gradual growth of the portfolio of retail loans. At the same time, loans to the central government and non-financial corporations recorded negative rates last year due to the government deleveraging in December 2017 (partial repayment of debt owed by road companies) and a continuous sale of non-performing loans of the corporate sector. At the end of November, total assets of other monetary financial institutions rose by 1.8 percent yoy, whereas total loans decreased by 1.2 percent. Thereby, total loans decreased by 1.8 percent yoy, of which loans to the central government and the social security funds by 19.6 percent yoy, while the demand of the private sector recorded a recovery and growth of loans of 1.9 percent. However, according to the transaction data, the growth of loans to the private sector is more substantial than they are implied by the balance sheet data, indicating that the cumulative growth of loans to the private sector in November reached 4.9 percent yoy, of which to households 6.2 and to non-financial corporations 3.1 percent. Driven by the economic growth, recovery of the labour market, higher consumer optimism, state subsidies for housing loans and lower interest rate, the strongest recovery in the retail credit portfolio was recorded by housing and cash loans, increasing at the end of November by 1.8 and 11.3 percent, respectively, yoy. Higher citizen demand for kuna loans led to a further increase in the share of kuna loans in total loans of households, due to which the share exceeded 50 percent for the first time, while it reached almost 52 percent at the end of November. The movements of corporate loans by purpose show volatility in 2018, as a consequence of the portfolio cleanup, therefore loans for working capital at the end of November recorded an 8.0 percent lower level yoy, whereas investment and other loans advanced by 4.1 and 1.8 percent, respectively. The growth of deposits accelerated in 2018, mainly due to the recovery of retail deposits, achieved despite the unfavourable impact of low interest on savings, stronger kuna and outflow of savings from banks to alternative forms of investment, while deposits of non-financial corporations continued their robust growth. At the end of November, total deposits were higher by 5.7 percent yoy, where deposits of households by 3.5 percent, and non-financial corporations by 8.5 percent.

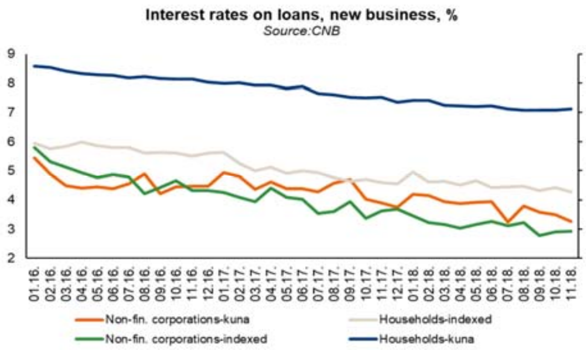
Ample liquidity amid moderate credit demand created space for banks for further reduction of both interest payable and interest receivable. Compared with the average of 2017, the average interest rate on loans to the private sector decreased by 60 b.p in the first eleven months 2018, for kuna loans but also for kuna loans with a currency clause, amounting to 6.4 and 3.7 percent, respectively. The average interest rate on housing loans dipped by 40 b.p. to 3.7 percent for kuna loans and by 30 b.p. to 3.5 percent for kuna loans with a currency clause. Over the same period, the average interest rate on time deposits of the private sector declined by 20 b.p. for kuna savings deposits, being around 0.6 percent, whereas the average interest rate rose by 10 b.p. to 0.5 percent for FX savings deposits, owing to a rise in interest rates on dollar deposits of non-financial corporations, while the interest rate on FX savings deposits of citizens decreased by an average of 20 b.p. to 0.3 percent.

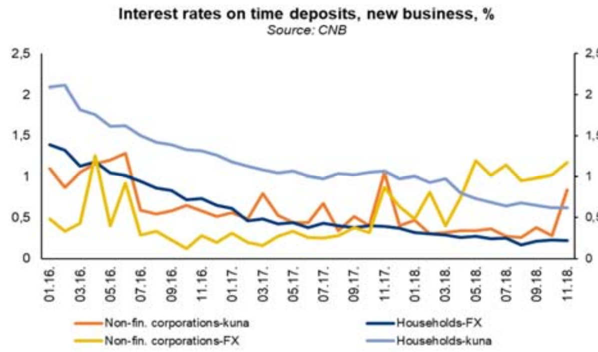
Macroeconomic developments in Croatia in 2018 (continued)

2018 in review (continued)

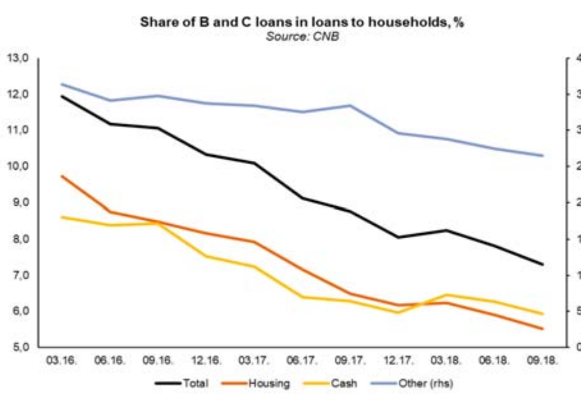


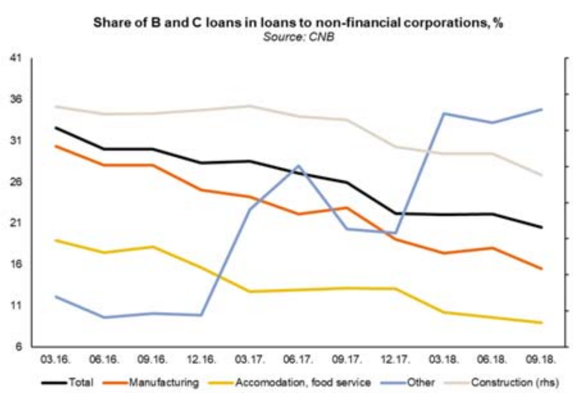






The downward trend in the share of non-performing loans continued over the first three quarters of 2018 due to the economic growth, overcoming of financial difficulties of the Agrokor Group, continuation of sale (gross 3.6 billion kuna, of which citizens 0.8 billion kuna, non-financial corporations 2.7 billion kuna) and a rise of new facilities. At the end of September, the share of B and C loans in total loans amounted to 10.3 percent, which is down by 1.1 p.p. compared with the end of the previous year, where the share in loans to households went down by 0.8 p.p. to 7.3 percent, whereas in loans to non-financial corporations by 1.7 p.p. to 20.5 percent. The breakdown of loans to households by purpose shows that the share in housing loans decreased to 5.5 percent (-0.7 p.p.) and in the most problematic loans for other purposes, to 26.5 percent (-3.1 p.p.), whereas the share in cash loans stagnated to 5.9 percent. Simultaneously, the data for corporate loans by activities show that, among the most significant activities, the sharpest deterioration of even 7.8 p.p. was recorded in construction, where the share of non-performing loans reached 47.6 percent. The above is followed by trade with a decline of 4.7 p.p. to 17.5 percent, accommodation and food service activities with a decline of 4.1 p.p. to 9.0 percent and manufacturing with a drop of 3.5 p.p. to 15.5 percent. However, the share in two following categories, professional, scientific and technical activities as well as other activities (Agrokor) increased by 7.5, i.e. 15.0 p.p. to 27.0 and 34.8 percent, respectively. The excess capital of banks was moderately reduced in 2018, under the impact of IFRS 9 application and higher risk weights on exposures to the central government denominated in a foreign currency, therefore the total capital ratio of banks was 22.2 percent at the end of September.





Macroeconomic developments in Croatia in 2018 (continued)

2018 in review (continued)

Global economic growth maintained its dynamics in 2018 as well, therefore, according to the forecast of the International Monetary Fund (World Economic Outlook, October 2018), it is projected at 3.7 percent, the same as in 2017. The growth in advanced economies is projected to accelerate to 2.4 percent (compared with 2.3 percent in 2017) in 2018, where particularly notable is the acceleration of growth in the United States (from 2.2 percent in 2017 to 2.9 percent in 2018), while the euro area slowed from 2.4 percent in 2017 to 2.0 percent in 2018. At the same time, growth in developing economies and emerging markets, maintained the growth rate of 4.7 percent.

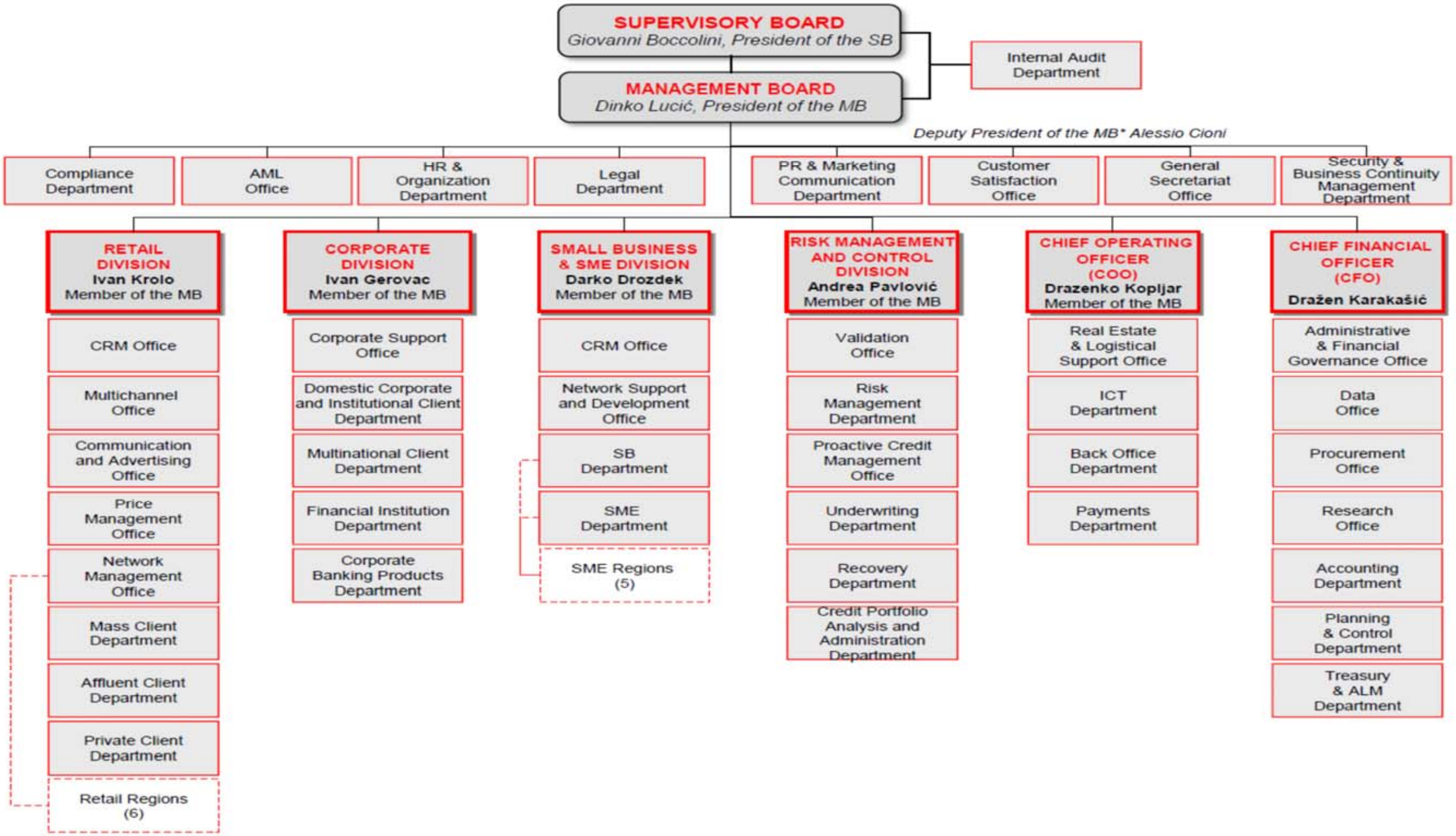
In 2018, financial markets were under the impact of further tightening of the monetary policy in the United States, but also a continued gradual winding down of quantitative easing of the European Central Bank (ECB). In particular, after the US FED raised its reference interest rate three times to 1,25-1,50 percent in 2017, additional four interest rate corrections followed in 2018, specifically, in March, June, September and December when the interest rate in the range 2.25-2.50 percent was established, whereas markets expect two more corrections in 2019. At the same time, ECB continued its gradual reduction in the quantitative easing volume in 2018 by keeping the key interest rate at 0.0 percent, however, reducing its asset purchase programme from January to the end of September 2018 to 30 billion euro (from 60 billion euro from April to December 2017), i.e. to barely 15 billion euro in the last quarter of 2018.

In 2018, the currency markets saw first the strengthening and then the weakening of the euro against the US dollar, therefore the exchange rate jumped from 1.18 dollar at the end of 2017 to 1.23 dollar during spring, yet, the euro weakened by the end of the year, amounting to 1.13 dollar to the euro. In the upcoming period, in line with the normalisation of the monetary policy, a gradual strengthening of the single European currency is expected.

Economic movements of major Croatian trade partners in 2018 remained favourable, although a notable slowdown of growth dynamics in relation to the peak of the cycle was registered in 2017. In the second half of the year, volatility of the markets reflected the instability of Italy's fiscal position, however, no risk spilled over to other countries and the situation calmed down towards the end of the year, since Rome reached an agreement with Brussels over their budget deficit level

Business description of the Bank

Organisational chart



Business description of the Bank (continued)

Privredna banka Zagreb d.d. 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 d.d. 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 2018, 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 d.d. 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 d.d. 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 2018 when it has won numerous prestigious awards for best bank in Croatia in the categories The Best Emerging Market Banks and The World's Best Banks in Central and Eastern Europe as well as Best digital bank 2018. in Croatia.

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, 2017 and 2018 for the previous year. Bank also received acknowledgement from Central European, Finance Central Europe, Adria Zeitung, Reader's Digest 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 d.d. currently employs some 3,637 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 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, Diners Club International, and China Union Pay cards (a total of 775 ATMs). PBZ is expanding the ATM network and generating new revenue in cooperation with partners; Croatian and foreign companies with an independent ATM network. Together with the partners, the PBZ ATM network has 1.160 ATMs. The number of EFT POS's (point of sale) has reached 32,000.

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 #withCASH (cardless cash withdrawal), Google Pay, 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, 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 authentification. 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.

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

PBZ's retail operations comprise the following departments: Multichannel Office, CRM Office, Communication & Advertising Office, Network Management Office, Price 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.

Price Management Office

The activities of Price Management Office encompass qualitative and quantitative analysis, as well as analysis of financial impacts related to pricing, measurement of key indicators for price realization and monitoring of market dynamics. Responsibilities of the Office include participation in price definition in cooperation with business segments, assessment of effectiveness of pricing activities and recommendation of corrective actions in case of need, as well as definition of business requirements and supervision over implementation and delivery of pricing tools.

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.

Business description of the Bank (continued)

Retail Division (continued)

Affluent Client Department

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

Private Client Department

The "Private" Client Department is responsible for defining and implementing business and 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 d.d. 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 d.d. 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 d.d. 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 d.d. 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 d.d. 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 description of the Bank (continued)

Corporate Division (continued)

Domestic Corporate and Institutional Client Department (continued)

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.

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, and it provides clients with a full range of banking services by offering both standardized and customized products in cooperation with other organizational units of the Bank as well as other members of the PBZ Group, and also in coordination with the Intesa Sanpaolo Group.

Clients receive an individual approach, which takes into account their specific needs, and are provided with various banking and advisory services as well as support to all aspects of their business activities. Clients have at their disposal the following banking products and services: opening of transaction accounts, centralized account management, contracting of internet banking services for businesses and INBIZ internet banking for Multinational clients, Cash Pooling, Global Cash Management, cash handling services (organization, collection and transportation of cash), approval of loan facilities, purchase of receivables, B/E discounting, issuing of guarantees and letters of credit, advisory services related to all aspects of financing, card operations, leasing, retail products designed for employees of our corporate clients, and many other products and services.

The leading clients of the Department are companies engaged in tourism, IT, energy industry, wholesale and retail trade, construction, food industry and pharmaceutical industry. Given the well-developed business network of Privredna banka Zagreb d.d., we have successfully organized the entire process of managing 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 construction of residential and commercial premises intended for sale we can offer a complete project implementation service – starting 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 relationships with clients, this unit also assists foreign investors in the process of starting up a subsidiary or branch in Croatia, provides advisory services and general information on business terms and conditions in Croatia and on regulations currently in force, makes contact with clients and helps them liaise with institutions that are crucial for the performance of their regular business activities.

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

Business description of the Bank (continued)

Corporate Division (continued)

Multinational Client Department (continued)

Apart from managing relationships with clients, this unit also assists foreign investors in the process of starting up a subsidiary or branch in Croatia, provides advisory services and general information on business terms and conditions in Croatia and on regulations currently in force, makes contact with clients and helps them liaise with institutions that are crucial for the performance of their regular business activities.

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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 1900 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 like trade finance, buyer's credits and forfaiting for the promotion of Croatian export, as well as loans and specialised arrangements with domestic and international financial institutions, etc. PBZ has profiled itself as the leading commercial bank in Croatia in providing export financing through Buyer's Credits. In order to support payments and the documentary business of the Bank's clients, as well as explore other possibilities for mutual cooperation with reputable international financial institutions, PBZ has put in place various agreements, such as: Low Value Payments Agreements, MT101 Bilateral Agreements, Rebate Agreements, Cash Letter Services Agreements, Risk Sharing Agreements etc. It should be emphasized that PBZ is the first Croatian bank that has fully implemented Global Cash Management and one of the first offering SEPA payments to its clients. By continuously investing in new channels and methods of effecting international payments, we are able to provide our clients with most efficient, time saving and cost beneficial execution of their payments around the world. In close cooperation with its foreign bank partners, Privredna banka Zagreb d.d. has achieved a Straight Through Processing (STP) rate of 99.9 percent, 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. 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 credit payments, being the first bank in Croatia that offers such service to its clients.

Through the EU Desk, the Bank participates in a number of EU financial instruments, which transform EU funds into financial products such as loans, guarantees, and other risk-bearing mechanisms. The Bank participates in the financial instruments '*ESIF Growth and Expansion Loans*' - long-term investment loans for SME projects in the processing industry, tourism, creative industry and knowledge-based services, as well as in several guarantee schemes. 'ESIF Capped Portfolio Guarantee', COSME Capped Portfolio Guarantee are financial instruments structured to support micro and medium sized enterprises. ERASMUS provide financial support for students from Croatia, studying for their Master degree in one of the 33 Erasmus+ programme countries, and Privredna banka Zagreb is the only bank in Croatia that provides such support to Croatian students.

Business description of the Bank (continued)

Corporate Division (continued)

Financial Institutions Department (continued)

Further, acting in close cooperation with supranationals, such as European Investment Bank, European Bank for Reconstruction and Development, Green for Growth Fund and also Croatian Bank for Reconstruction and Development (HBOR), the Bank provides 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. The abovementioned proves our dedication to the highest professional standards in dealings with supranational institutions and European Union.

The Department is also responsible for the long term funding of the entire PBZ Group, i.e. the Bank and its subsidiaries.

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. 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.

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.

Business description of the Bank (continued)

Corporate Division (continued)

Corporate Banking Products Department (continued)

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 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 public offerings of shares (IPOs, SPOs) that have been successfully arranged for our clients from different industries for the purpose of capital increase. PBZ is also a major player in the domestic debt market; as such, we have participated in the majority of domestic sovereign, corporate and municipal bond issues and commercial paper issues, thus handling the major portion of the total amount of debt issued in the domestic capital market. Together with Banca IMI, investment banking arm of ISP Group, we have participated on international markets in eurobond issues for Republic of Croatia and Croatian corporates.

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 265 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 65.000 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, AMLOffice, 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 and monitors compliance with the regulation relating to the protection of personal data, have due regard to the risks associated with processing operations, and taking into account the nature, scope, context, and purposes of processing, as well as, defining the relevant controls;
- mission of the **Anti 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;

Business description of the Bank (continued)

Logistics areas (continued)

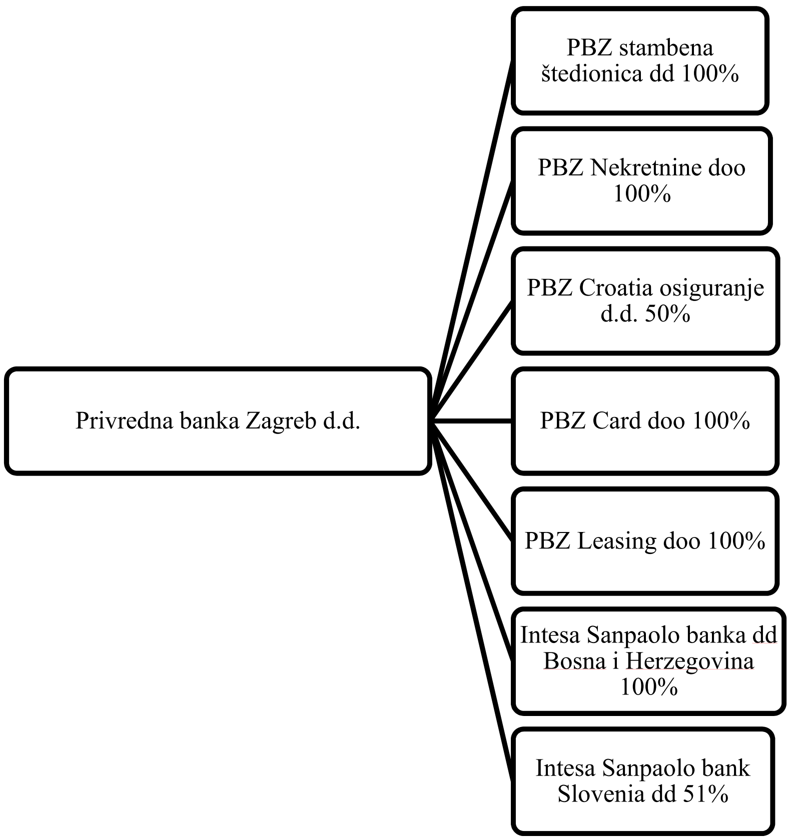
- mission of the **PR & Marketing Communication Department** is to manage and coordinate the communication activities addressed to the external audience with the purpose of providing them with economic, financial, institutional and regulatory information and developing and enhancing a positive corporate 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;
- 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 is responsible for management of retail customers' and SME customers' complaints and 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 (including occupational health and safety duties), 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 (including occupational health and safety duties), 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 d.d. 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 2018 the Group employs some 5,278 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 19.9 percent in Croatia (data from October 2018), 9.5 percent in Bosna and Herzegovina and 6.7 percent in Slovenia.

On 31 December 2018 the Group consisted of Privredna banka Zagreb d.d. and 6 subsidiaries and one associate (31 December 2017: 6 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 and MasterCard 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. PBZ Card's success is based on a wealth of knowledge and experience built over nearly fifty years of business with leading global card brands and a strong position that Privredna banka Zagreb has built as the leading bank in introducing new technologies and products in card business.

At the end of the last year, taking into account the number of cards, PBZ Group held 28.4 percent of the total Croatian active cards market, including the leading position on the credit cards market with a share of 33.6 percent. The total turnover of the cardholders per American Express, Visa and MasterCard products of PBZ Group in 2018 accounted for 28.05 percent of the total turnover that is 36.30 percent of the turnover realized on POS devices of Croatian card products market made in the first three quarters of the year 2018. In the same year, PBZ Card maintained its leading position on the total number of EFT POS terminals, in relation to which it holds 30.7 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 2018, 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.

The activities related to the segment of contactless payments during 2018 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 payment. During the year, in cooperation with business partners, there was also a continuous increase in the number of points of sale allowing a contactless payment. At the end of the year 2018, contactless payment services were available at approximately 32,000 POS terminals, i.e. 27,000 points of sale in the Republic of Croatia, which makes 93 percent of PBZ Group's POS network, the largest POS dvices network in the country.

During the year 2018, PBZ Card's sales network has been further enhanced by improving co-operation and business with existing sales outlets, expanding to new outlets as well as expanding acceptance functionality at existing sales outlets through the introduction of various benefits such as payment in instalments for American Express and Visa cards, payment of the bills through QR code, implementation of virtual POS devices etc.

In 2018, the adjustment of business operations with the new Electronic Money Act (OG 64/2018) and the Payment Transactions Act (OG 66/2018) was performed, and the Decision of the Croatian National Bank confirmed the compliance of PBZ Card to the provisions under the Electronic Money Act, also in the segment of the provision of payment services. During 2018, measures of compliance with the General Data Protection Regulation (GDPR) were also implemented.

In the year 2018, 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 "Doing Good Deeds Every Day" and American Express Card with Heart, supporting two important projects for the benefit of children, which marked the tenth anniversary of its existence last year. By the end of 2018, a total of HRK 15 million was collected for the project, and 37 donations were made, including 28 donations to hospitals throughout Croatia for the purchase of medical devices and nine donations to social care institutions for the purchase of necessary equipment in 25 cities and 19 counties throughout Croatia.

In addition, the beginning of 2018 was marked by American Express decision to abandon the licensed business model in the European Union market. This business decision has been brought by the company as a result of the changes brought about by the European regulatory payment and transport framework and which significantly affect the sustainability of the licensed business model for the issuance and acceptance of American Express cards, which is why it has cancelled such cooperation models in EU countries and will no longer grant licensing rights for issuing and accepting cards to third parties. Pursuant to this decision, American Express Card, the issuer of which is a PBZ Card, may be used until December 31, 2019.

Bearing in mind the long-standing successful business and PBZ Card's leadership position in the Croatian card market, as well as the strategic orientation of the PBZ Group to provide cutting-edge card services and services, the Company launched a number of activities during the year, in order to provide, after December 31, 2019, its customers and business partners with high quality card products, including the creation of a new card business model and its implementation, and the selection of a new strategic partner to whose brand American Express cards are to be migrated, and which will, in addition to the existing ones, also provide new, additional benefits.

By the end of the year 2019, American Express cards, which are issued by PBZ Card, will be replaced with Visa cards, specially developed new and innovative card products with unique features on the market and will continue to use all the existing functionalities and benefits of their American Express card and additional, new features and benefits brought by Visa cards.

Cooperation with Visa, one of the most powerful card brands in the world, is the result of PBZ Card's strategic direction to provide its customers and business partners with the best card service and benefits in the future, and accordingly, contractual documentation on the expansion of business cooperation between PBZ Card and Visa was signed

Business description of the Group (continued)

PBZ Card (continued)

Visa is a global payment technology company that enables fast, secure and reliable electronic payments in more than 200 countries and territories. Visa is the world leader in digital payments, providing its customers with technologically innovative solutions, a wide array of products, platforms and value-added services, with 3.3 billion issued cards and a strong network of approximately 54 million points of sale worldwide.

In addition to strengthening its partnership with Visa, PBZ Card remains strategically focused on providing premium card services and developing new benefits, enabling its customers to gain more acceptance of cards at home and abroad, new and innovative features in the field of state-of-the-art technology and even higher security standards

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 108,000 active housing savings accounts and deposits amounting to HRK 1.67 billion.

PBZ Leasing

PBZ Leasing is wholly owned by Privredna banka Zagreb d.d. 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 d.d.

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 452 million.

By the end of 2018, PBZ Leasing made over 7,5 thousand (2017.: 5.9 thousand) active lease arrangements with customers, which in financial terms reached HRK 1.038 million (2017; 938 million).

PBZ Nekretnine

PBZ Nekretnine is a wholly owned subsidiary of Privredna banka Zagreb d.d. which engages in property transaction services, real estate valuation, financial and technical supervision over the construction of real estate. Privredna banka Zagreb d.d. 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.

Business description of the Group (continued)

PBZ Nekretnine (continued)

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.

Intesa Sanpaolo banka Bosna i Hercegovina

Intesa Sanpaolo Banka dd Bosna i Hercegovina was established in Sarajevo in 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 the 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 from Italy, the Bank's majority shareholding was purchased in July 2015 by former sister company Privredna Banka Zagreb d.d., 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 9.5 percent in Total Assets, 10.6 percent in loans and 9.0 percent in Deposits.

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 of 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 more than HRK 6.6 billion gross disbursement of loans during 2018.

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, 6th largest bank in terms of loans and 5th largest in terms of deposits. The bank operates through a network of 49 branch offices located in the major Slovenian cities throughout the country.

Throughout the entire period of its existence, Intesa Sanpaolo Bank has grown and contributed to the growth of the economy through its successful operations. The Bank is one of the first banks in Slovenia to have shifted its business to digital platforms and at the same time the bank that maintained the highest credit rating of all commercial banks in Slovenia during the financial crisis period.

After more than 15 years of being part of the international banking group Intesa Sanpaolo, Banka Koper changed its name to Intesa Sanpaolo Bank. By renaming Banka Koper to Intesa Sanpaolo Bank and by transferring majority ownership to Privredna Banka Zagreb, the Bank laid the foundations in 2017 for a further development strategy. 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. With the new strategy, the Bank wish to outgrow the regional frameworks and establish itself as a modern and innovative bank in the all-Slovenian territory. For this reason, in 2018 the Bank adopted a new 2018–2021 Business Plan, which in its four pillars assumes the expansion of the solid business from the regional environment to the national level. With this simpler and agile model, the Bank will be able to adapt more easily to the current market standards, to the new needs and expectations of its users, and the technological boom the Bank is witnessing.

Business description of the Group (continued)

PBZ Croatia Osiguranje

PBZ Croatia Osiguranje 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 d.d. and Croatia osiguranje d.d. 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 2018.

At this point, pension funds under management have nearly 365 thousand members and net assets in personal accounts exceeding HRK 16.3 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 28 March 2018, while two Extraordinary General Meetings were held on 18 June 2018 and 19 December 2018.

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, independent – term of office from 1 April 2017

Draginja Đurić, Deputy President of the Supervisory Board – term of office from 31 March 2017

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

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

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

Paolo Sarcinelli, Member of the Supervisory Board – term of office from 30 March 2016

Christophe Velle, Member of the Supervisory Board – term of office from 17 October 2016

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 has been appointed in accordance with the law and the parent bank's rules. In the previous year it worked as a body composed of five members. The composition of the Audit Committee was aligned in June 2018 with the provisions of the new Audit Act so that the Committee is now composed of three independent members of the Supervisory Board of the Bank, appointed by the Supervisory Board, and two members appointed by the General Meeting of the Bank. The president of the Supervisory Board of the Bank then assumed also the role of the president of the Audit Committee. Most of the members of the Audit Committee are independent from the Bank. During 2018 five meetings of the Audit Committee were held, discussing the issues within the competence of the Supervisory Board. The Audit Committee helped the Supervisory Board in carrying out its duties related to the supervision of the financial reporting process, the audit process (including the recommendation of the General Meeting for the election of the external auditor), as well as compliance with laws, regulations, rules and the code of ethics.

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

Supervisory Board (continued)

Audit Committee (continued)

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

Composition of the Audit Committee starting from 18 June 2018:

- **Giovanni Boccolini,** President of the Audit Committee (independent)
- **Branko Jeren,** Member of the Audit Committee (independent)
- **Giulio Moreno,** Member of the Audit Committee (independent)
- **Mauro Zanni,** Member of the Audit Committee (President of the Committee until 17 June 2018)
- **Gianluca Tiani,** Member of the Audit Committee

Members until 17 June 2018:

- **Christophe Velle**
- **Marco Valle**
- **Antonio Furesi**

Permanent invitees attending Audit Committee meetings since 18 June 2018:

- **Antonio Furesi**
- **Federico Peretti**

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 in the Republic of Croatia. 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 2018 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, 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

Nomination Committee

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

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

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

Risk Committee

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

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

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

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

Management Board of the Bank

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

Enlarged meetings of the Management Board of the Bank are held monthly and they include the participation of heads of subsidiaries in the Republic of Croatia (PBZ Card d.o.o., PBZ Nekretnine d.o.o., PBZ stambena štedionica d.d., PBZ Lesing d.o.o.) and subsidiary banks (Intesa Sanpaolo Banka d.d., BiH, Banka Intesa Sanpaolo d.d., Koper). These meetings are also regularly attended by representatives of the responsible organisational units of the parent bank's ISBD. These meetings consider financial reports and important issues concerning business operations of the mentioned subsidiaries.

Members of the Management Board of the Bank as of 31 December 2018 were the following:

Dinko Lucić, 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, term of office from 11 February 2018.

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, term of office from 13 September 2017.

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

Ivan Gerovac, Member of the Management Board responsible for the Corporate Division, term of office from 11 February 2018.

Draženko Kopljar, Member of the Management Board responsible for the operations area (*Chief Operating Officer*): Payments, Back Office, ICT, Real Estate and Logistical Support, term of office from 11 February 2018.

Ivan Krolo, Member of the Management Board responsible for the Retail Division, term of office from 11 February 2018.

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 2018:

Božo Prka, President of the Management Board - term of office until 10 February 2018

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. During 2017 and 2018 a new corporate model was established for the Bank and the subsidiary banks. New committees were established, some committees were disbanded, and the Rules of Procedure of the Management Committees of the Bank were adopted to govern their composition and competences. The committees are mainly composed of members of the Management Board, but they are attended by the responsible management (as committee members or permanent invitees) and some also by representatives of the parent bank.

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

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

Management Committees:

- *Credit Risk Governance Committee* – decision-making and advisory committee whose mission is to ensure a qualified and coordinated management of credit risk within the exercise of credit prerogatives of the Bank 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 management policies based on the constant credit portfolio monitoring.
- *Credit Committee* – decision-making committee of the Bank regarding performing counterparties, whose 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.
  - *Junior Credit Committee* – responsible for adopting decisions on performing clients (legal entities) in accordance with the authority it was delegated by the Management Board of the Bank.
  - *Problem Assets Committee* – decision-making committee of the Bank regarding risky and non-performing counterparties, whose main responsibility consists in taking the necessary measures in order to prevent and mitigate credit losses connected with risky and deteriorated assets.
- *Assets and Liabilities Management Committee (ALCO*) – decision-making and consultative committee, focused on financial risks governance, on the active value management issues, on the strategic and operative management of assets and liabilities and on financial products governance in compliance with Parent Company guidelines, Bank's internal regulations, laws, rules and regulations set by the competent Authorities; the Committee, acting within the limits of the delegations and competences established by the Management Board, is dedicated to the following areas: (a) Financial Risk Governance and Assessment, (b) Operative Management, (c) Financial Products Governance.
- *Financial Products Technical Committee* – decision-making and consultative committee that, within the overall Bank's governance framework for financial product offered to retail clients, supports the Assets & Liabilities Management Committee and is entrusted with the definition, the analysis and the evaluation of the characteristics of the Financial Products' offer and monitors their performance over time, in compliance with ISP Group guidelines, Bank's internal regulations, applicable laws, rules and regulations set by the competent authorities.
  - *Operational Risk Committee* – decision-making and advisory committee whose mission is to ensure a qualified and competent management of operational risk issues (ICT/cyber risk and security management inclusive), in compliance with the applicable laws, Group regulations and internal procedures.
  - *Change Management Committee* – responsible for the strategic management of changes within the Bank's overall operations through the definition and monitoring of the Bank's project portfolio, prioritizing the respective projects and investments in line with the Bank's strategy, monitoring of the related activities and spending as well as solving any escalated issues.
  - *Internal Controls Coordination Committee* – advisory committee, acting within the limits of the delegations and competences established by the Management Board of the Bank, with the aim to strengthen the coordination and the cooperation among control functions in PBZ Group, facilitating the integration of risk management processes.
  - *Banking Subsidiaries Coordination Committee* – decision making and consultative committee whose aim is to set the operative strategy for a coordinated development of the Banking Subsidiaries of PBZ d.d. (Bank or PBZ), ensuring namely the efficient implementation of the ISP and PBZ Group initiatives, sharing best practices, application of the robust governance and optimization of the resource allocation.

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 9 May 2018 (Official Gazette 42/18)
- 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, introduction of new 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 procedure is also 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 ▪ Liquidity 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 2018, 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. Liquidity risk will continue to be treated 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. 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. 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**
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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 capitalized 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 d.d.

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 2018* (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 (as of 31 December 2018 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 statement on the implementation of corporate governance code (continued)

Statement on the implementation of the Code of Corporate Governance of Privredna banka Zagreb d.d. (continued)

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.

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 members of the Management Board of the Bank whose terms of office started in 2018 meet 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 (as of 31 December 2018 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), the members of the Supervisory Board of the Bank 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 OF 31 DECEMBER 2018

Dinko Lucić, President;

Alessio Cioni, Deputy President;

Ivan Gerovac, Member;

Darko Drozdek, Member;

Ivan Krolo, 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 2018, 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)
Yes.

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, other information and supplementary information

The Management Board of the Bank is required to prepare separate financial statements of Privredna banka Zagreb d.d. ("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 and the Group 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 Group and Corporate Governance Statement 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 Credit Institutions, from May 2018 (Official Gazette 42/2018).

The Management Board is responsible for the submission to the Supervisory Board of its Annual report which includes the separate and consolidated financial statements, other information and supplementary 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 69 to 249 as well as supplementary forms for the Croatian National Bank and reconciliation of the statutory financial statements with the supplementary forms for the Croatian National Bank, set out on pages 250 to 285 and Management Board Report for the Bank and the Group on pages 8 to 15, Report from the President of the Supervisory Board on pages 6 to 7, The statement on the Implementation of Corporate Governance Code on pages 43 to 59 and other information on pages 3 to 5 and 16 to 42 are approved by the Management Board on 19 February 2019 as confirmed by the signatures below.

For and on behalf of Privredna banka Zagreb d.d.

Dinko Lucić
President of the Management Board

Alessio Cioni
Deputy 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 d.d.

Report on the Audit of the Financial Statements

Opinion

We have audited the separate financial statements of Privredna banka Zagreb d.d. ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries ("the Group"), which comprise the separate and consolidated statements of financial position of the Bank and the Group, respectively, as at 31 December 2018, and their respective separate and consolidated statements of profit or loss and other comprehensive income, cash flows and changes in equity 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 unconsolidated financial position of the Bank and the consolidated financial position of the Group as at 31 December 2018, and of their respective unconsolidated and consolidated financial performance and 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 2018, in the consolidated financial statements, gross loans and advances to customers: HRK 70,874 million, related impairment allowance: HRK 4,004 million and impairment loss for the year then ended: HRK 371 million (31 December 2017: gross loans and advances: HRK 69,241 million, impairment allowance: HRK 3,860 million, impairment loss for the year: HRK 850 million).

As at 31 December 2018, in the separate financial statements, gross loans and advances to customers: HRK 48,454 million, impairment allowance: HRK 2,857 million and impairment loss for the year: HRK 221 million (31 December 2017: gross loans and advances: HRK 47,367 million, impairment allowance: HRK 2,632 million, impairment loss for the year: HRK 608 million).

Refer to pages 88 and 101 (Significant accounting policies), page 116 to 117 (Accounting estimates and judgements in applying accounting policies), page 158 (note 26 Loans and advances to customers), and pages 204 to 226 (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 d.d. *(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 the Management Board's best estimate of the expected credit losses 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 Board over both the timing of recognition and the amounts of any such impairment. Additionally, as at 1 January 2018, the Bank and the Group applied the new financial instruments standard, IFRS 9 Financial Instruments, whose impairment requirements are based on the expected credit loss (ECL) model rather than the incurred loss model, as previously used. The new model uses a dual-measurement approach, under which the impairment allowance is measured as either 12-months expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk since initial recognition. Following the initial application of the new standard, impairment allowances for performing exposures (Stage 1 and Stage 2 in the IFRS 9 hierarchy) and non-performing retail exposures as well as non-performing corporate exposures below HRK 3.8 million (Stage 3) individually (together "collective impairment allowance") are determined by modelling techniques. Historical experience, identification of exposures with	Our audit procedures in this area included, among others: – Inspecting the Bank's and the Group's new ECL impairment provisioning methodology and assessing its compliance with the relevant requirements of the new standard. As part of the above, we challenged the Management Board on whether the level of the methodology's sophistication is appropriate based on an assessment of the entity-level and portfolio-level risks; – Making relevant inquiries of the Bank's and the Group's risk management and information technology (IT) personnel to obtain an understanding of the provisioning process, IT applications used therein, as well as key data sources and assumptions for data used in the ECL model. Also, assessing and testing of IT control environment for data security and access, assisted by our own IT specialists; – Testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans and advances, including, but not limited to, the controls relating to the identification of loss events and default, appropriateness of classification of exposures between performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances; With respect to the impairment accounting under the new standard: – Understanding the overall transition process activities and controls, including the process and controls over determining the impact as well as the underlying process activities that generated the related disclosures; – Assessing whether the definition of default and the new standard's staging criteria were consistently applied; – Evaluating the overall modelling approach of calculation of ECLs, including the calculation of main risk parameters and macroeconomic factors (probability of default (PD), loss given default (LGD) and exposure at default (EAD)); – Performing an analysis of the ECL-based impairment allowances as at the new standard's initial application date, to those calculated at that same date in accordance with the previous standard, and assessing their reasonableness reasonableness based on inquiries of the credit risk management personnel.

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

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

Key Audit Matters (continued)

Key audit matter	How our audit addressed the matter
a significant deterioration in credit quality, forward-looking information 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. For the above reasons, impairment of loans and advances to customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered the area to be our key audit matter.	For impairment allowances that are calculated individually: – Selecting a sample of individual exposures, 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 watchlisted, 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 triggers for classification to Stage 2 or Stage 3; – For those loans where triggers for classification in Stage 3 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: – Obtaining an understanding of the key internal rating models for loans and advances, and assessing the reasonableness of the underlying assumptions, and the sufficiency of the data used by the management; – Testing the underlying impairment models, assessed as significant, including model approval and validation processes; – Obtaining the relevant forward looking information and macroeconomic forecasts used in the Bank's ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board; – Challenging LGD and PD parameters, assessed as significant, by performing back-testing of historical default and by reference to historical realized losses on defaults;

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

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

Key Audit Matters (continued)

Key audit matter	How our audit addressed the matter
	– For a sample of exposures, assessing the appropriateness of the staging; – For a sample of exposures tested collectively, assessing the application of the measurement models applied and checking that the impairment rates applied complied with those provided for in such models; – Critically assessing the rationale for the changes made to the model parameters in 2018, 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; Evaluating the accuracy and completeness of the financial statement disclosures relating to the adoption of the new standard.

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Independent Auditors' report to the shareholders of Privredna banka Zagreb d.d. *(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 Bank, Management Board Report for the Group, Macroeconomic Developments in Croatia in 2018, 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 Board Report of the Bank, Management Board Report for the Group and The Statement on the Implementation of Corporate Governance Code, we also performed procedures required by the Accounting Act in Croatia ("Accounting Act"). Those procedures include considering whether:

- the Management Board Report of the Bank and Management Board Report for the Group has been prepared in accordance with the requirements of Articles 21 and 24 of the Accounting Act;
- the specific information in The Statement on the Implementation of Corporate Governance Code required by Article 22, paragraph 1, items 3 and 4 of the Accounting Act ("relevant sections of the Implementation of Corporate Governance Code") has been prepared in accordance with the requirements of Article 22 of the Accounting Act; and
- The Statement on the Implementation of Corporate Governance Code 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 Management Board Report of the Bank, Management Board Report for the Group and the relevant sections of the The Statement on the Implementation of Corporate Governance Code for the financial year for which the financial statements are prepared, is consistent, in all material respects, with the financial statements;
- the information given in Management Board Report of the Bank, Management Board Report for the Group and the relevant sections of the The Statement on the Implementation of Corporate Governance Code have been prepared, in all material respects, in accordance with the requirements of Articles 21, 22 and 24 of the Accounting Act, respectively;
- the Implementation of Corporate Governance Code 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 an Introduction, Report from the President of the Supervisory Board, Management Board Report of the Bank, Management Board Report for the Group, Macroeconomic Developments in Croatia in 2018, Business Description of the Bank, Business Description of the Group and The Statement on the Implementation of Corporate Governance Code. We have nothing to report in this respect.

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Independent Auditors' report to the shareholders of Privredna banka Zagreb d.d. *(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.

Independent Auditors' report to the shareholders of Privredna banka Zagreb d.d. *(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 credit institutions, dated 9 May 2018 (Official Gazette 42/18), the Management Board of the Bank has prepared the forms ("the Forms"), which comprise an alternative presentation of the Bank and the Group financial position as at 31 December 2018, 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 Forms with the financial statements. The Forms and the Reconciliation are presented on pages 250 to 285. The Management Board of the Bank is responsible for the Forms and the Reconciliation. The financial information in the Forms is derived from the financial statements of the Bank and the Group set out on pages 69 to 249 on which we have expressed an opinion as set out above.

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

Report on Other Legal and Regulatory Requirements (continued)

We were appointed by those charged with governance on 29 March 2018 to audit the financial statements of the Bank and the Group for the year ended 31 December 2018. Our total uninterrupted period of engagement is 7 years, covering the periods ending 31 December 2012 to 31 December 2018. We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 19 February 2019;
- for the period to which our statutory audit relates, we have not provided any non-audit services (NASs), hence we have not provided any prohibited non-audit services 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

19 February 2019

Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

KPMG Croatia
d.o.o. za reviziju
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Ivana Lučića 2a, 10000 Zagreb
7

Goran Horvat
Director, Croatian Certified Auditor

Income statement

For the year ended 31 December

(in HRK million)

	Notes	GROUP 2018	GROUP Restated* 2017	BANK 2018	BANK 2017
Interest income calculated using the effective interest method	7	3,151	3,405	2,455	2,698
Other interest income	7	81	103	23	50
Interest expense	7	(419)	(529)	(271)	(374)
Net interest income		**2,813**	**2,979**	**2,207**	**2,374**
Fee and commission income	8a	1,960	1,850	880	811
Fee and commission expense	8b	(388)	(348)	(148)	(126)
Net fee and commission income		**1,572**	**1,502**	**732**	**685**
Dividend income	9	3	6	51	445
Net trading income and net gains on translation of monetary assets and liabilities	10	350	241	265	215
Fair value adjustment in hedge accounting	11	-	(1)	-	-
Other operating income	12	142	192	87	96
Total operating income		**4,880**	**4,919**	**3,342**	**3,815**
Net impairment losses on loans and advances to customers	15a	(371)	(850)	(221)	(608)
Other impairment losses and provisions	15b	(66)	(20)	(53)	(1)
Personnel expenses	13	(1,154)	(1,108)	(761)	(730)
Depreciation, amortisation and impairment of goodwill	16	(203)	(201)	(122)	(118)
Other operating expenses	14	(1,206)	(1,155)	(708)	(684)
Share of profits from associates	27	14	14	-	-
Profit before income tax		**1,894**	**1,599**	**1,477**	**1,674**
Income tax expense	17	(174)	(304)	(97)	(231)
Profit for the year		**1,720**	**1,295**	**1,380**	**1,443**
Attributable to:					
Equity holders of the Bank		1,681	1,280	1,380	1,443
Non-controlling interests		39	15	-	-
		1,720	**1,295**	**1,380**	**1,443**

in HRK

	Notes	GROUP 2018	GROUP 2017	BANK 2018	BANK 2017
Basic and diluted earnings per share	55	**88.4**	**67.3**	**72.6**	**75.9**

*Disclosed in Note 5

The companying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December

(in HRK million)

	GROUP		BANK	
	2018	Restated* 2017	2018	2017
Profit for the year	**1,720**	**1,295**	**1,380**	**1,443**
Other comprehensive income				
Items that will not be reclassified to profit or loss				
Net value adjustment from valuation of property	*-*	*290*	*-*	*106*
Net change in fair value on equity instrument	*20*	*-*	*15*	*-*
Remeasurement of defined benefit liability	*10*	*-*	*-*	*-*
Related tax	(4)	(51)	(3)	(19)
	26	**239**	**12**	**87**
Items that are or may be reclassified to profit or loss				
Net change in fair value on debt instruments	*(71)*	*-*	*(8)*	*-*
Net change in fair value on available-for-sale financial assets	*-*	*58*	*-*	*51*
Foreign exchange differences on translation of foreign operations	*(42)*	*(9)*	*-*	*-*
Net amount transferred to the income statement	*(28)*	*(37)*	*(20)*	*(15)*
Related tax	15	(2)	5	(6)
	(126)	**10**	**(23)**	**30**
Other comprehensive income for the year, net of tax	**(100)**	**249**	**(11)**	**117**
Total comprehensive income for the year, net of tax	**1,620**	**1,544**	**1,369**	**1,560**
Attributable to:				
Equity holders of the Bank	1,607	1,490	1,369	1,560
Non-controlling interests	13	54	-	-
	1,620	**1,544**	**1,369**	**1,560**

*Disclosed in Note 5

The accompanying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Statement of financial position

As of 31 December

(in HRK million)

		GROUP		BANK	
Assets	***Notes***	2018	Restated* 2017	2018	2017
Cash and current accounts with banks	19	18,442	18,984	14,180	15,466
Balances with the Croatian National Bank	20	4,698	4,246	4,698	4,185
Financial assets held for trading	22	828	550	828	550
Derivative financial assets	23a,b	10	22	1	2
Fair value changes of the hedged items in portfolio hedge of interest rate risk	23c	9	1	-	-
Loans and advances to banks	25	7,784	2,415	6,869	1,493
Loans and advances to customers	26	66,688	65,169	45,457	44,562
Investment securities	21	10,557	9,331	7,374	5,805
Investments in subsidiaries and associates	27	69	69	1,962	1,962
Intangible assets	28	240	227	186	162
Property and equipment	29	1,337	1,378	636	621
Investment property	30	7	8	1	1
Non-current assets held for sale	31	334	457	124	90
Deferred tax assets	17c	142	125	95	79
Other assets	32	740	1,050	360	515
Current tax assets		128	22	123	4
Total assets		**112,013**	**104,054**	**82,894**	**75,497**

*Disclosed in Note 5

The accompanying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Statement of financial position (continued)

As of 31 December

(in HRK million)

Liabilities	Notes	GROUP 2018	GROUP Restated* 2017	BANK 2018	BANK 2017
Current accounts and deposits from banks	33	1,843	1,371	1,480	1,064
Current accounts and deposits from customers	34	85,938	78,827	63,042	57,173
Derivative financial liabilities	24a,b	34	13	4	7
Fair value changes of the hedged items in portfolio hedge of interest rate risk	24c	4	9	-	-
Interest-bearing borrowings	35	4,160	3,816	3,032	2,377
Other liabilities	37	1,994	2,376	601	677
Accrued expenses and deferred income	38	372	363	159	165
Provisions	39	516	410	393	249
Deferred tax liabilities	17d	71	86	32	30
Current tax liability		11	6	-	-
Subordinated liabilities	36	-	1	-	-
Total liabilities		**94,943**	**87,278**	**68,743**	**61,742**
Equity					
Share capital	41a	1,907	1,907	1,907	1,907
Share premium	41b	1,570	1,570	1,570	1,570
Treasury shares	41c	(76)	(76)	(76)	(76)
Other reserves	41e	1,399	1,369	372	296
Fair value reserve	41f	82	99	59	49
Retained earnings	41g	12,368	11,859	10,319	10,009
Merger reserve	41h	(1,214)	(1,003)	-	-
Total equity attributable to equity holders of the Bank		**16,036**	**15,725**	**14,151**	**13,755**
Non-controlling interests		1,034	1,051	-	-
Total equity		**17,070**	**16,776**	**14,151**	**13,755**
Total liabilities and equity		**112,013**	**104,054**	**82,894**	**75,497**

*Disclosed in Note 5

The accompanying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

(in HRK million)

	Notes	GROUP 2018	GROUP Restated* 2017	BANK 2018	BANK 2017
Cash flows from operating activities					
Profit before income tax		1,894	1,599	1,477	1,674
Impairment losses on loans and advances to customers	15a	371	850	221	608
Other impairment losses and provisions	15b	66	20	53	1
Gain on disposal of property and equipment , intangible assets and investment property	12	(15)	(6)	(3)	(3)
Depreciation, amortisation and impairment of goodwill	16	203	201	122	118
Net (gains)/losses from securities at fair value through profit or loss	10	(63)	(8)	-	(9)
Share of profits from associates	27	(14)	(14)	-	-
Net interest income		(2,813)	(2,979)	(2,207)	(2,374)
Net gain on disposal of FVOCI securities (2017: available for sale)	12	(20)	(53)	(20)	(16)
Dividend income	9	(3)	(6)	(51)	(445)
		(394)	**(396)**	**(408)**	**(446)**
Decrease/(increase) in operating assets					
Balances with the Croatian National Bank		(442)	(264)	(484)	(269)
Loans and advances to banks		(2,532)	910	(2,444)	99
Loans and advances to customers		(2,756)	173	(1,602)	542
Financial assets at fair value through profit or loss and financial assets available for sale and fair value changes of the hedged items in portfolio hedge of interest rate risk		(1,477)	566	(1,807)	63
Other assets		296	(612)	151	(291)
(Increase)/decrease in operating assets		***(6,911)***	***773***	***(6,186)***	***144***
Increase/(decrease) in operating liabilities					
Current accounts and deposits from banks		472	(440)	416	(313)
Current accounts and deposits from customers		7,168	3,912	5,662	3,215
Other liabilities		(421)	510	(111)	217
Increase in operating liabilities		***7,219***	***3,982***	***5,967***	***3,119***
Interest received		3,284	3,144	2,460	2,710
Interest paid		(480)	(648)	(332)	(524)
Dividends received		17	6	51	445
Net cash inflow from operating activities before income taxes paid		**2,735**	**6,861**	**1,552**	**5,448**
Income tax paid		(300)	(458)	(232)	(391)
Net cash from operating activities		**2,435**	**6,403**	**1,320**	**5,057**

*Disclosed in Note 5

The accompanying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Statement of cash flows (continued)

For the year ended 31 December

(in HRK million)

	Notes	GROUP 2018	GROUP Restated* 2017	BANK 2018	BANK 2017
Cash flows from investing activities					
Purchase of property and equipment, intangible assets and investment property	28,29,30	(206)	(285)	(161)	(131)
Disposal of property and equipment, intangible assets and investment property	28,29,30	30	114	3	3
Disposal of non-current assets held for sale		128	-	-	-
Cash paid for the acquisition of Veneto bank d.d.	27	(152)	-	(152)	-
Cash paid for the acquisition of Intesa Sanpaolo Bank d.d.		-	(1,071)	-	(1,071)
Cash paid for squeeze out of minority shareholders		-	(32)	-	(32)
Net cash used in investing activities		**(200)**	**(1,274)**	**(310)**	**(1,231)**
Cash flows from financing activities					
Dividends paid		(304)	(481)	(289)	(481)
Increase in interest-bearing borrowings and subordinated liabilities		347	(451)	641	(369)
Net cash used in financing activities		**43**	**(932)**	**352**	**(850)**
Cash and cash equivalents acquired on merger of Veneto banka	27	-	-	270	-
Net increase in cash and cash equivalents		**2,278**	**4,197**	**1,632**	**2,976**
Cash and cash equivalents as at 1 January		20,565	16,388	16,972	14,016
Effect of exchange rate fluctuations on cash held		(3)	(20)	(3)	(20)
Cash and cash equivalents as at 31 December	**42**	**22,840**	**20,565**	**18,601**	**16,972**

*Disclosed in Note 5

The accompanying accounting policies and notes on pages 78 to 249 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 31 December 2017, as previously reported	**1,907**	**1,570**	**(76)**	**1,369**	**99**	**11,910**	**(1,231)**	**1,051**	**16,599**
Restatement for acquisition of Veneto banka in common control transaction	**-**	**-**	**-**	**-**	**-**	**(51)**	**228**	**-**	**177**
Balance as at 31 December 2017, as restated	**1,907**	**1,570**	**(76)**	**1,369**	**99**	**11,859**	**(1,003)**	**1,051**	**16,776**
Impact of adopting IFRS 9 at 1 January 2018 (Note 18b)	**-**	**-**	**-**	**-**	**34**	**(889)**	**-**	**(15)**	**(870)**
Restated balance at 1 January 2018	**1,907**	**1,570**	**(76)**	**1,369**	**133**	**10,970**	**(1,003)**	**1,036**	**15,906**
Other comprehensive income									
Net change in fair value on equity instrument	-	-	-	-	18	-	-	2	**20**
Related tax	-	-	-	-	(3)	-	-	(1)	**(4)**
Net change in fair value on debt instrument	-	-	-	-	(53)	-	-	(18)	**(71)**
Net amount transferred to the income statement	-	-	-	-	(24)	-	-	(4)	**(28)**
Related tax	-	-	-	-	11	-	-	4	**15**
Actuarial gain/loss	-	-	-	5	-	-	-	5	**10**
Foreign exchange differences on translation of foreign operations	-	-	-	(28)	-	-	-	(14)	**(42)**
Total other comprehensive income	-	-	-	**(23)**	**(51)**	-	-	**(26)**	**(100)**
Profit for the year	-	-	-			1,681	-	39	**1,720**
Total comprehensive income for the year	**-**	**-**	**-**	**(23)**	**(51)**	**1,681**	**-**	**13**	**1,620**
Dividends paid	-	-	-	-	-	(289)	-		**(289)**
Dividend paid by Banka Intesa Sanpaolo d.d. Slovenia	-	-	-	-	-	-	-	(15)	**(15)**
Acquisition of Veneto banka (Note 27)	-	-	-	76	-	-	(228)	-	**(152)**
Other movements	-	-	-	(23)	-	6	17	-	**-**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**53**	**-**	**(283)**	**(211)**	**(15)**	**(456)**
Balance as at 31 December 2018	**1,907**	**1,570**	**(76)**	**1,399**	**82**	**12,368**	**(1,214)**	**1,034**	**17,070**

The accompanying accounting policies and notes on pages 78 to 249 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 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 17f)	-	-	-	-	(4)			2	**(2)**
Revaluation of land and buildings	-	-	-	239	-	-	-	51	**290**
Deferred tax on tangible assets (Note 17f)	-	-	-	(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, restated (Note 5)	-	-	-	-	-	1,280	-	15	**1,295**
Total comprehensive income for the year, restated	**-**	**-**	**-**	**192**	**18**	**1,280**	**-**	**54**	**1,544**
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)**
Acquisition of Veneto banka (Note 27)	-	-	-	-	-	-	228	-	**228**
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, restated	**-**	**-**	**-**	**(94)**	**-**	**(548)**	**(749)**	**(127)**	**(1,518)**
Balance as at 31 December Restated 2017	**1,907**	**1,570**	**(76)**	**1,369**	**99**	**11,859**	**(1,003)**	**1,051**	**16,776**

The accompanying accounting policies and notes on pages 78 to 249 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 31 December 2017	**1,907**	**1,570**	**(76)**	**296**	**49**	**10,009**	**13,755**
Impact of adopting IFRS 9 at 1 January 2018 (Note 18b)	**-**	**-**	**-**	**-**	**21**	**(684)**	**(663)**
Restated balance at 1 January 2018	**1.907**	**1.570**	**(76)**	**296**	**70**	**9,325**	**13,092**
Other comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Net change in fair value on equity instrument	-	-	-	-	15	-	**15**
Related tax	-	-	-	-	(3)	-	**(3)**
Net change in fair value on debt instrument	-	-	-	-	(8)	-	**(8)**
Net amount transferred to the income statement	-	-	-	-	(20)	-	**(20)**
Related tax	-	-	-	-	5	-	**5**
Total other comprehensive income	**-**	**-**	**-**	**-**	**(11)**	**-**	**(11)**
Profit for the year	-	-	-	-	-	1,380	**1,380**
Total comprehensive income for the year	**-**	**-**	**-**	**-**	**(11)**	**1,380**	**1,369**
Dividends paid	-	-	-	-	-	(289)	**(289)**
Merger of Veneto banka (Note 27)	-	-	-	76	-	(97)	**(21)**
Transactions with owners, recorded directly in equity	**-**	**-**	**-**	**76**	**-**	**(386)**	**(310)**
Balance as at 31 December 2018	**1,907**	**1,570**	**(76)**	**372**	**59**	**10,319**	**14,151**
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 17)	-	-	-	-	(6)	-	**(6)**
Revaluation of land and buildings	-	-	-	106	-	-	**106**
Deferred tax on tangible assets (Note 17)	-	-	-	(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**

The accompanying accounting policies and notes on pages 78 to 249 are an integral part of these financial statements.

Notes to the financial statements

1 Reporting entity

Privredna banka Zagreb d.d. ("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) Basis of accounting

These separate and consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union ("EU IFRS"). This is the first set of the Group's and Bank's annual financial statements in which IFRS 9 Financial instruments and IFRS 15 Revenue from Contracts with Customers have been applied.

These separate and consolidated financial statements were authorised for issue by the Management Board on 19 February 2019 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 measured at fair value through other comprehensive income. 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 2018 amounted to EUR 1 = HRK 7,417, CHF 1= HRK 6,588, USD 1 = HRK 6,469 and BAM 1 = HRK 3,793 (31 December 2017: EUR 1 = HRK 7,514, CHF 1= HRK 6,432, USD 1 = HRK 6,270 and BAM 1 = HRK 3,842).
During 2018 and 2017 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 as adopted by EU 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 accounting policies 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 6.

Notes to the financial statements (continued)

2 Basis of preparation (continued)

e) Acquisition of Veneto bank d.d.

The structure of the Group was changed following a Group reorganisation in 2018.

As of 12 July 2018 the Bank purchased a 100% stake in Veneto bank d.d. (5,970,820 ordinary shares with 100% voting rights) from Intesa Sanpaolo S.p.A. Turin which is the ultimate owner of both banks and which acquired Veneto banka d.d. in 2017.

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. In the Bank's consolidated financial statement the transaction is accounted for using book values of Veneto banka d.d., as allowed under IFRS 3 and the Bank restated its comparatives and adjusted its current reporting period before the date of the transaction as if the combination had occurred during 2017, when the ultimate owner initially acquired Vento banka. For details, please refer to Note 5 Restatement of comparative information and Note 27 Investment in subsidiaries and associates.

f) Merger of Veneto bank d.d.

Effective from October 2018 Veneto banka (100% owned by the Bank) was legally merged into the Bank and ceased to exist as a separate legal and operational entity. The Bank's separate financial statements, income statement for 2018 does not include results of Veneto banka prior to the merger nor has the comparative information been restated to include Veneto banka. In addition, in the Bank's separate financial statements the assets and liabilities acquired as a result of merger are recognised at the carrying amounts recognised immediately before the merger in the financial statements of Veneto banka. The assets, liabilities and equity assumed on merger are summarised in Note 27.

g) Acquisition of Banka Intesa Sanpaolo d.d. 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 d.d. 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. In the Bank's consolidated financial statement the transaction is accounted for in line with the book value accounting allowed under IFRS 3 and in its 2017 consolidated financial statements the Bank restated its comparatives and adjusted its current reporting period before the date of the transaction as if the combination had occurred before the start of the earliest period presented. For details, please refer to Note 27 Investment in subsidiaries and associates.

Notes to the financial statements (continued)

3 Changes in accounting policies

The Group adopted IFRS 9 and IFRS 15 from 1 January 2018.

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Group's financial statements.

Due to the transition method chosen by the Group in applying IFRS 9, comparative information throughout these financial statements has not generally been restated to reflect its requirements.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Group. Accordingly, the impact on the comparative information is limited to new disclosure requirements.

The effect of initially applying these standards is mainly attributed to the following:

– an increase in impairment losses recognised on financial assets;

– additional disclosures related to IFRS 9 (see Note 18).

Except for the changes below, the Group has consistently applied the accounting policies as set out in Note 4 to all periods presented in these separate and consolidated financial statements.

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As permitted by IFRS 9, the Group has elected to continue to apply the hedge accounting requirements of IAS39. As a result of the adoption of IFRS 9, the Group has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require separate presentation in the income statement of interest revenue calculated using the effective interest method. Previously, the Group disclosed this amount in the notes to the financial statements.

The Group has adopted consequential amendments to IFRS 7 *Financial Instruments: Disclosures* that are applied to disclosures about 2018, but have not been applied to the comparative information.

The key changes to the Group's accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 18.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. For an explanation of how the Group classifies financial assets under IFRS 9, see Note 18.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

– the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and

– the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Group classifies financial liabilities under IFRS 9, see Note 18

Notes to the financial statements (continued)

3 Changes in accounting policies (continued)

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Group applies the impairment requirements of IFRS 9, see Note 18.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

Comparative periods generally have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

- The determination of the business model within which a financial asset is held.
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
- The designation of certain investments in equity instruments not held for trading as at FVOCI.
- For financial liabilities designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 18

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related interpretations.

The Group initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Group's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15.

Notes to the financial statements (continued)

4 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 equity transactions.

Notes to the financial statements (continued)

4 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. The Group controls an entity if it is exposed to, or has rights to, variable returns from the involvement with the entity and has the ability to alter those returns throughout its power over the entity. 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. In the consolidated financial statements the excess of consideration paid over the carrying value of share capital at the time of combination is treated as a merger reserve in equity.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 in Note 4 l Financial instruments) depending on the level of influence retained.

Notes to the financial statements (continued)

4 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 43.

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 (before 1 January 2018) and equity investments in respect of which an election has been made to present subsequent changes in fair value in OCI (from 1 January 2018), which are recognised in other comprehensive income.

Changes in the fair value of debt securities denominated in foreign currency classified as available for sale (before 1 January 2018) or financial instruments measured at FVOCI (from 1 January 2018) 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 (before 1 January 2018) or financial instruments measured at FVOCI (from 1 January 2018) 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 (before 1 January 2018) and financial instruments measured at FVOCI (from 1 January 2018) 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") and International Financial Reporting Standard 9 *Financial Instruments ("IFRS 9").*

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)

4 Significant accounting policies (continued)

c) Interest income and expense

Policy applicable from 1 January 2018

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or

- the amortised cost of the financial liability,

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit- impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit- impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset.The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

For information on when financial assets are credit-impaired, see L(xi)

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

- interest on financial assets and financial liabilities measured at amortised cost;

- interest on debt instruments measured at FVOCI; and

- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

c) Interest income and expense (continued)

Interest expense presented in the statement of profit or loss and OCI includes financial liabilities measured at amortised cost.

Interest income and expense on other financial assets and financial liabilities at FVTPL are presented in net income from other financial instruments at FVTPL (see (F)).

Policy applicable before 1 January 2018

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 and, from 1 January 2018, also non-trading assets mandatorily measured at FVTPL.

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)

4 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)

4 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. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainties related to income taxes, if any.

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 taxation. 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)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

ii) Classification

Policy applicable from 1 January 2018

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and

- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice.

- how the performance of the portfolio is evaluated and reported to the Group's management;

- the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed; and

- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

ii) Classification (continued)

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers a:

- contingent events that would change the amount and timing of cash flows;

- prepayment and extension terms; and

- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets.

Loans and advances

'Loans and advances' captions in the statement of financial position include loans and advances measured at amortised cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;

- loans and advances mandatorily measured at FVTPL or designated as at FVTPL (see J(ii)); these are measured at fair value with changes recognised immediately in profit or loss; and

- finance lease receivables.

When the Group purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Group's financial statements.

Investment securities

The 'investment securities' caption in the statement of financial position includes:

- debt investment securities measured at amortised cost (see J(ii)); these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;

- debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL (see J(ii)); these are at fair value with changes recognised immediately in profit or loss;

- debt securities measured at FVOCI; and

- equity investment securities designated as at FVOCI

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;

- ECL and reversals; and

- foreign exchange gains and losses.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

ii) Classification (continued)

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

The Group elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss (see J(ii)) unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

Policy applicable before 1 January 2018

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

ii) Classification (continued)

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.

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.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities, as explained in (O). 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 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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

iv) Modifications of financial assets and liabilities

Policy applicable from 1 January 2018

If the terms of a financial asset are modified, then the Group evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised (see (iii)) and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:
- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Group plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place (see below for write-off policy). This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Group first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification.a Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.
If such a modification is carried out because of financial difficulties of the borrower (see (vii)), then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method (see (C)).

The Group derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

iv) Modifications of financial assets and liabilities (continued)

Policy applicable before 1 January 2018

If the terms of a financial asset were modified, then the Group evaluated whether the cash flows of the modified asset were substantially different. If the cash flows were substantially different, then the contractual rights to cash flows from the original financial asset were deemed to have expired. In this case, the original financial asset was derecognised (see (iii)) and a new financial asset was recognised at fair value. If the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using the pre- modification interest rate (see (vii)).

The Group derecognised a financial liability when its terms were modified and the cash flows of the modified liability were substantially different. In this case, a new financial liability based on the modified terms was recognised at fair value. The difference between the carrying amount of the financial liability extinguished and consideration paid was recognised in profit or loss.
Consideration paid included non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability was not accounted for as derecognition, then any costs and fees incurred were recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

v) Reclassification

Policy applicable from 1 January 2018

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model for managing financial assets.

Policy applicable before 1 January 2018

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

vi) 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.

vii) Initial and subsequent measurement

When a financial asset or financial liability is recognised initially, the Group measures it at its fair value plus or minus, 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.
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.

viii) 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.

ix) 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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

x) 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.

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

xi) Impairment of financial assets

Policy applicable from 1 January 2018

The Group recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;

- lease receivables;

- financial guarantee contracts issued; and

- loan commitments issued.

No impairment loss is recognised on equity investments and financial assets at FVTPL.

The Group measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and

- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

Loss allowances for lease receivables are always measured at an amount equal to lifetime ECL.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as ‘Stage 1 financial instruments’.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as ‘Stage 2 financial instruments’.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive);

- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Group if the commitment is drawn down and the cash flows that the Group expects to receive; and

- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Group expects to recover.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

xi) Impairment of financial assets (continued)

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.

- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI, and finance lease receivables are credit-impaired (referred to as ‘Stage 3 financial assets’). A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;

- a breach of contract such as a default or past due event;

- the restructuring of a loan or advance by the Group on terms that the Group would not consider otherwise;

- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation.

A loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

xi) Impairment of financial assets (continued)

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;

- loan commitments and financial guarantee contracts: generally, as a provision,

- where a financial instrument includes both a drawn and an undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component.

- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

Policy applicable before 1 January 2018

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

xi) Impairment of financial assets (continued)

Impairment of financial assets identified as impaired (continued)

a) Financial assets carried at amortised cost (continued)

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)

4 Significant accounting policies (continued)

l) Financial instruments (continued)

xi) 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)

4 Significant accounting policies (continued)

m) Derivative financial assets

Policy applicable from 1 January 2018

Derivatives may be embedded in another contractual arrangement (a host contract), The Group accounts for an embedded derivative separately from the host contract when:

- the host contract is not an asset in the scope of IFRS 9;

- the host contract is not itself carried at FVTPL;

- the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and

- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contract.

Policy applicable before 1 January 2018

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

n) Hedge accounting (continued)

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.

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

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. Assets in 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 up to the residual value. 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)

4 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:

	2018	**2017**
Buildings	20 to 40 years	40 years
Office furniture	5 years	5 years
Computers	4 years	4 years
Motor vehicles	5 years	5 years
Equipment and other assets	2 to 10 years	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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

t) Property and equipment (continued)

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.

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)

4 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.

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 Inventory, 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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

y) Impairment of non-financial assets (continued)

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.

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.

Notes to the financial statements (continued)

4 Significant accounting policies (continued)

dd) Off-balance-sheet commitments and contingent liabilities (continued)

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:

- *from 1 January 2018* at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

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 43.

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.

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 2018 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.

Notes to the financial statements (continued)

4 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)

IFRS 16 Leases

IFRS 16 supersedes IAS 17 Leases and related interpretations. The Standard eliminates the current dual accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases.

Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals.

The new Standard introduces a number of limited scope exceptions for leases which include:
- leases with a lease term of 12 months or less and containing no purchase options, and
- leases where the underlying asset has a low value (‘small-ticket’ leases).

Lessor accounting, however, shall remain largely unchanged and the distinction between operating and finance leases will be retained.

The Group and the Bank will recognise in the balance sheet new assets and liabilities for its operating leases (premises, cars and equipment) in total amount of HRK 284 million for the Group and HRK 338 million for the Bank, respectively. The nature and expenses related to those leases will not have a significant influence, because the Group will recognise a depreciation charge for right-of-use assets and interest expense on the lease liabilities. Previously, the Group recognised operating lease expenses on a straight-line basis over the time of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between the actual lease payments and the expense recognised. Instead, the Bank will include payments due under the lease in lease liability.

No impact is expected for the Group’s finance leases.

No impact is expected for other leases in which the Group is a lessor.

The Group applies the practical expedient to grandfather the definition of lease on transition. This means that it will apply IFRS 16 to all contracts entered into before 1 January 2019 and identified as leases in accordance with IAS 17 and IFRIC 4.

Notes to the financial statements (continued)

5 Restatement of comparative information

As further explained in Note 27 of the financial statements in July 2018 the Bank acquired a 100% stake in Veneto bank d.d. 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, and taking into account all the facts and circumstances, as explained below, the control is not considered transitory. 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.

Since the ultimate owner of both banks is Intesa Sanpaolo S.p.A. Turin the transaction was accounted using book values of Intesa Sanpaolo S.p.A., as allowed under IFRS 3 (as disclosed in Note 4e). In its consolidated financial statements, the Bank restated its comparatives as if Veneto banka was part of the Group from the date Veneto banka was part of ISP Group (July 2017).

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 2017

(in HRK million)

	As previously reported	Veneto	Restated
Interest income	3,500	8	**3,508**
Interest expense	(526)	(3)	**(529)**
Net interest income	**2,974**	**5**	**2,979**
Fee and commission income	1,848	2	**1,850**
Fee and commission expense	(347)	(1)	**(348)**
Net fee and commission income	**1,501**	**1**	**1,502**
Dividend income	6	-	**6**
Net trading income and net gains on translation of monetary assets and liabilities	240	1	**241**
Fair value adjustments in hedge accounting	(1)	-	**(1)**
Other operating income	188	4	**192**
Total operating income	**4,908**	**11**	**4,919**
Net impairment loss on loans and advances to customers	(823)	(27)	**(850)**
Other impairment losses and provisions	(6)	(14)	**(20)**
Personnel expenses	(1,102)	(6)	**(1,108)**
Depreciation, amortisation and impairment of goodwill	(198)	(3)	**(201)**
Other operating expenses	(1,143)	(12)	**(1,155)**
Share of profits from associates	14		**14**
Profit before income tax	**1,650**	**(51)**	**1,599**
Income tax expense	(304)	-	**(304)**
Profit for the year	**1,346**	**(51)**	**1,295**
Attributable to:			
Equity holders of the parent	1,331	(51)	**1,280**
Non-controlling interest	15	-	**15**
	1,346	**(51)**	**1,295**

Notes to the financial statements (continued)

5 Restatement of comparative information (continued)

Consolidated statement of financial position

As at 31 December 2017

(in HRK million)

Assets	As previously reported	Veneto	Restated
Cash and current accounts with banks	18,711	273	**18,984**
Balances with the Croatian National Bank	4,185	61	**4,246**
Financial assets held for trading	550	-	**550**
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	1	**2,415**
Loans and advances to customers	64,900	269	**65,169**
Investment securities	9,252	79	**9,331**
Investments in subsidiaries and associates	69	-	**69**
Intangible assets	227	-	**227**
Property and equipment	1,360	18	**1,378**
Investment property	8	-	**8**
Non current assets held for sale	342	115	**457**
Deferred tax assets	125	-	**125**
Other assets	724	326	**1,050**
Tax prepayments	22	-	**22**
Total assets	**102,912**	**1,142**	**104,054**

Notes to the financial statements (continued)

5 Restatement of comparative information (continued)

Consolidated statement of financial position (continued)

As at 31 December 2017

(in HRK million)

Liabilities	As previously reported	Veneto	Restated
Current accounts and deposits from banks	1,191	180	**1.371**
Current accounts and deposits from customers	78,157	670	**78,827**
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	33	**3,816**
Subordinated liabilities	1	-	**1**
Other liabilities	2,354	22	**2,376**
Accrued expenses and deferred income	362	1	**363**
Provisions	351	59	**410**
Deferred tax liabilities	86	-	**86**
Current tax liability	6	-	**6**
Total liabilities	**86,313**	**965**	**87,278**
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	1,369	-	**1,369**
Fair value reserve	99	-	**99**
Retained earnings	11,910	(51)	**11,859**
Merger reserve	(1,231)	228	**(1,003)**
Total equity attributable to equity holders of the Bank	**15,548**	**177**	**15,725**
Non-controlling interests	**1,051**	**-**	**1,051**
Total equity	**16,599**	**177**	**16,776**
Total liabilities and equity	**102,912**	**1,142**	**104,054**

Notes to the financial statements (continued)

5 Restatement of comparative information (continued)

Consolidated statement of cash flows

For the year ended 31 December2017

(in HRK million)

	As previously reported	Veneto	Restated
Cash flows from operating activities			
Profit before income tax	1,650	(51)	**1,599**
Impairment losses on loans and advances to customers	823	27	**850**
Other impairment losses and provisions	6	14	**20**
Gain on disposal of property and equipment and intangible assets	(6)	-	**(6)**
Depreciation and amortisation	198	3	**201**
Net gains from securities at fair value through profit or loss	(8)	-	**(8)**
Share of profits from associates	(14)	-	**(14)**
Net interest income	(2,974)	(5)	**(2,979)**
Gain on disposal of associate	-	-	**-**
Net gain on disposal of AFS securities	(53)	-	**(53)**
Dividend income	(6)	-	**(6)**
	(384)	**(12)**	**(396)**
Decrease/(increase) in operating assets			
Balances with the Croatian National Bank	(269)	5	**(264)**
Loans and advances to banks	910	-	**910**
Loans and advances to customers	(166)	339	**173**
Financial assets at fair value through profit or loss and financial assets available for sale	466	100	**566**
Other assets	(310)	(302)	**(612)**
Increase in operating assets	***631***	***142***	**773**
Increase/(decrease) in operating liabilities			
Current accounts and deposits from banks	(403)	(37)	**(440)**
Current accounts and deposits from customers	3,987	(75)	**3,912**
Other liabilities	452	58	**510**
Increase/(decrease) in operating liabilities	***4,036***	***(54)***	**3,982**
Interest received	3,136	8	**3,144**
Interest paid	(643)	(5)	**(648)**
Dividends received	6	-	**6**
Net cash inflow from operating activities before income taxes paid	**6,782**	**79**	**6,861**
Income tax paid	(458)		**(458)**
Net cash from operating activities	**6,324**	**79**	**6,403**

Notes to the financial statements (continued)

5 Restatement of comparative information (continued)

Consolidated statement of cash flows (continued)

For the year ended 31 December 2017

(in HRK million)

	As previously reported	Veneto	Restated
Cash flows from investing activities			
Purchase of property and equipment, intangible assets and investment property	(285)	-	**(285)**
Disposal of property and equipment, intangible assets and investment property	112	2	**114**
Purchase of subsidiary	-	-	**-**
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	-	-	**-**
Net cash used in investing activities	**(1,276)**	**2**	**(1,274)**
Cash flows from financing activities			
Dividends paid to equity holders of the parent	(481)	-	**(481)**
Decrease in interest-bearing borrowings and subordinated liabilities	(450)	(1)	**(451)**
Net cash used in financing activities	**(931)**	**(1)**	**(932)**
Net increase/(decrease) in cash and cash equivalents	**4,117**	**80**	**4,197**
Cash and cash equivalents as at 1 January	16,195	193	**16,388**
Effect of exchange rate fluctuations on cash held	(20)		**(20)**
Cash and cash equivalents as at 31 December	**20,292**	**273**	**20,565**

Notes to the financial statements (continued)

6 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 allowance for credit losses represents management's best estimate of risk of default and ECLs on the financial assets, including any off-balance sheet exposures, at the reporting date 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) Classification of financial assets

Business Model Assessment

The Bank determines its business models based on the objective under which its portfolios of financial assets are managed. Refer to Note 4 L(ii) for details on the Bank's business models. In determining its business models, the Bank considers the following:

- Management's intent and strategic objectives and the operation of the stated policies in practice;
- The primary risks that affect the performance of the business model and how these risks are managed;
- How the performance of the portfolio is evaluated and reported to management; and
- The frequency and significance of financial asset sales in prior periods, the reasons for such sales and the expected future sales activities.

Solely Payments of Principal and Interest Test

In assessing whether contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that they would not be consistent with a basic lending arrangement. In making the assessment, the Group considers the primary terms as follows and assess if the contractual cash flows of the instruments continue to meet the SPPI test:

- Performance-linked features;
- Terms that limit the Bank's claim to cash flows from specified assets (non-recourse terms);
- Prepayment and extension terms;
- Leverage features; and
- Features that modify elements of the time value of money.

b) Impairment of financial assets

Significant Increase in Credit Risk

Criteria for assessing significant increase in credit risk for retail exposures are defined at the appropriate portfolio level and vary based on the exposure's credit risk at origination. The criteria include changes in internal credit risk rating, forbearance measures and delinquency backstop when contractual payments are materially more than 30 days past due Additional criteria that are used for identification of significant increase in credit risk are based on internal assessment (internal watch list) and applied forbearance measures Credit risk has increased significantly since initial recognition when one of the criteria is met.

Significant Increase in Credit Risk for corporate exposures is determined based on internal credit risk rating which is assessed at individual borrower basis using sector-specific credit risk models that are based on historical data. Current and forward-looking information that is specific to the borrower, industry, and sector is considered based on expert credit judgment. Criteria for assessing significant increase in credit risk are defined at the appropriate segmentation level and vary based on the internal credit risk rating of the exposure at origination. Criteria include relative changes in internal credit risk rating and delinquency backstop when contractual payments are more than 30 days past due. Credit risk has increased significantly since initial recognition when one of the criteria is met.

Notes to the financial statements (continued)

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

b) *Impairment of financial assets (continued)*

Measurement of Expected Credit Loss

Expected credit losses are calculated as the product of PD, loss given default (LGD), and exposure at default (EAD) over the remaining expected life of the financial asset and discounted to the reporting date at the effective interest rate for exposures with significant increase in credit risk (i.e. stage 2 contracts). On the other hand, for exposures classified as stage 1, expected credit loss is calculated over 1 year horizon, i.e. 1 year expected credit loss is estimated. PD estimates represent the point-in-time PD, updated on a yearly basis based on the group’s historical experience, current conditions, and relevant forward-looking expectations. LGD estimates are determined based on historical recovery payments. EAD incorporates forward-looking expectations about repayments of drawn balances and expectations about future draws where applicable.

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, (2017: corporate exposure with total balance exceeding HRK 3,8 million) and collectively for assets that are not individually significant (retail exposures and corporate exposures below threshold of HRK 3,8 million).

Impairment allowance on assets individually assessed as credit-impaired (2017: impaired) 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 separately, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Forward-Looking Information

In calculating the ECL, the Group employs internally developed models that utilize parameters for PD, LGD, and EAD. Forward-looking macroeconomic factors determined at the regional level are incorporated in the risk parameters as relevant. Additional risk factors that are segment specific are also incorporated, where relevant.

The measurement of the financial assets also reflects the best estimate of the effects of future conditions and in particular the economic conditions that affect the forward-looking PDs and LGDs.

In terms of method, various possible alternative approaches designed to take account of these elements have been analysed. Of the various alternatives considered, the Group has decided to adopt the “Most likely scenario+Add-on” approach. According to this approach, the macroeconomic conditioning of PD and LGD is carried out through a baseline scenario (“Most Likely”) and then corrected with an Add-On to include any differences compared to downside and upside scenarios.

Expected Credit Losses

ECLs are recognized on initial recognition of the financial assets. Allowance for credit losses represents management's best estimate of risk of default and ECLs on the financial assets, including any off-balance sheet exposures, at the reporting date.

Management's judgment is used to determine the point within the range that is the best estimate for the qualitative component contributing to ECLs, based on an assessment of business and economic conditions, historical loss experience, loan portfolio composition, and other relevant indicators and forward-looking information. 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. Changes in these assumptions would have a direct impact on the provision for credit losses and may result in a change in the allowance for credit losses.

c) *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*.

Notes to the financial statements (continued)

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

d) 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 28.

e) 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. 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.

f) Taxation

The Group provides for tax liabilities in accordance with the tax laws of the Republic of Croatia and other jurisdictions (Slovenia and Bosnia and Hercegovina). Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayers' records. Deferred tax assets are recognised only when it is probable that sufficient taxable profit will be available in future periods against which deductible temporary differences may be utilized..

g) 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.

h) 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 39a the Group and the Bank provided HRK 85 million (2017: HRK 59 million) and HRK 54 million (2017: HRK 32 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.

i) 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.

j) 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.

Notes to the financial statements (continued)

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

k) 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.

Impairment of financial assets prior to 1 January 2018 under IAS 39

l) 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.

m) 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.

n) 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. A loan, including a debt security classified as a loan, was considered impaired when there was objective evidence that there had been a deterioration of credit quality subsequent to the initial recognition of the loan to the extent the Bank no longer had reasonable assurance as to the timely collection of the full amount of principal and interest.

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, (2017: 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.

Notes to the financial statements (continued)

7 Net interest income

a) Interest income – analysis by source

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Retail	2,010	2,014	1,602	1,625
Corporate	840	967	572	678
Public sector and other institutions	329	483	267	421
Banks	53	44	37	24
	3,232	**3,508**	**2,478**	**2,748**

b) Interest income– analysis by financial assets category

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Loans and advances to customers	3,004	3,252	2,365	2,614
Investment securities at amortized cost (2017: debt securities classified as loans and receivables)	27	39	27	38
Loans and advances to banks	34	23	34	23
Held-to-maturity investments	-	1	-	-
Investment securities at FVOCI (2017: available for sale)	75	78	29	23
Derivatives - hedge accounting	11	12	-	-
Total interest income calculated using the effective interest rate	**3,151**	**3,405**	**2,455**	**2,698**

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Finance lease	51	53	-	-
Financial assets initially designated at fair value through profit or loss	7	31	-	31
Financial assets held for trading	23	19	23	19
Total other interest income	**81**	**103**	**23**	**50**

Interest income includes collected interest income from credit impaired loans of the Group of HRK 123 million (2017 impaired: HRK 168 million) and of the Bank of HRK 80 million (2017 impaired: HRK 97 million).

Notes to the financial statements (continued)

7 Net interest income (continued)

c) Interest expense – analysis by recipient

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Retail	249	355	172	266
Banks	131	126	76	75
Corporate	21	27	12	18
Public sector and other institutions	18	21	11	15
	419	**529**	**271**	**374**

d) Interest expense – analysis by product

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Current accounts and deposits from retail customers	229	355	173	266
Interest-bearing borrowings	76	69	34	43
Current accounts and deposits from corporate customers and public sector	38	48	25	33
Current accounts and deposits from banks	41	29	39	32
Derivative assets held for hedge accounting	35	28	-	-
	419	**529**	**271**	**374**

Notes to the financial statements (continued)

8 Net fee and commission income

a) Fee and commission income

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Credit cards	931	892	129	122
Payment transactions	513	481	411	381
Customer services	191	178	94	87
Investment banking fees	122	84	79	42
Guarantees	58	59	40	42
Investment management, brokerage and consultancy	48	48	44	44
Other	97	108	83	93
	1,960	**1,850**	**880**	**811**

b) Fee and commission expense

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Credit cards	279	247	97	82
Payment transactions	54	52	28	28
Bank charges	15	13	9	8
Other	40	36	14	8
	388	**348**	**148**	**126**

9 Dividend income

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Dividends from subsidiaries	-	-	36	431
Dividends from associates	-	-	14	12
Dividends from other equity securities	3	6	1	2
	3	**6**	**51**	**445**

Notes to the financial statements (continued)

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

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Foreign exchange spot trading	261	212	244	204
Net gains/(losses) from translation of monetary assets and liabilities denominated in foreign currency	12	71	7	52
Net trading (expense)/income from forward foreign exchange contracts and swaps	14	(50)	14	(50)
Net gains on financial assets held for trading	6	21	6	21
Net gains from securities initially designated at fair value through profit or loss	57	(13)	(6)	(12)
	350	**241**	**265**	**215**

11 Fair value adjustments in hedge accounting

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Net effect on derivatives used as hedging instruments	(35)	21	-	-
Net effect on hedged items	35	(22)	-	-
	-	**(1)**	-	-

12 Other operating income

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Rental income from investment property and assets under operating lease	47	66	2	3
Net gain on sale of debt investment securities measured at FVOCI (2017: Available for sale)	20	53	20	16
Gain on disposal of property and equipment, intangible assets and investment property	15	6	3	3
Other income	60	67	62	62
Net value adjustment from valuation of property	-	-	-	12
	142	**192**	**87**	**96**

Notes to the financial statements (continued)

13 Personnel expenses

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Net salaries	575	584	373	385
Contributions for pension insurance	156	157	106	109
Taxes and surtaxes	111	116	74	80
Contributions for health insurance	110	114	79	83
Other personnel expenses	202	137	129	73
	1,154	**1,108**	**761**	**730**

During the year the average number of employees within the Group based on full-time employment equivalence was 4,874 (2017: 5,015) of which the Bank accounted for 3,377 (2017: 3,395) employees.

14 Other operating expenses

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Materials and services	473	454	362	360
Deposit insurance premium	160	149	129	121
Rental expenses	78	69	70	68
Indirect and other taxes	19	19	15	14
Other expenses	476	464	132	121
	1,206	**1,155**	**708**	**684**

15 Impairment losses

a) Net impairment losses on loans and advances to customers

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Impairment losses on loans and advances to customers at amortised cost	336	823	202	589
Legal expenses related to loans and advances to customers	35	27	19	19
	371	**850**	**221**	**608**

Notes to the financial statements (continued)

15 Impairment losses (continued)

b) Other impairment losses and provisions

(in HRK million)

	Notes	GROUP 2018	GROUP Restated 2017	BANK 2018	BANK 2017
Provisions/(release of provisions) for loans and advances to banks	25	2	(13)	2	(13)
Release of provisions for CNB		(10)	-	(10)	-
Movement in impairement loss on financial assets FVOCI	49	(26)	-	(13)	-
Movement in impairement loss on investment securities at amortized cost	49	(8)	-	(7)	-
Movement in impairment losses on other assets	32	26	17	20	13
Provisions for off-balance-sheet items	39	23	(2)	14	8
(Release of provisions)/Provisions for court cases	39	(5)	4	4	(5)
Provisions for other items	39	62	12	43	(2)
Provision for retirement benefit obligations	39	2	2	-	-
		66	**20**	**53**	**1**

16 Depreciation, amortisation and impairment of goodwill

(in HRK million)

	Notes	GROUP 2018	GROUP Restated 2017	BANK 2018	BANK 2017
Depreciation and impairment of property and equipment	29	103	124	55	62
Amortisation of intangible assets	28	84	71	67	54
Impairment of goodwill	28	15	-	-	-
Depreciation and impairment of investment property	30	1	6	-	2
		203	**201**	**122**	**118**

Depreciation of property and equipment includes HRK 26 million of depreciation of assets under operating lease (2017: HRK 36 million).

Notes to the financial statements (continued)

17 Income tax expense

a) Income tax expense recognised in the income statement

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Current income tax charge	199	292	113	222
Net deferred tax charge	(25)	12	(16)	9
Income tax expense recognised in the income statement	**174**	**304**	**97**	**231**

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	
	2018	Restated 2017	2018	2017
Accounting profit before tax	**1,894**	**1,599**	**1,477**	**1,674**
Tax calculated at rate of 18%	341	288	266	301
Effect of different tax rates in Bosnia and Herzegovina	(23)	(8)	-	-
Effect of different tax rates in Slovenia	2	(1)	-	-
Tax effects of:				
Non-deductible expenses	39	42	9	11
Tax exempt income	(15)	(16)	(9)	(80)
Recognition of FTA effect as tax deductible expense	(119)	-	(119)	-
Recognition of tax assets from tax loss in earlier years, acquired on merger of Veneto Banka	(49)	-	(49)	-
Expenses/income included directly in income tax expense	(2)	(1)	(1)	(1)
Total income tax expense	**174**	**304**	**97**	**231**
Effective income tax rate	**9.2%**	**19.0%**	**6.6%**	**13.8%**

Notes to the financial statements (continued)

17 Income tax expense (continued)

c) Deferred tax assets

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Timing differences				
On unrealised losses on financial assets at fair value through profit or loss	31	38	37	38
On impairment of loans	30	31	-	-
On deferred fees	19	24	18	22
On impairment of real estate	10	9	7	6
On unrealised losses on available-for-sale financial assets	2	2	-	-
On other items	50	21	33	13
Deferred tax assets	**142**	**125**	**95**	**79**

d) Deferred tax liabilities

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Timing differences				
On unrealised gains on tangible assets	51	51	19	19
On unrealised gains on available-for-sale financial assets	20	35	13	11
Deferred tax liabilities	**71**	**86**	**32**	**30**

Notes to the financial statements (continued)

17 Income tax expense (continued)

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 2018	**125**	**24**	**9**	**38**	**2**	**21**	**31**
Increase credited to income statement	***73***	*8*	*2*	*2*	-	*61*	-
Utilisation charged to income statement	***(48)***	*(13)*	*(1)*	*(3)*	-	*(30)*	*(1)*
Net amount charged to income statement	**25**	(5)	1	(1)	-	31	(1)
Transfer to deferred tax liabilities	**(8)**	-	-	(6)	-	(2)	-
Balance as at 31 December 2018	**142**	**19**	**10**	**31**	**2**	**50**	**30**
Balance as at 1 January 2017, restated	**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)
Transfer to deferred tax liabilities	-	-	-	-	-	-	-
Balance as at 31 December 2017, restated	**125**	**24**	**9**	**38**	**2**	**21**	**31**

Notes to the financial statements (continued)

17 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 2018	**79**	**22**	**6**	**38**	**13**
Increase credited to income statement	***52***	*9*	*2*	*2*	*39*
Utilisation charged to income statement	***(36)***	*(13)*	*(1)*	*(3)*	*(19)*
Net amount charged to income statement	**16**	(4)	1	(1)	20
Transfer to deferred tax liabilities	**-**	-	-	-	-
Balance as at 31 December 2018	***95***	***18***	***7***	***37***	***33***
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)	-
Transfer to deferred tax liabilities	**-**	-	-	-	-
Balance as at 31 December 2017	**79**	**22**	**6**	**38**	**13**

Notes to the financial statements (continued)

17 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 2018	**86**	**35**	**51**
FTA effect	**4**	4	**-**
Increase credited to comprehensive income	**(11)**	(11)	**-**
Transfer from DTA	**(8)**	(8)	-
Balance as at 31 December 2018	**71**	**20**	**51**
Balance as at 1 January 2017, restated	**33**	**33**	**-**
Increase credited to comprehensive income	53	2	51
Balance as at 31 December 2017, restated	**86**	**35**	**51**

Bank

	Total	Unrealised gains on available-for-sale financial assets	Unrealised gains on tangible assets
Balance as at 1 January 2018	**30**	**11**	**19**
FTA effect	**4**	4	-
Increase credited to comprehensive income	**(2)**	(2)	-
Balance as at 31 December 2018	**32**	**13**	**19**
Balance as at 1 January 2017	**5**	**5**	**-**
Increase credited to comprehensive income	25	6	19
Balance as at 31 December 2017	**30**	**11**	**19**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities

a) Classification of financial assets and financial liabilities

GROUP **(in HRK million)**

As at 31 December 2018	Mandatorily at FVTPL	Designated at FVTPL	FVOCI - debt instruments	FVOCI - equity instruments	Amortised cost	Total carrying amount
Cash and current accounts with banks	-	-	-	-	18,442	**18,442**
Balances with the Croatian National Bank	-	-	-	-	4,698	**4,698**
Financial assets held for trading	828	-	-	-	-	**828**
Derivative financial assets	10	-	-	-	-	**10**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	-	-	-	-	**9**
Loans and advances to banks	-	-	-	-	7,784	**7,784**
Loans and advances to customers	6	-	-	-	66,682	**66,688**
Investment securities	54	-	9,795	168	540	**10,557**
Total financial assets	**907**	**-**	**9,795**	**168**	**98,146**	**109,016**
Current accounts and deposits from banks	-	-	-	-	1,843	**1,843**
Current accounts and deposits from customers	-	-	-	-	85,938	**85,938**
Derivative financial liabilities	34	-	-	-	-	**34**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	-	-	-	-	**4**
Interest-bearing borrowings	-	-	-	-	4,160	**4,160**
Total financial liabilities	**38**	**-**	**-**	**-**	**91,941**	**91,979**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

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

BANK **(in HRK million)**

As at 31 December 2018	Mandatorily at FVTPL	Designated at FVTPL	FVOCI - debt instruments	FVOCI - equity instruments	Amortised cost	Total carrying amount
Cash and current accounts with banks	-	-	-	-	14,180	**14,180**
Balances with the Croatian National Bank	-	-	-	-	4,698	**4,698**
Financial assets held for trading	828	-	-	-	-	**828**
Derivative financial assets	1	-	-	-	-	**1**
Loans and advances to banks	-	-	-	-	6,869	**6,869**
Loans and advances to customers					45,457	**45,457**
Investment securities	36	-	6,745	62	531	**7,374**
Total financial assets	**865**	**-**	**6,745**	**62**	**71,735**	**79,407**
Current accounts and deposits from banks	-	-	-	-	1,480	**1,480**
Current accounts and deposits from customers	-	-	-	-	63,042	**63,042**
Derivative financial liabilities	4	-	-	-	-	**4**
Interest-bearing borrowings	-	-	-	-	3,032	**3,032**
Total financial liabilities	**4**	**-**	**-**	**-**	**67,554**	**67,558**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

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

GROUP **(in HRK million)**

As at 31 December 2017 (re-stated)	Trading	Desig-nated at FVTPL	Held to maturity	Loans and receivables	Availa-ble for sale	Other amortised cost	Total carrying amount
Cash and current accounts with banks	-	-	-	18,984	-	-	**18,984**
Balances with the Croatian National Bank	-	-	-	4,246	-	-	**4,246**
Financial assets held for trading	550	-	-	-	-	-	**550**
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	-	-	-	2,415	-	-	**2,415**
Loans and advances to customers	-	-	-	65,169	-	-	**65,169**
Investment securities	-	1,663	16	-	7,652	-	**9,331**
Total financial assets	**573**	**1,663**	**16**	**90,814**	**7,652**	**-**	**100,718**
Current accounts and deposits from banks	-	-	-	-	-	1,371	**1,371**
Current accounts and deposits from customers	-	-	-	-	-	78,827	**78,827**
Derivative financial liabilities	13	-	-	-	-	-	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	-	-	-	-	-	**9**
Interest-bearing borrowings	-	-	-	-	-	3,816	**3,816**
Subordinated liabilities	-	-	-	-	-	1	**1**
Total financial liabilities	**22**	**-**	**-**	**-**	**-**	**84,015**	**84,037**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

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

BANK **(in HRK million)**

As at 31 December 2017	Trading	Desig-nated at FVTPL	Held to maturity	Loans and receivables	Availa-ble for sale	Other amortised cost	Total carrying amount
Cash and current accounts with banks	-	-	-	15,466	-	-	**15,466**
Balances with the Croatian National Bank	-	-	-	4,185	-	-	**4,185**
Financial assets held for trading	550	-	-	-	-	-	**550**
Derivative financial assets	2	-	-	-	-	-	**2**
Loans and advances to banks	-	-	-	1,493	-	-	**1,493**
Loans and advances to customers	-	-	-	44,562	-	-	**44,562**
Investment securities	-	1,660	-	-	4,145	-	**5,805**
Total financial assets	**552**	**1,660**	**-**	**65,706**	**4,145**	**-**	**72,063**
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 financial liabilities	**7**	**-**	**-**	**-**	**-**	**60,614**	**60,621**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as of 1 January 2018.

GROUP **(in HRK million)**

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 (restated)	New carrying amount under IFRS 9
Financial assets				
Cash and current accounts with banks	Loans and receivables	Amortised cost	18,984	18,997
Balances with the Croatian National Bank	Loans and receivables	Amortised cost	4,246	4,234
Trading assets	FVTPL	FVTPL (mandatory)	550	550
Derivatives	FVTPL	FVTPL (mandatory)	23	23
Loans and advances to banks	Loans and receivables	Amortised cost	2,415	2,431
Loans and advances to customers	Loans and receivables)	FVTPL (mandatory)	142	135
Loans and advances to customers	Loans and receivables	Amortised cost	64,276	63,467
Investment securities – debt	Loans and receivables -	FVOCI	26	26
Investment securities – debt	FVTPL (designated)	FVOCI	1,662	1,659
Investment securities – debt	Held-to-maturity investments	FVOCI	16	17
Investment securities – debt	Available for sale	Amortised cost	11	10
Investment securities – debt	Loans and receivables	Amortised cost	725	723
Investment securities – debt	Available for sale	FVOCI	7,430	7,430
Investment securities – equity	FVTPL (designated)	FVTPL (mandatory)	1	1
Investment securities – equity	Available for sale	FVTPL (mandatory)	63	63
Investment securities – equity	Available for sale	FVOCI	148	148
Total financial assets			**100,718**	**99,914**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as of 1 January 2018.

GROUP **(in HRK million)**

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 (restated)	New carrying amount under IFRS 9
Financial liabilities and provisions				
Derivative liabilities	FVTPL	FVTPL (held for trading)	22	22
Deposits from banks	Amortised cost	Amortised cost	1,371	1,371
Deposits from customers	Amortised cost	Amortised cost	78,827	78,827
Interest – bearing borrowings	Amortised cost	Amortised cost	3,816	3,816
Subordinated liabilities	Amortised cost	Amortised cost	1	1
Provisions			410	475
Total financial liabilities and provisions			**84,447**	**84,512**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as of 1 January 2018.

BANK **(in HRK million)**

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets				
Cash and current accounts with banks	Loans and receivables	Amortised cost	15,466	15,478
Balances with the Croatian National Bank	Loans and receivables	Amortised cost	4,185	4,173
Trading assets	FVTPL	FVTPL (mandatory)	550	550
Derivative assets	FVTPL	FVTPL (mandatory)	2	2
Loans and advances to banks	Loans and receivables	Amortised cost	1,493	1,509
Loans and advances to customers	Loans and receivables	Amortised cost	43,837	43,212
Investment securities – debt	Loans and receivables	Amortised cost	725	723
Investment securities – debt	FVTPL (designated)	FVOCI	1,659	1,659
Investment securities – debt	Available for sale	FVOCI	4,053	4,053
Investment securities – equity	FVTPL (designated)	FVTPL (mandatory)	1	1
Investment securities – equity	Available for sale	FVTPL (mandatory)	45	45
Investment securities – equity	Available for sale	FVOCI	47	47
Total financial assets			**72,063**	**71,452**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as of 1 January 2018.

BANK **(in HRK million)**

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial liabilities and provisions				
Derivative liabilities	FVTPL	FVTPL (held for trading)	7	7
Deposits from banks	Amortised cost	Amortised cost	1,064	1,064
Deposits from customers	Amortised cost	Amortised cost	57,173	57,173
Interest – bearing borrowings	Amortised cost	Amortised cost	2,377	2,377
Subordinated liabilities	Amortised cost	Amortised cost	-	-
Provisions			249	300
Total financial liabilities and provisions			**60,870**	**60,921**

The Group's accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 4, The application of these policies resulted in the reclassifications set out in the table above and explained below.

a) Certain loans and advances to customers held by the Group are classified under IFRS 9 as mandatorily measured at FVTPL because it was determined that the contractual cash flows are not solely payments of principal and interest. Before the adoption of IFRS 9, these loans and advances to customers were measured at amortised cost.

b) Before the adoption of IFRS 9, certain trading assets and investment securities were reclassified out of the FVTPL and available-for-sale categories to loans and advances. On the adoption of IFRS 9, the carrying amount of those assets was adjusted so that their amortised cost under IFRS 9 was as if those assets were accounted for at amortised cost from their inception.

c) Before the adoption of IFRS 9, certain investment securities were designated as at FVTPL because the securities were managed, evaluated and reported internally on fair value basis. Under IFRS 9, these assets meet the criteria for FVOCI portfolio because they are held within a business model whose objective is achieved by both collecting the contractual cash flows and selling.

d) Certain debt securities are held by the Central Treasury in separate portfolios to meet everyday liquidity needs. The Group Central Treasury seeks to minimise the costs of managing these liquidity needs and therefore actively manages the return on the portfolio. That return consists of collecting contractual payments as well as gains and losses from the sale of financial assets. The investment strategy often results in sales activity that is significant in value. The Group considers that under IFRS 9 these securities are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets

e) Certain equity investments held by the Group for strategic purposes have been designated under IFRS 9 as at FVOCI.

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 as of 1 January 2018.

GROUP **(in HRK million)**

	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets				
Amortised cost				
Cash , current accounts and balances with CNB:				
Opening balance	23,230	-	-	23,230
Closing balance	**23,230**	**-**	**-**	**23,230**
Loans and advances to banks:				
Opening balance under IAS 39 and closing balance under IFRS 9	2,415	-	16	2,431
Closing balance	**2,415**	**-**	**16**	**2,431**
Loans and advances to customers:				
Opening balance	65,169	(893)	-	64,276
Remeasurement	-	-	(809)	(809)
Closing balance	**65,169**	**(893)**	**(809)**	**63,467**
Investment securities:				
Opening balance	-	-	-	-
From loans and advances to customers	-	725	(2)	723
From available-for-sale	-	11	(1)	10
Remeasurement	-	-	-	-
Closing balance	**-**	**736**	**(3)**	**733**
Total amortised cost	**90,814**	**(157)**	**(796)**	**89,861**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 as of 1 January 2018.

GROUP **(in HRK million)**

	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets				
Available-for-sale				
Investment securities:				
Opening balance	7,652	-	-	7,652
To FVOCI – equity	-	(148)	-	(148)
To FVOCI – debt	-	(7,430)	-	(7,430)
To FVTPL	-	(63)	-	(63)
To amortised cost	-	(11)	-	(11)
Closing balance	**7,652**	**(7,652)**	**-**	**-**
FVOCI – debt				
Investment securities:				
Opening balance	-	-	-	-
From loans and receivables	-	26	-	26
From available-for-sale	-	7,430	-	7,430
From HTM	-	16	1	17
From FVTPL	-	1,662	(3)	1,659
Closing balance	**-**	**9,134**	**(2)**	**9,132**
FVOCI – equity				
Investment securities:				
Opening balance	**-**	**-**	**-**	**-**
From available-for-sale	**-**	**148**	**-**	**148**
Closing balance	**-**	**148**	**-**	**148**
Total FVOCI	-	**9,282**	**(2)**	**9,280**
FVTPL				
Financial assets held for trading	550	-	-	550
Derivative assets held for risk management	23	-	-	23
Loans and advances to customers	142	-	(7)	135
Investment securities:				
Opening balance	1,662	-	-	1,662
From available-for-sale	-	63	-	63
To FVOCI	-	(1,662)	3	(1,659)
Closing balance	**2,377**	**(1,599)**	**(4)**	**774**
Total FVTPL	**2,377**	**(1,599)**	**(4)**	**774**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 as of 1 January 2018.

BANK				**(in HRK million)**
	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets				
Amortised cost				
Cash, current accounts with banks and balances with CNB:				
Opening balance	**19,651**	**-**	**-**	**19,651**
Remeasurement	-	-	-	-
Closing balance	**19,651**	**-**	**-**	**19,651**
Loans and advances to banks:				
Opening balance	1,493	-	16	1,509
Closing balance	**1,493**	**-**	**16**	**1,509**
Loans and advances to customers:				
Opening balance	44,562	(725)	-	43,837
Remeasurement	-	-	(625)	(625)
Closing balance	**44,562**	**(725)**	**(625)**	**43,212**
Investment securities:				
Opening balance	-	-	-	-
From loans and advances to customers	-	725	(2)	723
Closing balance	**-**	**725**	**(2)**	**723**
Total amortised cost	**65,706**	**-**	**(611)**	**65,095**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 as of 1 January 2018.

BANK **(in HRK million)**

	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018
Financial assets				
Available-for-sale				
Investment securities:				
Opening balance	4,145	-	-	**4,145**
To FVOCI – equity	-	(47)	-	**(47)**
To FVOCI – debt	-	(4,053)	-	**(4,053)**
To FVTPL	-	(45)	-	**(45)**
Closing balance	**4,145**	**(4,145)**	**-**	**-**
FVOCI – debt				
Investment securities:				
Opening balance	-	-	-	**-**
From available-for-sale	-	4,053	-	**4,053**
From FVTPL	-	1,659		**1,659**
Closing balance	**-**	**5,712**	**-**	**5,712**
FVOCI – equity				
Investment securities:				
Opening balance	-	-	-	-
From available-for-sale	-	47	-	**47**
Closing balance	**-**	**47**	**-**	**47**
Total FVOCI	**-**	**5,759**	-	**5,759**
FVTPL				
Financial assets held for trading	550	-	-	**550**
Derivative assets held for risk management	2	-	-	**2**
Loans and advances to customers	-	-	-	**-**
Investment securities:				
Opening balance	1,660	-	-	**1,660**
From available-for-sale	-	45	-	**45**
To FVOCI	-	(1,659)	-	**(1,659)**
Closing balance	**2,212**	**(1,614)**	**-**	**598**
Total FVTPL	**2,212**	**(1,614)**	**-**	**598**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table analyses the impact, net of tax, of transition to IFRS 9 on reserves and retained earnings. The impact relates to the fair value reserve, retained earnings and non-controlling interest. There is no impact on other components of equity.

GROUP	(in HRK million)
	Impact of adopting IFRS 9 at 1 January 2018
Fair value reserve	
Closing balance under IAS 39 (31 December 2017)	99
Reclassification of investment securities (debt) from available-for-sale to amortised cost	(1)
Reclassification of investment securities (debt and equity) from available-for-sale to FVTPL	(19)
Reclassification of investment securities (debt) from amortised cost to FVOCI	16
Reclassification of investment securities (debt) from FV to FVOCI	6
Recognition of expected credit losses under IFRS 9 for debt financial assets at FVOCI	32
Opening balance under IFRS 9 (1 January 2018)	**133**
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	11,859
Reclassifications under IFRS 9	(3)
Recognition of expected credit losses under IFRS 9 (including lease receivables, loan commitments and financial guarantee contracts)	(886)
Opening balance under IFRS 9 (1 January 2018)	**10,970**

Non- controlling interest	
Closing balance under IAS 39	1,051
Recognition of expected credit loss under IFRS 9	(15)
	1,036

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table analyses the impact, net of tax, of transition to IFRS 9 on reserves and retained earnings. The impact relates to the fair value reserve and retained earnings. There is no impact on other components of equity.

BANK	(in HRK million)
	Impact of adopting IFRS 9 at 1 January 2018
Fair value reserve	
Closing balance under IAS 39 (31 December 2017)	49
Reclassification of investment securities (debt) from available-for-sale to amortised cost	-
Reclassification of investment securities (debt and equity) from available-for-sale to FVTPL	(6)
Reclassification of investment securities (debt) from amortised cost to FVOCI	1
Reclassification of investment securities (debt) from FV to FVOCI	4
Reclassification of investment securities (equity) measured at cost from available-for-sale to FVOCI	-
Recognition of expected credit losses under IFRS 9 for debt financial assets at FVOCI	22
Opening balance under IFRS 9 (1 January 2018)	**70**
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	10,009
Reclassifications under IFRS 9	-
Recognition of expected credit losses under IFRS 9 (including lease receivables, loan commitments and financial guarantee contracts)	(684)
Opening balance under IFRS 9 (1 January 2018)	**9,325**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as of 1 January 2018.

GROUP **(in HRK million)**

	31 December 2017 (IAS 39/ IAS 37)	Reclassification	Remeasurement	1 January 2018 (IFRS 9)
Loans and receivables and held to maturity securities under IAS 39/financial assets at amortised cost under IFRS 9 (includes cash and cash equivalents, loans and advances to banks and loans and advances to customers)	3,883	(117)	792	4,558
Available-for-sale debt investment securities under IAS 39 reclassified to amortised cost under IFRS 9	-	-	-	-
	3,883	**(117)**	**792**	**4,558**
Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9	-	-	32	32
Loan commitments and financial guarantee contracts	251	-	65	316
Total	**4,134**	**(117)**	**889**	**4,906**

Notes to the financial statements (continued)

18 Financial assets and financial liabilities (continued)

b) Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

The following table reconciles:

- the closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2017; to
- the opening ECL allowance determined in accordance with IFRS 9 as of 1 January 2018.

BANK **(in HRK million)**

	31 December 2017 (IAS 39/ IAS 37)	Reclassification	Remeasurement	1 January 2018 (IFRS 9)
Loans and receivables and held to maturity securities under IAS 39/financial assets at amortised cost under IFRS 9 (includes cash and current accounts with banks, loans and advances to banks and loans and advances to customers)	2,655	-	611	3,266
Available-for-sale debt investment securities under IAS 39 reclassified to amortised cost under IFRS 9	-	-	-	-
	2,655	**-**	**611**	**3,266**
Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9	-	-	22	22
Loan commitments and financial guarantee contracts issued	215	-	51	266
Total	**2,870**	**-**	**684**	**3,554**

Notes to the financial statements (continued)

19 Cash and current accounts with banks

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Current accounts with the CNB	9,678	11,911	9,678	11,694
Current accounts with foreign banks	5,525	4,422	2,727	2,139
Cash in hand	3,218	2,610	1,770	1,616
Current accounts with domestic banks	20	39	4	15
Other cash items	1	2	1	2
	18,442	**18,984**	**14,180**	**15,466**

20 Balances with the Croatian National Bank

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Obligatory reserve	4,698	4,246	4,698	4,185
	4,698	**4,246**	**4,698**	**4,185**

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 2018 amounted to 12% (2017: 12%) of kuna and foreign currency deposits and borrowings.

As at 31 December 2018, the required rate for the part of the obligatory reserve calculated based on kuna liabilities to be deposited with the CNB amounted to 70% (2017: 70%), while the remaining 30% (2017: 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 (2017: 0%), but it must be held in the form of other liquid receivables, 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. 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 2018 (2017: nil).

Notes to the financial statements (continued)

21 Investment securities

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Investment securities mandatorily measured at FVTPL	54	-	36	-
Investment securities designated as at FVTPL	-	1,663	-	1,660
Investment securities measured at amortised cost	540	-	531	-
Investment securities measured at FVOCI – debt instruments	9,795	-	6,745	-
Investment securities designated as at FVOCI – equity investments	168	-	62	-
Held-to-maturity investment securities	-	16	-	-
Available-for-sale investment securities	-	7,652	-	4,145
	10,557	**9,331**	**7,374**	**5,805**

a) Investment securities mandatorily measured at FVTPL

(in HRK million)

	GROUP	BANK
	2018	2018
Equity securities	54	36
	54	**36**

b) Investment securities measured at amortised cost

(in HRK million)

	GROUP	BANK
	2018	2018
Corporate bonds	9	-
Debt securities	531	531
	540	**531**

Notes to the financial statements (continued)

21 Investment securities (continued)

c) Investment securities measured at FVOCI – debt instruments

(in HRK million)

	GROUP	BANK
	2018	2018
Republic of Croatia bonds	1,712	895
Treasury bills	5,854	5,850
Foreign government treasury bills	1,996	-
Foreign government bonds	233	-
	9,795	**6,745**

d) Investment securities measured at FVOCI – equity investments

(in HRK million)

	GROUP	BANK
	2018	2018
Listed securities	2	1
Unlisted securities	166	61
	168	**62**

e) Held to maturity investment securities

(in HRK million)

	GROUP	BANK
	Restated 2017	2017
Republic of Croatia bonds	16	-
	16	**-**

f) Available for sale investment securities

(in HRK million)

	GROUP	BANK
	Restated 2017	2017
Debt securities	7,441	4,053
Equity securities	131	92
Investment in National Bank Resolution Fund	80	-
	7,652	**4,145**

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

Notes to the financial statements (continued)

21 Investment securities (continued)

f) Available for sale investment securities (continued)

Available-for-sale debt securities

(in HRK million)

	GROUP	BANK
	Restated 2017	2017
Corporate debt securities	11	-
Bank debt securities	21	-
Republic of Croatia bonds	1,451	674
Domestic treasury bills	3,444	3,369
Foreign government treasury bills	301	-
Foreign government bonds	2,178	-
	7,406	**4,043**
Accrued interest	35	10
	7,441	**4,053**
Listed securities	3,927	679
Unlisted securities	3,514	3,374
	7,441	**4,053**

Notes to the financial statements (continued)

21 Investment securities (continued)

f) Available for sale investment securities (continued)

Available-for-sale equity securities

	GROUP	BANK
	(in HRK million)	
	Restated 2017	2017
Listed securities	35	28
Unlisted securities	96	64
	131	**92**

Unquoted equity securities carried at cost

	GROUP	BANK
	(in HRK million)	
	Restated 2017	2017
Cost/fair value at acquisition	23	20
Impairment losses	-	-
	23	**20**

Financial assets initially designated at fair value through profit or loss

	GROUP	BANK
	(in HRK million)	
	Restated 2017	2017
Financial assets initially designated at fair value through profit or loss		
Ministry of Finance treasury bills	1,652	1,652
Equity securities	4	1
Accrued interest	7	7
	1,663	**1,660**
Listed securities	*4*	*1*
Unlisted securities	*1,659*	*1,659*
	1,663	**1,660**

Notes to the financial statements (continued)

22 Financial assets held for trading

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Financial assets held for trading				
Republic of Croatia bonds	817	524	817	524
Equity securities	-	20	-	20
Domestic corporate bonds	-	-	-	
Accrued interest	11	6	11	6
Financial assets held for trading	**828**	**550**	**828**	**550**
Listed securities	*828*	*550*	*828*	*550*
	828	**550**	**828**	**550**

Notes to the financial statements (continued)

23 Derivative financial assets

a) Derivative financial assets classified as held for trading

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Fair value:				
Forward foreign exchange contracts and swaps	2	3	1	2
Interest rate cap	-	1	-	-
	2	**4**	**1**	**2**
Notional amount:				
Forward foreign exchange contracts and swaps	769	1,463	768	1,426
Interest rate cap	29	37	-	-
	798	**1,500**	**768**	**1,426**

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)

23 Derivative financial assets (continued)

b) Derivative financial assets held for hedge accounting

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Fair value:				
Interest rate swaps - micro hedge	3	10	-	-
Interest rate swaps - macro hedge	5	8	-	-
	8	**18**	**-**	**-**
Notional amount:				
Interest rate swaps - micro hedge	120	1,400	-	-
Interest rate swaps - macro hedge	291	431	-	-
	411	**1,831**	**-**	**-**

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	
	2018	Restated 2017	2018	2017
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	1	-	-
	9	**1**	**-**	**-**

Notes to the financial statements (continued)

24 Derivative financial liabilities

a) Derivative financial liabilities classified as held for trading

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Fair value:				
Forward foreign exchange contracts and swaps	4	8	4	7
	4	**8**	**4**	**7**
Notional amount:				
Forward foreign exchange contracts and swaps	767	1,467	767	1,431
	767	**1,467**	**767**	**1,431**

b) Derivative financial liabilities held for hedge accounting

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Fair value:				
Interest rate swaps - micro hedge	21	4	-	-
Interest rate swaps - macro hedge	9	1	-	-
	30	**5**	**-**	**-**
Notional amount:				
Interest rate swaps - micro hedge	2,022	378	-	-
Interest rate swaps - macro hedge	761	304	-	-
	2,783	**682**	**-**	**-**

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

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	9	-	-
	4	**9**	**-**	**-**

Notes to the financial statements (continued)

25 Loans and advances to banks

a) Analysis by type of product

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Term deposits and placements	6,585	1,574	6,493	1,376
Loans	400	155	385	140
Obligatory reserve with CBBH	656	566	-	-
Obligatory reserve with BoS	152	143	-	-
	7,793	**2,438**	**6,878**	**1,516**
Impairment loss allowance	(9)	(23)	(9)	(23)
	7,784	**2,415**	**6,869**	**1,493**

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 3% (2017: in the range of (-1,0%) and 4,4%).

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	2018	Restated 2017	2018	2017
Balance at 1 January		**23**	**41**	**23**	**41**
FTA effect		(16)	-	(16)	-
Net remeasurement of loss allowance	15b	2	(13)	2	(13)
Amounts written off		-	(5)	-	(5)
Balance at 31 December		**9**	**23**	**9**	**23**

Notes to the financial statements (continued)

25 Loans and advances to banks (continued)

c) Geographical analysis

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Germany	1,320	105	1,320	105
Republic of Croatia	1,100	337	1,104	340
France	1,002	251	1,002	251
Austria	902	323	742	267
Belgium	836	-	836	-
Netherlands	668	-	668	-
Bosnia and Herzegovina	656	570	223	3
Switzerland	568	506	568	506
Great Britain	388	3	388	3
Slovenia	200	188	-	-
Italy	125	114	1	-
Norway	24	28	24	28
Other countries	4	13	2	13
	7,793	**2,438**	**6,878**	**1,516**
Impairment loss allowance	(9)	(23)	(9)	(23)
	7,784	**2,415**	**6,869**	**1,493**

As at 31 December 2018 loans and advances to banks included reverse repurchase agreements in the amount of HRK 381 million for the Group and for the Bank (2017: HRK 120 million for the Group and 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)

26 Loans and advances to customers

Loans and advances to customers at amortized cost

a) Analysis by type of customer

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Retail customers	37,751	35,522	26,429	24,832
Corporate customers	23,245	24,054	14,055	15,147
Public sector and other institutions	9,872	9,665	7,970	7,388
	70,868	**69,241**	**48,454**	**47,367**
Impairment allowance	(4,004)	(3,860)	(2,857)	(2,632)
Loans and advances to customers net of impairment allowance	**66,864**	**65,381**	**45,597**	**44,735**
Deferred interest and fees recognised as an adjustment to the effective yield	(162)	(192)	(120)	(153)
CHF conversion not yet finalised	(20)	(20)	(20)	(20)
	66,682	**65,169**	**45,457**	**44,562**

Loans and advances to customers at fair value through profit and loss

	GROUP	BANK
	2018	2018
Retail customers	6	-
	6	**-**

Notes to the financial statements (continued)

26 Loans and advances to customers (continued)

b) Analysis by sector

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Individuals	37,757	35,522	26,429	24,832
Construction	5,249	4,956	4,622	4,349
Public administration and defence; compulsory social security	4,540	4,530	3,535	3,376
Wholesale and retail trade; repair of motor vehicles and motorcycles	4,526	4,883	2,372	2,719
Manufacturing	5,060	4,769	2,871	2,667
Transporting and storage	2,943	3,257	706	1,002
Accommodation and food service activities	2,653	2,543	2,263	2,183
Real estate activities	1,083	1,807	933	1,633
Electricity, gas, steam and air conditioning supply	1,477	1,133	879	862
Professional, scientific and technical activities	704	930	457	695
Information and communication	674	715	208	115
Agriculture, forestry and fishing	1,119	1,065	995	959
Administrative and support service activities	815	1,012	145	167
Financial and insurance activities	571	319	809	437
Human health and social work activities	365	365	244	258
Education	342	319	295	267
Water supply; sewerage; waste management and remediation activities	233	256	171	201
Arts, entertainment and recreation	376	402	301	307
Other services activities	198	201	92	130
Mining and quarrying	150	135	88	86
Activities of extraterritorial organisations and bodies	39	122	39	122
	70,874	**69,241**	**48,454**	**47,367**

Loans and advances to customers also include finance lease receivables. For a more detailed analysis of finance lease receivables please refer to Note 44 *Leases*.

Notes to the financial statements (continued)

26 Loans and advances to customers (continued)

c) Collateral repossessed

During the year, the Group foreclosed on assets previously charged to them as collateral, and thereby recognised foreclosed assets with a carrying value of HRK 1 million and nil for the Bank (2017: HRK 131 million Group and HRK 0,3 million Bank). The repossessed collateral, which the Group is in the process of selling, is disclosed as foreclosed assets within Other assets (Note 32). In general, the Group does not occupy repossessed properties for business use.

d) Sale of receivables

In 2018, the Group sold HRK 723 million gross receivable (HRK 302 million net receivable) to a third party for HRK 406 million what resulted with a release of impairment allowance of HRK 104 million and the Bank sold HRK 369 million gross receivables (HRK 155 million net receivable) for HRK 200 million what resulted with a release of specific impairment allowance of HRK 85 million.

In 2017, the Group sold HRK 948 million gross receivables (HRK 213 million net receivables) to a third party for HRK 374 million what resulted with a release of specific impairment allowance of HRK 161 million.

Notes to the financial statements (continued)

27 Investments in subsidiaries and associates

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Consolidated subsidiaries	-	-	1,934	1,934
Associates accounted for under the equity method by the Group and at cost by the Bank	69	69	28	28
	69	**69**	**1,962**	**1,962**
Movements				
Balance at 1 January	**69**	**67**	**1,962**	**953**
Share of profits from associates	14	14	-	-
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	(14)	(12)	-	-
Balance at 31 December	**69**	**69**	**1,962**	**1,962**

Notes to the financial statements (continued)

27 Investments in subsidiaries and associates (continued)

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

	COUNTRY	NATURE OF BUSINESS	2018 holding %	2017 holding %
CONSOLIDATED SUBSIDIARIES				
PBZ Card d.o.o.	Croatia	card services	100	100
PBZ Leasing d.o.o.	Croatia	leasing	100	100
PBZ Nekretnine d.o.o.	Croatia	real estate agency	100	100
PBZ Stambena Štedionica d.d.	Croatia	housing savings bank	100	100
Veneto Banka *	Croatia	credit institution	-	-
Intesa Sanpaolo Banka d.d.	Bosnia and Herzegovina	credit institution	99	99
Banka Intesa Sanpaolo d.d.	Slovenia	credit institution	51	51
ASSOCIATES				
PBZ Croatia osiguranje d.d.	Croatia	pension management	50	50

* the holding legal ownership of Veneto banka dd in 2017 was nil, but for the purpose of the consolidated annual report it was accounted for using an effective ownership of 100% from the date it formed part of the Intesa Sanpaolo Group. As of 13 October 2018 Veneto bank d.d. was legally merged into the Bank and ceased to exist as a separate legal and operational entity.

The Group considers that its 50% investment in PBZ Croatia osiguranje dd represent investment in associates (31 December 2017: 50% investment in PBZ Croatia osiguranje) as the Group does not have control over the company. 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 d.d.:

(in HRK million)

	2018 PBZ Croatia osiguranje	2017 PBZ Croatia osiguranje
Associates' statement of financial position		
Current assets	143	144
Non-current assets	1	1
Current liabilities	(3)	(3)
Non-current liabilities	(3)	(4)
Net assets of associates'	**138**	**138**
Attributable to PBZ Group	**69**	**69**
Associates' income statements		
Revenue	68	69
Expenses	(41)	(41)
Profit	**27**	**28**
Attributable to PBZ Group	**14**	**14**

Notes to the financial statements (continued)

27 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.

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.

Acquisition of Veneto bank d.d. – common control transaction

As of 12 July 2018 the Bank purchased a 100% stake in Veneto bank d.d. (5,970,820 ordinary shares with 100% voting rights) from Intesa Sanpaolo S.p.A. Turin. Intesa Sanpaolo S.p.A. Turin acquired Veneto banka in 2017.

The consideration paid was determined based on the carrying value of the net assets of the purchased bank as of 31 December 2017 as stated in the financial statements of Intesa Sanpaolo S.p.A. and amounted to HRK 152 million.

Since the ultimate owner of both banks is Intesa Sanpaolo S.p.A. Turin the transaction was accounted for in accordance with accounting policy as disclosed in Note 2e.

Notes to the financial statements (continued)

27 Investments in subsidiaries and associates (continued)

Acquisition of Veneto bank d.d. – common control transaction (continued)

The carrying values of assets and liabilities of Veneto banka were as follows:

	(in HRK million) 1 July 2018
Cash and current accounts with banks	281
Balances with the Croatian National Bank	27
Loans and advances to banks	26
Loans and advances to customers	183
Financial assets available for sale	15
Intangible assets	-
Property and equipment	1
Non-current assets held for sale	19
Other assets	6
Tax prepayments	-
Total assets	**558**
Current accounts and deposits from banks	-
Current accounts and deposits from customers	316
Interest-bearing borrowings	22
Other liabilities	32
Accrued expenses and deferred income	1
Provisions for liabilities and charges	48
Total liabilities	**419**
Net assets and liabilities	**139**

Notes to the financial statements (continued)

27 Investments in subsidiaries and associates (continued)

Merger of Veneto bank d.d. – common control transaction

As of 13 October 2018 Veneto banka was legally merged into the Bank, whereby Veneto bank ceased to exist as a separate legal and operational financial institution. In the separate financial statements of the Bank the assets and liabilities acquired by the Bank as a result of the merger are recognized at the carrying amounts recognized immediately prior to the merger in the financial statements of Veneto banka. Loss acquired on merger of Veneto banka d.d. was recognised in equity of Privredna banka Zagreb d.d. in the amount of HRK 21 million. The Bank's separate financial statements 2018 income statement does not include results of Veneto banka before merger, and separate comparative financial information of the Bank was not restated. There is no effect of the merger on the consolidated financial statements.

The carrying values of assets and liabilities of Veneto bank as at 12 October 2018, the date that preceded the merger were as follows (effect on Bank's standalone assets and liabilities):

	12 October 2018
Cash and current accounts with banks	270
Balances with the Croatian National Bank	19
Loans and advances to banks	-
Loans and advances to customers	143
Financial assets available for sale	19
Intangible assets	-
Property and equipment	-
Non-current assets held for sale	5
Other assets	15
Tax prepayments	-
Total assets	**471**
Current accounts and deposits from banks	-
Current accounts and deposits from customers	264
Interest-bearing borrowings	18
Other liabilities	14
Accrued expenses and deferred income	-
Provisions for liabilities and charges	44
Total liabilities	**340**
Net identifiable assets of Veneto bank	**131**
Less: carrying value of the investment in the subsidiary	**152**
Differences recorded directly in Bank's equity	(21)

Merger of subsidiary – decrease in reserve of the Bank

Other reserves	76
Retained earnings	(97)
	(21)

Notes to the financial statements (continued)

28 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 2017	**29**	**743**	**50**	**26**	**848**
Acquisition of Veneto bank	-	21	-	-	**21**
Additions	-	-	-	112	**112**
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**	**843**	**49**	**48**	**969**
Additions	-	-	-	117	**117**
Transfer into use	-	115	-	(115)	**-**
Disposals and eliminations	-	(5)	(3)	(4)	**(12)**
Translation differences in respect of foreign operations	-	-	-	-	**-**
Balance at 31 December 2018	**29**	**953**	**46**	**46**	**1,074**
Accumulated amortisation					
Balance at 1 January 2017	**-**	**621**	**38**	**-**	**659**
Acquisition of Veneto bank	-	20	-	-	**20**
Charge for the year	-	67	4	-	**71**
Disposals and eliminations	-	(2)	(6)	-	**(8)**
Translation differences in respect of foreign operations	-	-	-	-	**-**
Balance at 31 December 2017	**-**	**706**	**36**	**-**	**742**
Charge for the year	-	80	4	-	**84**
Disposals and eliminations	-	(5)	(2)	-	**(7)**
Impairment of goodwill	15	-	-	-	**15**
Translation differences in respect of foreign operations	-	-	-	-	**-**
Balance at 31 December 2018	**15**	**781**	**38**	**-**	**834**
Carrying value					
Balance at 31 December 2017	**29**	**137**	**13**	**48**	**227**
Balance at 31 December 2018	**14**	**172**	**8**	**46**	**240**

Notes to the financial statements (continued)

28 Intangible assets (continued)

Goodwill represents goodwill arising from the acquisition of Međimurska banka in the amount of HRK 15 million (2017: HRK 15 million), recognised as a purchased goodwill following the merger of Međimurska banka into Privredna banka Zagreb d.d. as at 1 December 2012.

Goodwill recognised in PBZ card 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, PBZ Card impaired previously recognised goodwill in full amount in 2018.

Notes to the financial statements (continued)

28 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 2017	**14**	**550**	**3**	**14**	**581**
Additions	-	-	-	92	**92**
Disposals	-	-	-	-	**-**
Transfer into use	-	71	-	(71)	**-**
Balance at 31 December 2017	**14**	**621**	**3**	**35**	**673**
Additions	-	-	-	91	**91**
Disposals	-	-	-	-	**-**
Transfer into use	-	104	-	(104)	**-**
Balance at 31 December 2018	**14**	**725**	**3**	**22**	**764**
Accumulated amortisation					
Balance at 1 January 2017	**-**	**456**	**1**	**-**	**457**
Charge for the year	-	53	1	-	**54**
Disposals	-	-	-	-	**-**
Balance at 31 December 2017	**-**	**509**	**2**	**-**	**511**
Charge for the year	-	67	-	-	**67**
Disposals	-	-	-	-	**-**
Balance at 31 December 2018	**-**	**576**	**2**	**-**	**578**
Carrying value					
Balance at 31 December 2017	**14**	**112**	**1**	**35**	**162**
Balance at 31 December 2018	**14**	**149**	**1**	**22**	**186**

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)

29 Property and equipment

(in HRK million)

Group	Land and buildings	Furniture and other equipment	Motor vehicles	Computer equipment	Assets acquired but not brought into use	Total
Acquisition cost						
Balance at 1 January 2017	**1,553**	**551**	**133**	**515**	**30**	**2,782**
Acquisition of Veneto bank	47	13	2	9	-	**71**
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, restated	**1,205**	**567**	**126**	**528**	**33**	**2,459**
Additions	-	-	-	1	88	**89**
Disposals	-	(16)	(39)	(39)	-	**(94)**
Transfer into use	7	16	21	40	(84)	**-**
Transfer to non-current assets held for sale	(49)	-	-	-	-	**(49)**
Balance at 31 December 2018	**1,163**	**567**	**108**	**530**	**37**	**2,405**
Accumulated depreciation						
Balance at 1 January 2017	**609**	**509**	**58**	**454**	**-**	**1,630**
Acquisition of Veneto bank	30	12	1	9	-	**52**
Charge for the year	46	19	22	30	-	**117**
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, restated	**31**	**526**	**53**	**471**	**-**	**1,081**
Charge for the year	35	18	16	34	-	**103**
Reversal of impairment	(7)	-	-	-	-	**(7)**
Disposals	-	(17)	(24)	(36)	-	**(77)**
Transfer to held for sale	(32)	-	-	-	-	**(32)**
Balance at 31 December 2018	**27**	**527**	**45**	**469**	**-**	**1,068**
Carrying value						
Balance at 31 December 2017	**1,174**	**41**	**73**	**57**	**33**	**1,378**
Balance at 31 December 2018	**1,136**	**40**	**63**	**61**	**37**	**1,337**

Notes to the financial statements (continued)

29 Property and equipment (continued)

(in HRK million)

Bank	Land and buildings	Furniture and other equip-ment	Motor vehicles	Computer equipment	Assets acquired but not brought into use	Total
Acquisition cost						
Balance at 1 January 2017	**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 accu-mulated depreciation	(297)	-	-	-	-	**(297)**
Balance at 31 December 2017	**528**	**424**	**2**	**355**	**30**	**1,339**
Additions	-	-	-	-	70	**70**
Transfer into use	15	14	-	36	(65)	**-**
Disposals	-	(12)	(1)	(7)	-	**(20)**
Reclassifications	-	-	-	-	-	**-**
Balance at 31 December 2018	**543**	**426**	**1**	**384**	**35**	**1,389**
Accumulated depreciation						
Balance at 1 January 2017	**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 accu-mulated depreciation	(297)	-	-	-	-	**(297)**
Balance at 31 December 2017	**-**	**396**	**2**	**320**	**-**	**718**
Charge for the year	17	13	-	25	-	**55**
Disposals	-	(12)	(1)	(7)	-	**(20)**
Reversal of impairment losses	-	-	-	-	-	**-**
Balance at 31 December 2018	**17**	**397**	**1**	**338**	**-**	**753**
Carrying value						
Balance at 31 December 2017	**528**	**28**	**-**	**35**	**30**	**621**
Balance at 31 December 2018	**526**	**29**	**-**	**46**	**35**	**636**

Notes to the financial statements (continued)

30 Investment property

(in HRK million)

	GROUP	BANK
Acquisition cost		
Balance at 1 January 2017	**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**
Additions	-	-
Disposals	-	-
Balance at 31 December 2018	**8**	**1**
Accumulated depreciation		
Balance at 1 January 2017	**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	**-**	**-**
Charge for the year	-	-
Impairment	1	-
Balance at 31 December 2018	**1**	**-**
Carrying value		
Balance at 31 December 2017	**8**	**1**
Balance at 31 December 2018	**7**	**1**

Notes to the financial statements (continued)

30 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 3 million (2017: HRK 4,4 million) and nil for the Bank (2017: HRK 1,8 million and was presented within other operating income (Note 12).

31 Non-current assets held for sale

During the year 2017, the Bank's Management Board resolved to dispose all real estate's 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 as at 31 December 2018. Impairment loss in the amount of HRK 14 million for the Group and HRK 8 million for the Bank was recognized on the classification of these assets as held for sale.

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Property and equipment	52	34	37	19
Investment property	136	184	39	39
Foreclosed assets	124	124	26	32
Loans and receivables	22	115	22	-
	334	**457**	**124**	**90**

Notes to the financial statements (continued)

32 Other assets

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Receivables from card business	330	360	171	79
Foreclosed assets	127	128	34	36
Prepaid expenses	59	40	30	22
Accrued fees	54	50	62	56
Receivables in course of collection	78	61	3	5
Leasehold improvements	37	42	19	19
Advance payments	9	13	6	11
Receivables from debtors	16	13	1	1
Other assets	144	436	103	340
	854	**1,143**	**429**	**569**
Impairment	(114)	(93)	(69)	(54)
	740	**1,050**	**360**	**515**

Movement in impairment

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Balance at 1 January	**93**	**113**	**54**	**49**
Net (release)/charge for the year	26	17	20	13
Amounts written off	(5)	(37)	(5)	(8)
Balance at 31 December	**114**	**93**	**69**	**54**

Movement in impairment on other assets is presented as part of Provisions for other items and other assets (Note 15b).

Notes to the financial statements (continued)

33 Current accounts and deposits from banks

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Term deposits	737	756	355	501
Demand deposits	1,106	615	1,125	563
	1,843	**1,371**	**1,480**	**1,064**

34 Current accounts and deposits from customers

a) Analysis by term

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Demand deposits	53,817	44,503	37,418	29,785
Term deposits	32,121	34,324	25,624	27,388
	85,938	**78,827**	**63,042**	**57,173**

b) Analysis by source

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Retail deposits	58,552	56,141	43,205	40,758
Corporate deposits	19,218	16,609	13,121	11,712
Public sector and other institutions	8,168	6,077	6,716	4,703
	85,938	**78,827**	**63,042**	**57,173**

Notes to the financial statements (continued)

35 Interest–bearing borrowings

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Foreign borrowings	1,623	2,068	605	777
Domestic borrowings	2,542	1,753	2,433	1,606
Accrued fee	(5)	(5)	(6)	(6)
	4,160	**3,816**	**3,032**	**2,377**

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 1,4 billion (2017: HRK 1,6 billion) and Croatian National Bank in the amount of HRK 1 billion (2017: nil)

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.

36 Subordinated liabilities

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Ministry of Finance of Bosnia and Herzegovina	-	1	-	-
	-	**1**	**-**	**-**

Notes to the financial statements (continued)

37 Other liabilities

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Credit card payables and other payables	1,177	1,360	52	39
Items in the course of settlement and other liabilities	618	845	391	506
Salaries and other personnel costs	199	171	158	132
	1,994	**2,376**	**601**	**677**

38 Accrued expenses and deferred income

(in HRK million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Accrued expenses	293	270	139	145
Deferred income	79	93	20	20
	372	**363**	**159**	**165**

Notes to the financial statements (continued)

39 Provisions

(in HRK million)

	GROUP 2018	GROUP Restated 2017	BANK 2018	BANK 2017
Provisions for liabilities and charges	494	378	393	249
Retirement benefit obligations	22	32	-	-
	516	**410**	**393**	**249**

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 2018	**378**	**251**	**103**	**24**
FTA effect	**65**	**65**	**-**	**-**
Net (release)/charge in the income statement	80	23	(5)	62
Provisions used during the year	(29)	(2)	(13)	(14)
Balance as at 31 December 2018	**494**	**337**	**85**	**72**
Balance as at 1 January 2017, restated	**330**	**252**	**67**	**11**
Aquistion of Veneto bank	46	1	44	1
Net (release)/charge in the income statement	14	(2)	4	12
Provisions used during the year	(12)	-	(12)	-
Balance as at 31 December 2017, restated	**378**	**251**	**103**	**24**

Notes to the financial statements (continued)

39 Provisions (continued)

a) Provisions for liabilities and charges (continued)

(in HRK million)

Bank	Total	Provisions for off-balance-sheet items	Provisions for court cases	Provisions for other items
Balance as at 1 January 2018	**249**	**215**	**32**	**2**
FTA effect	**51**	**51**	**-**	**-**
Merger of Veneto Bank	37	16	21	-
Net charge/(release) in the income statement	61	14	4	43
Provisions used during the year	(5)	-	(3)	(2)
Balance as at 31 December 2018	**393**	**296**	**54**	**43**
Balance as at 1 January 2017	**257**	**207**	**46**	**4**
Net (release)/charge 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**

Provisions for off-balance-sheet items, court cases and other items are recognised in other impairment losses and provisions in the income statement (Note 15b).

Provision for off-balance-sheet items relates to specific and collective impairment provisions on credit-related contingencies as disclosed in Note 40.

As at 31 December 2018 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 2018 in the amount of HRK 85 million (31 December 2017: HRK 103 million) for the Group and HRK 54 million (31 December 2017: HRK 32 million), for the Bank, respectively.

Notes to the financial statements (continued)

39 Provisions (continued)

b) Retirement benefit obligation

(in HRK million)

Group	Retirement benefit obligations
Balance as at 1 January 2018	**32**
Net charge in the income statement	2
Provisions used during the year	(2)
Actuarial losses	(10)
Balance as at 31 December 2018	**22**
Balance as at 1 January 2017	**32**
Net charge in the income statement	2
Provisions used during the year	(2)
Actuarial losses	-
Balance as at 31 December 2017, restated	**32**

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 1.88% (2017: 1.47%), and
- Future salary increases of 2.5% p.a. for 2019 and 2.5% p.a. from 2020 onwards (2017: 1.62% p.a. for 2018 and 1.8% p.a. from 2019 onwards).

Notes to the financial statements (continued)

40 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 337 million for the Group and HRK 296 million for the Bank (2017: HRK 251 million and HRK 215 million respectively) is sufficient to cover risks due to the default of the respective counterparties (refer to Note 39a).

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	
	2018	Restated 2017	2018	2017
Undrawn lending commitments	15,077	14,242	11,103	11,224
Performance guarantees	2,699	3,117	2,149	2,329
Kuna payment guarantees	633	447	633	445
Foreign currency payment guarantees	1,658	1,530	761	583
Foreign currency letters of credit	89	65	65	53
Other contingent liabilities	1	1	1	1
	20,157	**19,402**	**14,712**	**14,635**

Notes to the financial statements (continued)

40 Contingent liabilities and commitments (continued)

Credit-related contingencies and commitments (continued)

Long-term commitments as lessees

On 31 December 2018 the Group and the Bank had long-term commitments as lessees in respect of rent for business premises, motor vehicels, hardware and other equipment lease agreements. The future minimum commitments for each type of lease are presented in the tables bellow:

(in HRK million)

Group

	Within 1 year	1 to 5 years	Over 5 years	Total
Hardware	31	51	7	**89**
Motor vehicles	3	8	-	**11**
Other	15	26	-	**41**
Real estate	51	150	60	**261**
	100	**235**	**67**	**402**

(in HRK million)

Bank

	Within 1 year	1 to 5 years	Over 5 years	Total
Hardware	15	50	7	**72**
Motor vehicles	3	6	-	**9**
Other	9	21	-	**30**
Real estate	33	100	34	**167**
	60	**177**	**41**	**278**

Notes to the financial statements (continued)

41 Share capital

a) Issued share capital

Issued share capital as at 31 December 2018 amounted to HRK 1,907 million (31 December 2017: HRK 1,907 million). The total number of authorised registered shares at 31 December 2018 was 19,074,769 (2017: 19,074,769) with a nominal value of HRK 100 per share (2017: 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 2018 and 31 December 2017 was as follows:

	REGISTERED SHARES			
	31 December 2018		31 December 2017	
	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%	418,614	2.2%
Treasury shares	64,633	0.3%	64,633	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 2018 the share price of the Bank's ordinary shares quoted on the Zagreb Stock Exchange was HRK 725 (31 December 2017: HRK 755).

On 31 December 2018, the other members of the Management Board, Mr Ivan Gerovac held 120 shares (31 December 2017: 120) and Mr Draženko Kopljar held 108 shares (31 December 2017: 108).

b) Share premium

The Bank recognises share premium in an amount of HRK 1,570 million (31 December 2017: HRK 1,570 million) representing the excess of the paid-in amount over the nominal value of the issued shares.

c) Treasury shares

There were no movements of treasury shares were during 2018.

d) Own shares held as collateral

The Bank holds 2,508 (31 December 2017: 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)

41 Share capital (continued)

e) Other reserves (continued)

Treasury share reserve

During 2018 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 2018 translation reserve amounted to HRK 55 million (2017: HRK 18 million) for the Group.

Other revaluation reserves

Other revaluation reserves includes valuation reseve of tangible assets due to the change in the accounting criteria in the year 2017 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 measured at fair value through other comprehensive income (2017 : 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 2018 in respect of 2017 is HRK 15,19 (2017 in respect of 2016: HRK 25,33) 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 part of other reserves may not be distributed to shareholders. As at 31 December 2018 non-distributable reserves amount to HRK 1,405 million (31 December 2017: HRK 1,468 million) and HRK 35 million (31 December 2017: HRK 345 million), for the Group and the Bank, respectively.

Notes to the financial statements (continued)

42 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** 2018	**GROUP** Restated 2017	**BANK** 2018	**BANK** 2017
Cash and current accounts with banks	19	18,442	18,984	14,180	15,466
Loans and advances to banks with maturity of up to 90 days		4,398	1,581	4,421	1,506
		22,840	**20,565**	**18,601**	**16,972**

43 Managed funds for and on behalf of third parties

(in HRK million)

	GROUP 2018	**GROUP** Restated 2017	**BANK** 2018	**BANK** 2017
Assets under custody - investment funds	9,046	7,269	3,499	3,723
Assets under custody	5,984	6,126	5,984	6,126
Assets under portfolio management	1,095	1,016	815	819
	16,125	**14,411**	**10,298**	**10,668**

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 16,334 million as at 31 December 2018 (31 December 2017: HRK 15,154 million). These funds are held by a custody bank which is not a member of the Group.

Notes to the financial statements (continued)

44 Leases

PBZ Leasing doo and Banka Intesa Sanpaolo d.d., 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 2018 amounted to HRK 1,112 million (31 December 2017: HRK 1,050 million) which is included within loans and advances to customers (Note 26) in the Group financial statements.

The carrying value of leased property and equipment under operating lease as at 31 December 2018 amounted to HRK 363 million (31 December 2017: HRK 394 million) and are classified within property and equipment (Note 29).

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 2018	Present value of payments 2018	Minimum payments Restated 2017	Present value of payments Restated 2017
Less than one year	465	424	458	419
Between one and five years	735	666	661	587
More than five years	161	137	211	179
Gross investment in finance lease	**1,361**	**1,227**	**1,330**	**1,185**
Unearned finance income	(134)	-	(145)	-
	1,227	**1,227**	**1,185**	**1,185**
Less: Impairment allowance	(115)	(115)	(135)	(135)
Net investment in finance lease	**1,112**	**1,112**	**1,050**	**1,050**

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

(in HRK million)

	2018	Restated 2017
Less than one year	34	47
Between one and five years	84	97
More than five years	36	46
	154	**190**

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

Notes to the financial statements (continued)

45 Related party transactions

The parent company of Privredna banka Zagreb d.d. and its subsidiaries is Intesa Sanpaolo Holding International which holds 97,5% of the Bank's share capital as at 31 December 2018 (97,5% as at 31 December 2017). 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 d.d.; 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 2018	**11**	**509**	**-**	**49**
Changes during the year	(1)	(6)	-	14
Balance at 31 December 2018	**10**	**503**	-	**63**
Interest income for the year ended 31 December 2018	**-**	**2**	**-**	**-**
Interest income for the year ended 31 December 2017 restated	-	-	-	-
Deposits and loans received				
Balance at 1 January 2018	**40**	**478**	**-**	**325**
Changes during the year	(3)	(144)	91	410
Balance at 31 December 2018	**37**	**334**	**91**	**735**
Interest expense for the year ended 31 December 2018	**-**	**5**	**-**	**4**
Interest expense for the year ended 31 December 2017 restated	-	-	-	(1)
Contingent liabilities and commitments at 31 December 2018	**1**	**178**	**-**	**2**
Contingent liabilities and commitments at 31 December 2017 restated	1	13	-	151
Fees and other income for the year ended 31 December 2018	**-**	**14**	**15**	**54**
Fees and other income for the year ended 31 December 2017 restated	-	13	-	51
Fees and other expense for the year ended 31 December 2018	**-**	**(7)**	**-**	**(15)**
Fees and other expense for the year ended 31 December 2017 restated	-	(4)	-	(16)

Notes to the financial statements (continued)

45 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 2018	**9**	**437**	**17**	**-**	**18**
Changes during the year	(1)	357	(4)	-	9
Balance at 31 December 2018	**8**	**794**	**13**	**-**	**27**
Interest income for the year ended 31 December 2018	**-**	**11**	**-**	**-**	**-**
Interest income for the year ended 31 December 2017	-	18	-	-	-
Deposits and loans received					
Balance at 1 January 2018	**31**	**460**	**29**	**-**	**25**
Changes during the year	(3)	(13)	(16)	91	516
Balance at 31 December 2018	**28**	**447**	**13**	**91**	**541**
Interest expense for the year ended 31 December 2018	**-**	**(4)**	**-**	**-**	**-**
Interest expense for the year ended 31 December 2017	-	(4)	-	-	(1)
Contingent liabilities and commitments at 31 December 2018	**1**	**62**	**111**	**-**	**-**
Contingent liabilities and commitments at 31 December 2017	1	166	13	-	151
Lease expense for the year ended 31 December 2018	**-**	**(25)**	**-**	**-**	**-**
Lease expense for the year ended 31 December 2017	-	(23)	-	-	-
Fees and other income for the year ended 31 December 2018	**-**	**145**	**13**	**15**	**53**
Fees and other income for the year ended 31 December 2017	-	529	13	12	51
Fees and other expense for the year ended 31 December 2018	**-**	**(31)**	**(5)**	**-**	**(15)**
Fees and other expense for the year ended 31 December 2017	-	(16)	(3)	-	(16)

No provisions were recognised in respect of deposits and loans given to related parties as at 31 December 2018 (31 December 2017: nil).

Notes to the financial statements (continued)

45 Related party transactions (continued)

Annual key management remuneration:

(in HRK million)

	BANK	
	2018	Restated 2017
Short-term benefits	**34**	**37**
- salaries paid for the current year	34	37
Long-term benefits	**9**	**20**
- paid during the current year in respect of earlier years	9	20
	43	**57**

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 2018 was 31 (31 December 2017: 35).

Bonuses in 2018 were mostly paid in cash, while for 6 Risk takers 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 2018	Restated 31 December 2017	31 December 2018	Restated 31 December 2017
Awards granted	272,702	268,112	5	5

Notes to the financial statements (continued)

46 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.

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.

For the purposes of capital adequacy computation the Bank choose to adopt the 'static approach' which allows the bank to gradually include IFRS 9 impact in the common capital calculation as follows 5% in 2018, 15% in 2019, 30% in 2020, 50% in 2021 and 75% in 2022.

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	
	2018	2017
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)	8,939	8,566
Profit for the period, decreased by proposed dividend	-	-
Accumulated other comprehensive income	156	(3)
Other reserves	140	140
Deductions in accordance with EBA regulations	396	(233)
Common Equity Tier 1 capital (unaudited)	**13,090**	**11,929**
Additional Tier 1	-	-
Tier 1 capital	**13,090**	**11,929**
Tier 2 capital	-	-
Total regulatory capital (unaudited)	**13,090**	**11,929**
Risk weighted assets and other risk elements (unaudited)	**53,209**	**51,523**
Common Equity Tier 1 capital ratio (unaudited)	24,60%	23,15%
Tier 1 (unaudited)	24,60%	23,15%
Total capital ratio (unaudited)	24,60%	23,15%

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. Investment securities measured at fair value through other comprehensive income (2017 : 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				2018				Restated 2017
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative assets	-	10	-	**10**	-	22	-	**22**
Trading assets	-	-	-	**-**	-	-	-	**-**
Government bonds	828	-	-	**828**	530	-	-	**530**
Equities	-	-	-	**-**	20	-	-	**20**
Total	**828**	**-**	**-**	**828**	**550**	**-**	**-**	**550**
Investment securities	-	-	-	**-**	-	-	-	**-**
Government bonds	3,943	5,852	-	**9,795**	3,993	5,107	-	**9,100**
Equities	23	168	31	**222**	33	85	97	**215**
Total	3,966	6,020	31	10,017	4,026	5,192	97	9,315
Financial assets	**4,794**	**6,030**	**31**	**10,855**	**4,576**	**5,214**	**97**	**9,887**
Derivative financial liabilities	-	34	-	**34**	-	13	-	**13**
Financial liabilities	**-**	**34**	**-**	**34**	**-**	**13**	**-**	**13**

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)

Bank				2018				Restated 2017
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Derivative assets	-	1	-	**1**	-	2	-	**2**
Trading assets	-	-	-	**-**	-	-	-	**-**
Government bonds	828	-	-	**828**	530	-	-	**530**
Equities	-	-	-	**-**	20	-	-	**20**
Total	**828**	**-**	**-**	**828**	**550**	**-**	**-**	**550**
Investment securities	-	-	-	**-**	-	-	-	**-**
Government bonds	895	5,850	-	**6,745**	680	5,033	-	**5,713**
Equities	18	59	21	**98**	28	-	64	**92**
Total	913	5,909	21	6,843	708	5,033	64	5,805
Financial assets	**1,741**	**5,910**	**21**	**7,672**	**1,258**	**5,035**	**64**	**6,357**
Derivative financial liabilities	-	4	-	**4**	-	7	-	**7**
Financial liabilities	**-**	**4**	**-**	**4**	**-**	**7**	**-**	**7**

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 2018, 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% (2017: 2,1% to 5,6%) with weighted average used of 2,8% (2017: 2,8%). 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	
	Investment securities	Equities	Investment securities	Equities
Balance at 31 December 2017, restated	**-**	**97**	**-**	**64**
Total gains or losses:	-	-	-	-
in profit or loss	-	-	-	-
in OCI	-	-	-	-
Purchases	-	-	-	-
Sale	-	-	-	-
Settlements	-	-	-	-
Transfer out of Level 3	-	(66)	-	(43)
Balance at 31 December 2018	**-**	**31**	**-**	**21**

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	
	Investment securities	Equities	Investment securities	Equities
Balance at 1 January 2017	**-**	**63**	**-**	**44**
Total gains or losses:	-	13	-	10
in profit or loss	-	-	-	-
in OCI	-	*13*	-	*10*
Purchases	-	14	-	-
Sale	-	-	-	-
Settlements	-	(14)	-	(11)
Transfer in to Level 3	-	21	-	21
Balance at 31 December 2017, restated	**-**	**97**	**-**	**64**

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 2018					
Assets					
Cash and current accounts with banks	-	-	18,442	18,442	**18,442**
Balances with CNB	-	-	4,698	4,698	**4,698**
Loans and advances to banks	-	-	7,655	7,655	**7,784**
Loans and advances to customers	-	-	65,569	65,569	**66,682**
Investment securities measured at amortised cost	-	-	543	543	**540**
Liabilities					
Current accounts and deposits from banks	-	1,843	-	1,843	**1,843**
Current accounts and deposits from customers	-	84,967	-	84,967	**85,938**
Interest-bearing borrowings and subordinated liabilities	-	4,128	-	4,128	**4,160**

Group	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
31 December 2017 restated					
Assets					
Cash and current accounts with banks	-	-	18,984	18,984	18,984
Balances with CNB	-	-	4,246	4,246	4,246
Loans and advances to banks	-	-	2,415	2,415	2,415
Loans and advances to customers	-	-	65,533	65,533	65,169
Investment securities measured at amortised cost	16	-	-	16	16
Liabilities					
Current accounts and deposits from banks	-	1,371	-	1,371	1,371
Current accounts and deposits from customers	-	78,957	-	78,957	78,827
Interest-bearing borrowings and subordinated liabilities	-	3,798	-	3,798	3,817

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 2018					
Assets					
Cash and current accounts with banks	-	-	14,180	14,180	**14,180**
Balances with CNB	-	-	4,698	4,698	**4,698**
Loans and advances to banks	-	-	6,870	6,870	**6,869**
Loans and advances to customers	-	-	44,374	44,374	**45,457**
Investment securities measured at amortised cost	-	-	534	534	**531**
Liabilities					
Current accounts and deposits from banks	-	1,480	-	1,480	**1,480**
Current accounts and deposits from customers	-	62,097	-	62,097	**63,042**
Interest-bearing borrowings	-	3,009	-	3,009	**3,032**

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	-	-	44,989	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

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 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)

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 2018**	Corporate banking	Retail banking	Finance banking	Central Structure	PBZ Card	Other subsidiaries	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	843	1,587	(106)	422	22	45	**2,813**	**-**	**2,813**
Net commission income/(expense)	434	560	-	2	560	16	**1,572**	**-**	**1,572**
Net profit/(loss) from trading and dividend and other operating income	55	97	118	36	(179)	72	**199**	296	**495**
Operating income	**1,332**	**2,244**	**12**	**460**	**403**	**133**	**4,584**	**296**	**4,880**
Operating expenses	(417)	(1,097)	(56)	(256)	(163)	(84)	**(2,073)**	(476)	**(2,549)**
Operating profit	**915**	**1,147**	**(44)**	**204**	**240**	**49**	**2,511**	**(180)**	**2,331**
Impairments and provisions	(379)	(76)	9	62	(64)	(3)	**(451)**	14	**(437)**
Profit before tax	**536**	**1,071**	**(35)**	**266**	**176**	**46**	**2,060**	**(166)**	**1,894**
Segment assets	30,379	34,404	38,409	10,042	2,418	2,773	**118,425**	(6,481)	**111,944**
Investments in associates	-	-	-	69	-	-	**69**	**-**	**69**
Total segment assets	**30,379**	**34,404**	**38,409**	**10,111**	**2,418**	**2,773**	**118,494**	**(6,481)**	**112,013**
Total segment liabilities	**25,236**	**59,336**	**3.847**	**7,515**	**1,314**	**2,367**	**99,615**	**(4,672)**	**94,943**
Capital expenditure	15	25	3	139	-	19	**201**	-	**201**

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 2017 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	948	1,584	(116)	509	22	32	**2,979**	**-**	**2,979**
Net commission income/(expense)	395	531	11	6	546	13	**1,502**	**-**	**1,502**
Net profit/(loss) from trading and dividend and other operating income	49	57	100	34	(171)	77	**146**	292	**438**
Operating income	**1,392**	**2,172**	**(5)**	**549**	**397**	**122**	4,627	292	4,919
Operating expenses	(310)	(866)	(39)	(585)	(143)	(65)	**(2,008)**	(442)	**(2,450)**
Operating profit	**1,082**	**1,306**	**(44)**	**(36)**	**254**	**57**	2,619	**(150)**	2,469
Impairments and provisions	(898)	7	2	38	(25)	(1)	**(877)**	7	**(870)**
Profit before tax	**184**	**1,313**	**(42)**	**2**	**229**	**56**	1,742	**(143)**	1,599
Segment assets	30,279	31,769	32,488	10,693	2,626	2,565	**110,420**	(6,435)	**103,985**
Investments in associates	-	-	-	69	-	-	**69**	-	**69**
Total segment assets	**30,279**	**31,769**	**32,488**	**10,762**	**2,626**	**2,565**	110,489	**(6,435)**	104,054
Total segment liabilities	**21,249**	**58,963**	**3,101**	**6,579**	**1,623**	**2,158**	93,673	**(6,395)**	87,278
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)

Bank **As of and for the year ended 31 December 2018**	Corporate banking	Retail banking	Finance banking	Central Structure	Managerial financial statements	Reconciliation to financial statements	Financial statements
Net interest income	613	1,259	(87)	422	**2,207**		**2,207**
Net commission income	361	377	(6)	-	**732**		**732**
Net profit/(loss) from trading and dividend and other operating income	95	142	55	7	**299**	104	**403**
Operating income	**1,069**	**1,778**	**(38)**	**429**	3,238	104	3,342
Operating expenses	(403)	(883)	(46)	(26)	**(1,358)**	(233)	**(1,591)**
Operating profit	**666**	**895**	**(84)**	**403**	**1,880**	**(129)**	**1,751**
Impairments and provisions	(350)	(4)	-	84	**(270)**	(4)	**(274)**
Profit before tax	**316**	**891**	**(84)**	**487**	**1,610**	**(133)**	**1,477**
Total segment assets	**23,722**	**25,917**	**33,348**	**4,714**	**87,701**	**(4,807)**	**82,894**
Total segment liabilities	**25,317**	**42,688**	**1,659**	**3,887**	**73,551**	**(4,808)**	**68,743**
Capital expenditure	15	25	3	139	182	-	**182**

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**	**40,525**	**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)

b) Geographical segment information

(in HRK million)

	GROUP	
	2018	Restated 2017
Operating income	**4,880**	**4,919**
Croatia	3,978	4,025
Slovenia	556	329
Bosnia and Herzegovina	346	565
Non-current assets*	**1,584**	**1,613**
Croatia	1,295	1,323
Slovenia	224	225
Bosnia and Herzegovina	65	65
Capital expenditure	**201**	**171**
Croatia	188	158
Slovenia	7	4
Bosnia and Herzegovina	6	9

* Includes property and equipment, intangible assets and investment property.

Geographical segmentation is based on the domicile of Group subsidiaries.

Notes to the financial statements (continued)

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 40.

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)

		GROUP		BANK	
	Notes	2018	Restated 2017	2018	2017
Cash and current accounts with banks (excluding cash in hand)	19	15,224	16,374	12,410	13,850
Balances with the Croatian National bank	20	4,698	4,246	4,698	4,185
Financial assets held for trading (w/o equities and investments in funds)	22	828	530	828	530
Derivative financial assets	23	10	22	1	2
Fair value changes of the hedged items in portfolio hedge of interest rate risk	23	9	1	-	-
Loans and advances to banks	25	7,784	2,415	6,869	1,493
Loans and advances to customers	26	66,688	65,169	45,457	44,562
Investment securities (w/o equities)	21	10,335	9,196	7,276	5,712
Other assets (excluding foreclosed assets, prepaid expenses and leaseholds improvements)	32	517	840	277	438
Total		**106,093**	**98,793**	**77,816**	**70,772**
Contingent liabilities and commitments	40	20,157	19,402	14,712	14,635
Total credit risk exposure		**126,250**	**118,195**	**92,528**	**85,407**

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. 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 Group'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 impairment loss 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 4,836 million (2017: HRK 5,202 million). Exposure to Croatian municipalities is included in the above analysis. The following table sets out the appraised value of collateral for loans and receivables to customers.

Analysis by type of collateral

(in HRK million)

	2018		2017, restated	
Group	Net loans	Appraised value of collateral	Net loans	Appraised value of collateral
Residential Real Estate	12,975	28,729	10,764	28,490
Commercial Real Estate	10,215	26,804	9,350	27,779
Other Real Estate	550	1,528	219	544
Real Estate	**23,740**	**57,061**	**20,333**	**56,813**
First Rate Guarantees	5,788	6,111	5,983	6,327
Central Government	5,637	5,954	5,720	5,756
Local Government	116	121	120	124
Banks	35	36	143	447
Other Guarantees	478	574	4,026	5,792
Guarantees	**6,266**	**6,685**	**10,009**	**12,119**
Loan Insurance	1,183	1,297	1,573	1,988
Life Insurance	1,835	2,047	452	528
Deposits	307	471	439	478
Shares	465	744	114	272
Bonds	242	266	146	158
Funds	2	2	21	26
Other	1,669	2,755	1,350	3,696
Other Collaterals	**5,703**	**7,582**	**4,095**	**7,146**
Total	**35,709**	**71,328**	**34,437**	**76,078**
Unsecured loans	31,161	-	30,944	-
Total	**66,870**	**71,328**	**65,381**	**76,078**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

(in HRK million)

	2018		2017	
Bank	Net loans	Appraised value of collateral	Net loans	Appraised value of collateral
Residential Real Estate	9,064	20,557	8,402	20,035
Commercial Real Estate	6,613	16,710	6,333	16,605
Other Real Estate	0	508	-	22
Real Estate	**15,677**	**37,775**	**14,735**	**36,662**
First Rate Guarantees	4,086	4,121	3,905	3,943
Central Government	3,935	3,964	*3,762*	*3,796*
Local Government	116	121	*116*	*120*
Banks	35	36	*27*	*27*
Other Guarantees	478	552	488	539
Guarantees	**4,564**	**4,673**	**4,393**	**4,482**
Loan Insurance	35	36	790	819
Life Insurance	922	944	379	381
Deposits	224	306	257	337
Shares	195	361	114	272
Bonds	242	266	110	121
Funds	2	2	21	24
Other	782	1,992	953	2,296
Other Collaterals	**2,402**	**3,907**	**2,624**	**4,250**
Total	**22,643**	**46,355**	**21,752**	**45,394**
Unsecured loans	22,954	-	22,983	-
Total	**45,597**	**46,355**	**44,735**	**45,394**

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 rescheduling have been marked with forbearance flag in line with relevant regulation. Compared to the end of 2017, forborne portfolio exposure of the Group has declined in volume by 22,2% in 2018, amounting to HRK 3,340 million (2017: HRK 4,292 million). Provisions coverage of forborne portfolio as of 31 December 2018 was 30,1% (2017: 20,8%). Forborne performing portfolio exposure has declined in volume by 19,1% (amounting to HRK 1,449 million, 2017: HRK 1,792 million), while forborne NPL portfolio exposure has declined in volume by 24,4% (amounting to HRK 1,891 million, 2017: HRK 2,500 million) primarily driven by the sale of receivables and refinancing.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Refinanced loans (continued)

The Group is also continuously improving collection and workout processes (problem loan management framework) by introducing new application support boosting process efficiency and developing new 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.

Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt investments (2018) and available-for-sale debt assets (2017). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively

Credit risk of financial assets and loan commitments and financial guarantee contracts is presented using internal classifications for the credit risk.

The Group internally classifies the loan exposures into the following risk categories:

- Standard monitoring: the client is timely servicing its liabilities and there and the exposure is not classified as credit-impaired;
- Special monitoring: 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 addition to corporate clients, Bank adopted monitoring of retail clients on portfolio level within PCEM office.
- 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.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Credit quality analysis (continued)

Group						**(in HRK million)**
	2018					2017, restated
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Purchased credit – im-paired	Total	Total
Loans and advances to banks at amortised cost						
Standard monitoring	7,790	-	-	-	7,790	2,434
Doubtful	-	-	3	-	3	4
Loss allowance	**(6)**	**-**	**(3)**	**-**	**(9)**	**(23)**
Carrying amount	**7,784**	**-**	**-**	**-**	**7,784**	**2,415**
Loans and advances to customers at amortised cost						
Standard monitoring	58,665	5,560	-	30	64,255	61,163
Special monitoring	38	1,740	-	-	1,778	1,895
Past due impaired	-	-	121	-	121	132
Unlikely to pay	-	-	2,531	81	2,612	3,478
Doubtful	-	-	2,049	53	2,102	2,573
Loss allowance	**(646)**	**(569)**	**(2,748)**	**(41)**	**(4,004)**	**(3,860)**
Carrying amount	**58,057**	**6,731**	**1,953**	**123**	**66,864**	**65,381**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Credit quality analysis (continued)

Bank **(in HRK million)**

	2018					2017
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Purchased credit – im-paired	Total	Total
Loans and advances to banks at amortised cost						
Standard monitoring	6,875	-	-	-	6,875	**1,512**
Doubtful	-	-	3	-	3	**4**
Loss allowance	(6)	-	(3)	-	(9)	**(23)**
Carrying amount	**6,869**	**-**	**-**	**-**	**6,869**	**1,493**
Loans and advances to customers at amortised cost						
Standard monitoring	39,488	4,367	-	30	43,885	**41,510**
Special monitoring	38	925	-	-	963	**1,588**
Past due impaired	-	-	42	-	42	**54**
Unlikely to pay	-	-	2,066	23	2,089	**2,656**
Doubtful	-	-	1,422	53	1,475	**1,559**
Loss allowance	**(458)**	**(441)**	**(1,917)**	**(41)**	**(2,857)**	(2,632)
Carrying amount	**39,068**	**4,851**	**1,613**	**65**	**45,597**	**44,735**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Credit quality analysis (continued)

GROUP **(in HRK million)**

	2018				2017, restated
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Total	Total
Debt investment securities at amortised cost					
Standard monitoring	548	-	-	548	-
Loss allowance	(8)	-	-	**(8)**	-
Carrying amount	**540**	-	-	**540**	-
Debt investment securities at FVOCI (2017: available-for-sale)					
Standard monitoring	9,805	-	-	9,805	7,652
Loss allowance	(10)	-	-	(10)	-
Carrying amount	9,795	-	-	9,795	**7,652**
Loan commitments					
Standard monitoring	14,255	782	-	15,037	14,195
Special monitoring	-	-	-	-	-
Past due impaired	-	-	2	2	2
Unlikely to pay	-	-	20	20	31
Doubtful	-	-	18	18	14
Loss allowance	(55)	(27)	(20)	(102)	(78)
Carrying amount	**14,200**	**755**	**20**	**14,975**	14,164
Financial guarantee contracts					
Standard monitoring	3,912	248	-	4,160	4,736
Special monitoring	-	-	-	-	-
Past due impaired	-	-	2	2	-
Unlikely to pay	-	-	716	716	208
Doubtful	-	-	202	202	216
Loss allowance	(8)	(6)	(221)	(235)	(173)
Carrying amount	**3,904**	**242**	**699**	**4,845**	**4,987**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Credit quality analysis (continued)

Bank **(in HRK million)**

	2018				2017
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Total	Total
Debt investment securities at amortised cost					
Standard monitoring	538	-	-	538	-
Loss allowance	(7)	-	-	(7)	-
Carrying amount	**531**	**-**	**-**	**531**	**-**
Debt investment securities at FVOCI (2017: available-for-sale)					
Standard monitoring	6,754	-	-	6,754	4,145
Special monitoring	-	-	-	-	-
Past due impaired	-	-	-	-	-
Unlikely to pay	-	-	-	-	-
Doubtful	-	-	-	-	-
Loss allowance	(9)	-	-	(9)	-
Carrying amount	6,745	-	-	6,745	4,145
Loan commitments					
Standard monitoring	10,403	669	-	11,072	11,183
Special monitoring	-	-	-	-	-
Past due impaired	-	-	2	2	2
Unlikely to pay	-	-	19	19	31
Doubtful	-	-	10	10	8
Loss allowance	(43)	(24)	(14)	(81)	(65)
Carrying amount	**10,360**	**645**	**17**	**11,022**	**11,159**
Financial guarantee contracts					
Standard monitoring	2,579	133	-	2,712	3,019
Special monitoring	-	-	-	-	-
Past due impaired	-	-	2	2	-
Unlikely to pay	-	-	716	716	208
Doubtful	-	-	179	179	184
Loss allowance	(3)	(4)	(208)	(215)	(150)
Carrying amount	**2,576**	**129**	**689**	**3,394**	**3,261**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Credit quality analysis (continued)

The following table sets out the credit analysis for non-trading financial assets measured at FVTPL-

Group

	(in HRK million)	
	2018	2017
Loans and advances to customers	-	-
Standard monitoring	-	-
Special monitoring	-	-
Past due impaired	-	-
Unlikely to pay	6	-
Doubtful	-	-
Total carrying amount	6	-

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment and including forward-looking information. 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".

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 initial recognition 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.

Credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Group's modelling, one of the following criteria is met:

- Default probability change in relation to the initial recognition of the financial instrument. It is therefore an assessment implemented by adopting the "relative" criterion;
- Clients that are under special monitoring treatment (PCEM)
- Eventual presence of due amount which remains overdue over 30 days (based on materiality threshold),
- Existence of "forbearance" measures;
- Exposures with certain rating downgrades since origination
- Finally, certain indicators of the internal credit risk tracking system are considered for the purpose of transition between "Stages" where appropriate.

Recognition of significant increase in credit risk since origination can also be based on the number of rating downgrades since origination. The number of downgrades required for Stage 2 classification is determined based on the Iinternal credit rating at origination and distance from the low credit quality rating grade.

Forward looking information

The measurement of the financial assets also reflects the best estimate of the effects of future conditions and in particular the economic conditions that affect the forward-looking PDs and LGDs. 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.

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,

According to this approach, the macroeconomic conditioning of PD and LGD is carried out through a baseline scenario ("Most Likely") and then corrected with an Add-On to include any differences compared to downside and upside scenarios. If the overall impact of the Add-On on the risk parameters is positive, the decision has been made to neutralise the effect for both staging and ECL calculation purposes. The macroeconomic scenario is determined by the Group based on adjusted publicly available information.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Modification of financial asset

In some cases, during the lifetime of these financial assets, and of loans in particular, the original contractual conditions may be subsequently modified by the parties to the contract. When the contractual clauses are subject to change during the lifetime of an instrument, it is necessary to verify whether the original asset should continue to be recognised in the balance sheet or whether, instead, the original instrument needs to be derecognised and a new financial instrument needs to be recognised. In general, changes to a financial asset lead to its derecognition and the recognition of a new asset when they are "substantial". The assessment of the "substantial nature" of the change must be made using both qualitative and quantitative information.

The qualitative and quantitative analyses aimed at defining the "substantial nature" of contractual changes made to a financial asset must therefore consider:

- the purposes for which the changes were made: e.g. renegotiations for commercial reasons and forbearance measures due to financial difficulties of the counterparty:
  - the former, aimed at "retaining" the customer, involve a borrower that is not in financial difficulty.
  - the latter, carried out for "reasons of credit risk" (forbearance measures), relate to the bank's attempt to maximise the recovery of the cash flows of the original loan.
- the presence of specific triggers that affect the contractual characteristics and/or cash flows of the financial instrument.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables: probability of default (PD), loss given default (LGD) and exposure at default (EAD), while for stage 2 exposures remaining maturity and discounting rate should be given as well.

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL (stage 2 exposures) is defined as the expected present value measure of losses that arise if a borrower defaults on their obligation throughout the life of financial instrument. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD properly discounted to the reporting date.

The following definitions apply for PD, LGD and EAD:

- PD (Probability of Default): likelihood of migrating from performing to non-performing status over the period of one year. The PD factor is typically quantified through the rating. In the Group, the PD values are derived from internal rating models where available

- LGD (Loss Given Default): percentage loss in the event of default, LGD rates are derived from internally developed, collection models;

- EAD (Exposure At Default) or credit equivalent: amount of the exposure at the time of default.

The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default.

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Group **(in HRK million)**

	2018					2017, restated		
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Purchased credit - impaired	Total	Individual	Collective	Total
Loans and advances to customers at amortised cost								
Balance at 1 January	**566**	**705**	**3,194**	**52**	**4,517**	**3,552**	**671**	**4,223**
Transfer to 12-month ECL	265	(223)	(42)	-	**-**	-	-	**-**
Transfer to lifetime ECL not credit-impaired	(60)	172	(112)	-	**-**	-	-	**-**
Transfer to lifetime ECL credit – impaired	(14)	(29)	43	-	**-**	-	-	**-**
Net remeasurement of loss allowance	(123)	(62)	532	(11)	**336**	864	(41)	**823**
Financial assets that have been derecognised	6	(4)	(296)	-	**(294)**	-	-	**-**
Write-offs	-	-	(541)	-	**(541)**	(1,169)	-	**(1,169)**
Changes in models/ risk parameters	2	-	-	-	**2**	-	-	**-**
Foreign exchange and other movements	4	10	(30)	-	**(16)**	(16)	(1)	**(17)**
Balance at 31 December	**646**	**569**	**2,748**	**41**	**4,004**	**3,231**	**629**	**3,860**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Bank **(in HRK million)**

	2018					2017		
	12-month ECL	Lifetime ECL not credit - impaired	Lifetime ECL credit - impaired	Purchased credit - impaired	Total	Individual	Collective	Total
Loans and advances to customers at amortised cost								
Balance at 1 January	**397**	**575**	**2,219**	**52**	**3,243**	**2,369**	**508**	**2,877**
Transfer to 12-month ECL	159	(141)	(18)	-	-	-	-	-
Transfer to lifetime ECL not credit-impaired	(45)	148	(103)	-	-	-	-	-
Transfer to lifetime ECL credit – impaired	(12)	(2)	14	-	-	-	-	-
Net remeasurement of loss allowance	(48)	(145)	406	(11)	**202**	607	(18)	**589**
Financial assets that have been derecognised	-	-	(251)	-	**(251)**	-	-	-
Write-offs	-	-	(378)	-	**(378)**	(819)	-	**(819)**
Changes in models/ risk parameters	-	-	-	-	-	-	-	-
Foreign exchange and other movements	7	6	28	-	41	(15)	-	**(15)**
Balance at 31 December	**458**	**441**	**1,917**	**41**	**2,857**	**2,142**	**490**	**2,632**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Group

(in HRK million)

	2018				2017, restated
	12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Total	Total
Debt investment securities at FVOCI (2017: available-for-sale investment securities)					
Balance at 1 January	**32**	**-**	**-**	**32**	**-**
Net remeasurement of loss allowance	(19)	-	-	(19)	-
New financial assets originated or purchased	6	-	-	6	-
Financial assets that have been derecognised	(13)	-	-	(13)	-
Foreign exchange and other movements	4	-	-	4	-
Balance at 31 December	**10**	**-**	**-**	**10**	**-**

Bank **(in HRK million)**

		2018				2017
	Notes	12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Total	Total
Debt investment securities at FVOCI (2017: debt available-for-sale investment securities)						
Balance at 1 January		**22**	**-**	**-**	**22**	**-**
Net remeasurement of loss allowance		(6)	-	-	(6)	-
New financial assets originated or purchased		6	-	-	6	-
Financial assets that have been derecognised		(13)	-	-	(13)	-
Balance at 31 December		**9**	**-**	**-**	**9**	**-**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers: analysis by performance (comparative information under IAS39)

(in HRK million)

	GROUP Restated 2017	BANK 2017
Loans and advances to customers		
Neither past due nor impaired	60,044	41,186
Past due but not impaired	3,014	1,912
Impaired	6,183	4,269
Gross	**69,241**	**47,367**
Specific impairment allowance	(3,207)	(2,142)
IBNR	(653)	(490)
Net of impairment allowance	**65,381**	**44,735**

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 Restated 2017	BANK 2017
Loans and advances to corporate customers		
Standard monitoring	27,734	18,654
Special monitoring	1,895	1,588
Loans and advances to retail customers		
Standard monitoring	30,415	20,944
Total	**60,044**	**41,186**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers: analysis by performance (comparative information under IAS39) (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, 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	-	-	3	-	-	**3**
Enterprises	**301**	**137**	**143**	**-**	**-**	**581**
of which:						
Micro enterprises	15	1	50	-	-	**66**
Small enterprises	44	77	71	-	-	**192**
Mid enterprises	216	59	22	-	-	**297**
Large corporate	26	-	-	-	-	**26**
Others	223	-	285	-	-	**508**
Loans and advances to corporate customers	**524**	**137**	**431**	**-**	**-**	**1,092**
Housing loans	330	187	237	33	-	**787**
Mortgage loans	8	33	22	3	-	**66**
Car loans	4	-	1	-	-	**5**
Non-purpose loans	128	158	132	17	-	**435**
Quick loans	25	6	25	1	-	**57**
Overdrafts	14	5	7	1	-	**27**
Refinancing	52	53	72	17	-	**194**
Credit cards	111	106	36	-	-	**253**
Others	14	41	14	1	-	**70**
Craftsmen	10	1	16	1	-	**28**
Loans and advances to retail customers	**696**	**590**	**562**	**74**	**-**	**1,922**
Total	**1,220**	**727**	**993**	**74**	**-**	**3,014**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Loans and advances to customers: analysis by performance (comparative information under IAS39) (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**

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: analysis by performance (comparative information under IAS39) (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	2017
Loans and advances to corporate customers		
Government and municipalities	5	5
Enterprises	3,354	1,887
of which:		
Micro enterprises	677	*268*
Small enterprises	466	*277*
Mid enterprises	497	*106*
Large corporate	1,714	*1,236*
Others	252	252
Total gross amount	**3,611**	**2,144**
Specific impairment allowance	(2,074)	(1,291)
Net amount	**1,537**	**853**
Loans and advances to retail customers		
Housing loans	578	507
Mortgage loans	94	75
Car loans	13	9
Non-purpose loans	251	158
Quick loans	31	31
Overdrafts	82	68
Refinancing	1,192	1,170
Credit cards	158	14
Others	17	4
Craftsmen	156	89
Total gross amount	**2,572**	**2,125**
Specific impairment allowance	(1,133)	(851)
Net amount	**1,439**	**1,274**
Total gross amount	**6,183**	**4,269**
Specific impairment allowance	(3,207)	(2,142)
Net amount	**2,976**	**2,127**

Notes to the financial statements (continued)

49 Financial risk management policies (continued)

a) Credit risk (continued)

Analysis of performance of other financial assets (comparative information under IAS39)

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, restated				
Neither past due nor impaired	2,189	2,434	7,441	16
Past due but not impaired	-	-	-	-
Impaired	-	4	-	-
Gross	**2,189**	**2,438**	**7,441**	**16**
Specific impairment allowance	-	(4)	-	-
IBNR	-	(19)	-	-
Net of impairment allowance	**2,189**	**2,415**	**7,441**	**16**

(in HRK million)

Bank	Financial assets at fair value through profit or loss	Loans and advances to banks	Financial assets available for sale
As at 31 December 2017			
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**

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	
	2018	2017 restated	2018	2017
Government bonds and treasury bills	**828**	**2,189**	**828**	**2,189**
BB+	650	-	650	-
BB	-	355	-	355
B	-	1,559	-	1,559
Ba2	4	-	4	-
no rating	174	275	174	275
Domestic corporate bonds	**-**	**-**	**-**	**-**
no rating	-	-	-	-
Municipal bonds	**-**	**-**	**-**	**-**
no rating	-	-	-	-
Total	**828**	**2,189**	**828**	**2,189**

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 2018 derivative financial instruments with positive fair value amounted to HRK 10 million (31 December 2017: HRK 22 million) for the Group and HRK 1 million (31 December 2017: HRK 2 million) for the Bank, while derivative financial instruments with negative fair value amounted to HRK 34 million (31 December 2017: HRK 13 million) for the Group and HRK 4 million (31 December 2017: HRK 7 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	
	2018	2017	2018	2017
Receivables from reverse sale and repurchase agreements related to:	**625**	**228**	**625**	**232**
- loans and advances to banks	*380*	97	*380*	101
- loans and advances to customers	*245*	131	*245*	131
Fair value of collateral accepted in respect of the above	701	185	701	189
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% (2017: 17%) of foreign currency liabilities in short-term assets. The actual figures were as follows:

2018	%	2017	%
"17% ratio" (at year end)	25.26	"17% ratio" (at year end)	32.6
Average	33.38	Average	26.7
Maximum	42.05	Maximum	37.8
Minimum	24.35	Minimum	19.3

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 53 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
2018 – 2 January	288	1,776	3,337	(1,860)	**3,541**
2018 – 31 December	-	2,487	235	(125)	**2,597**
2018 – Average daily	99	1,843	1,234	(695)	**2,481**
2018 – Lowest	-	922	1	26	**949**
2018 – Highest	308	2,771	5,523	(3,358)	**5,244**

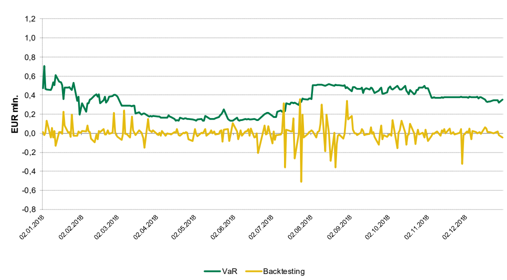
Note: historical simulation used for VaR calculations

(in HRK thousand)

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

Note: historical simulation used for VaR calculations

Chart below presents Bank's Total VaR movements in 2017 and 2018 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 2018 three backtest breaches were observed, all due to change in interest 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 2018 and 31 December 2017 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 2018*	Scenario 2018		FX Open position 31 December 2017*	Scenario 2017 restated	
		10% Move Up	10% Move Down		10% Move Up	10% Move Down
EUR	**234**	23	(23)	**(125)**	(12,5)	12,5
CHF	**2**	0,2	(0,2)	**6**	0,6	(0,6)
USD	**18**	1,8	(1,8)	**7**	0,7	(0,7)
Other	**2,133**	213	(213)	**1,947**	195	(195)

* 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)

Currency risk (continued)

Bank

(in HRK million)

Currency	FX Open position 31 December 2018*	Scenario 2018 10% Move Up	Scenario 2018 10% Move Down	FX Open position 31 December 2017*	Scenario 2017 10% Move Up	Scenario 2017 10% Move Down
EUR	**260**	26	(26)	**627**	63	(63)
CHF	**2**	0,2	(0,2)	**8**	0,8	(0,8)
USD	**18**	2	(2)	**15**	1,5	(1,5)
Other	**5**	1	(1)	**89**	9	(9)

* 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 2018. 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 2018			Change at 31 December 2017 restated		
	Increase in basis points	interest income	interest expenses	net interest income	interest income	interest expenses	net interest income
Group	+25	138,1	(59,5)	84,7	129,0	(46,9)	82,1
	+50	276,1	(119,0)	169,5	259,4	(98,9)	160,5
Bank	+25	105,9	(44,9)	61,0	97,7	(40,0)	57,7
	+50	211,8	(89,7)	122,1	196,8	(85,2)	111,6

A decrease in basis points would have an opposite effect on the Bank and Group's net interest income in the same amount.

Interest rate risk management is further analysed in Note 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 2018						
HRK	(167)	(314)	(637)	(906)	(325)	**(2,349)**
EUR	(199)	293	271	(1.471)	(692)	**(1,798)**
USD	(12)	33	39	4	19	**83**
CHF	(3)	(1)	2	(8)	(7)	**(17)**
Other	-	(1)	(20)	(190)	15	**(196)**
Total	**(381)**	**10**	**(345)**	**(2,571)**	**(990)**	**(4,277)**
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)**

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 2018						
HRK	(90)	(177)	(822)	(1,286)	(117)	(2,492)
EUR	(206)	329	150	(1,386)	(452)	(1,565)
USD	(9)	31	36	-	19	77
CHF	(2)	-	2	(7)	(7)	(14)
Other	-	2	-	-	-	2
Total	**(307)**	**185**	**(634)**	**(2,679)**	**(557)**	**(3,992)**
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)**

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	
	2018	Restated 2017	2018	2017
	%	%	%	%
Current accounts with banks	(0.06)	(0.12)	(0.03)	(0.07)
Balances with the Croatian National Bank	0.00	0.00	0.00	0.00
Financial assets at fair value through profit or loss	0.88	0.96	3.14	0.96
Loans and advances to banks	(0.08)	(0.14)	(0.11)	(0.18)
Loans and advances to customers	4.28	4.72	4.87	5.34
Current accounts and deposits from customers	0.35	0.54	0.32	0.54
Current accounts and deposits from banks and interest-bearing borrowings	0.82	0.99	0.88	1.06

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 2018**	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	6,196	106	246	1,280	178	10,436	**18,442**
Balances with the Croatian National Bank	-	-	-	-	-	4,698	**4,698**
Financial assets held for trading	118	-	202	-	-	508	**828**
Derivative financial assets	6	-	2	1	-	1	**10**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	9	-	-	-	-	-	**9**
Loans and advances to banks	4,542	591	1,556	656	427	12	**7,784**
Loans and advances to customers	39,461	77	671	2,137	-	24,342	**66,688**
Investment securities	4,532	-	379	2	-	5,644	**10,557**
Investments in subsidiaries and associates	-	-	-	-	-	69	**69**
Intangible assets	30	-	-	21	-	189	**240**
Property and equipment	193	-	-	44	-	1,100	**1,337**
Investment property	-	-	-	-	-	7	**7**
Non-current assets held for sale	130	-	-	3	-	201	**334**
Deferred tax assets	-	-	-	1	-	141	**142**
Other assets	251	-	26	39	-	424	**740**
Current tax assets	-	-	-	5	-	123	**128**
Total assets	**55,468**	**774**	**3,082**	**4,189**	**605**	**47,895**	**112,013**
Liabilities							
Current accounts and deposits from banks	954	16	5	32	37	799	**1,843**
Current accounts and deposits from custom-ers	49,884	752	3,259	2,731	540	28,772	**85,938**
Derivative financial liabilities	33	-	1	-	-	-	**34**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	-	-	-	-	-	**4**
Interest-bearing borrowings	2,275	-	64	-	-	1,821	**4,160**
Subordinated liabilities	-	-	-	-	-	-	**-**
Other liabilities	224	2	16	116	3	1,633	**1,994**
Accrued expenses and deferred income	67	-	-	-	-	305	**372**
Provisions	202	-	13	18	30	253	**516**
Deferred tax liabilities	15	-	-	8	-	48	**71**
Current tax liability	6	-	-	-	-	5	**11**
Total liabilities	**53,664**	**770**	**3,358**	**2,905**	**610**	**33,636**	**94,943**
Net position	**1,804**	**4**	**(276)**	**1,284**	**(5)**	**14,259**	**17,070**

Notes to the financial statements (continued)

52 Currency risk (continued)

(in HRK million)

Group As at 31 December 2017 restated	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	9,571	683	290	834	386	7,220	**18,984**
Balances with the Croatian National Bank	-	-	-	-	-	4,246	**4,246**
Financial assets held for trading	96	-	55	-	-	399	**550**
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	571	-	1,094	566	184	-	**2,415**
Loans and advances to customers	39,438	87	750	2,148	-	22,746	**65,169**
Investment securities	4,594	-	358	253	-	4,126	**9,331**
Investments in subsidiaries and associates	-	-	-	-	-	69	**69**
Intangible assets	26	-	-	25	-	176	**227**
Property and equipment	199	-	-	50	-	1,129	**1,378**
Non-current assets held for sale	262	-	-	3	-	192	**457**
Investment property	-	-	-	-	-	8	**8**
Deferred tax assets	7	-	-	1	-	117	**125**
Other assets	527	-	16	40	-	467	**1,050**
Current tax assets	4	-	-	11	-	7	**22**
Total assets	**55,313**	**770**	**2,565**	**3,932**	**570**	**40,904**	**104,054**
Liabilities							
Current accounts and deposits from banks	757	14	9	53	45	493	**1,371**
Current accounts and deposits from customers	48,602	745	2,976	2,731	519	23,254	**78,827**
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	2,772	-	103	-	-	941	**3,816**
Subordinated liabilities	-	-	-	1	-	-	**1**
Other liabilities	358	2	11	100	2	1,903	**2,376**
Accrued expenses and deferred income	66	-	-	-	-	297	**363**
Provisions	126	-	12	17	25	230	**410**
Deferred tax liabilities	29	-	1	8	-	48	**86**
Current tax liability	-	-	-	1	-	5	**6**
Total liabilities	**52,724**	**761**	**3,112**	**2,912**	**591**	**27,178**	**87,278**
Net position	**2,589**	**9**	**(547)**	**1,020**	**(21)**	**13,726**	**16,776**

Notes to the financial statements (continued)

52 Currency risk (continued)

(in HRK million)

Bank **As at 31 December 2018**	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	3,353	86	186	5	119	10,431	14,180
Balances with the Croatian National Bank	-	-	-	-	-	4,698	4,698
Financial assets held for trading	118	-	202	-	-	508	828
Derivative financial assets	-	-	-	-	-	1	1
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	-	-	-	-	-	-
Loans and advances to banks	4,550	513	1,421	-	381	4	6,869
Loans and advances to customers	22,806	52	577	-	-	22,022	45,457
Investment securities	1,757	-	59	-	-	5,558	7,374
Investments in subsidiaries and associates	-	-	-	-	-	1,962	1,962
Intangible assets	-	-	-	-	-	186	186
Property and equipment	-	-	-	-	-	636	636
Investment property	-	-	-	-	-	1	1
Non-current assets held for sale	22	-	-	-	-	102	124
Deferred tax assets	-	-	-	-	-	95	95
Other assets	32	-	26	-	-	302	360
Current tax assets	-	-	-	-	-	123	123
Total assets	**32,638**	**651**	**2,471**	**5**	**500**	**46,629**	**82,894**
Liabilities							
Current accounts and deposits from banks	492	23	5	-	36	924	**1,480**
Current accounts and deposits from custom-ers	30,709	619	2,709	3	438	28,564	**63,042**
Derivative financial liabilities	-	-	-	-	-	4	**4**
Interest-bearing borrowings	1,320	-	-	-	-	1,712	**3,032**
Subordinated liabilities	-	-	-	-	-	-	**-**
Other liabilities	55	2	9	-	2	533	**601**
Accrued expenses and deferred income	1	-	-	-	-	158	**159**
Provisions	108	-	13	-	30	242	**393**
Deferred tax liabilities						32	**32**
Total liabilities	**32,685**	**644**	**2,736**	**3**	**506**	**32,169**	**68,743**
Net position	**(47)**	**7**	**(265)**	**2**	**(6)**	**14,460**	**14,151**

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 currencies	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 held for trading	97	-	56	-	-	397	**550**
Derivative financial assets	-	-	-	-	-	2	**2**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	-	-	-	-	-	**-**
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**
Investment securities	1,695	-	44	-	-	4,066	**5,805**
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**
Current tax assets	-	-	-	-	-	4	**4**
Total assets	**32,968**	**636**	**1,967**	**86**	**466**	**39,374**	**75,497**
Liabilities							
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**
Subordinated liabilities	-	-	-	-	-	-	**-**
Other liabilities	89	2	8	-	1	577	**677**
Accrued expenses and deferred income	1	-	-	-	-	164	**165**
Provisions	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)

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 2018 and 31 December 2017.

(in HRK million)

Group **As at 31 December 2018**	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	1,254	451	208	(70)	-	**1,843**	**1,843**
Current accounts and deposits from custom-ers	42,513	4,919	13,994	24,524	333	**86,283**	**85,938**
Derivative financial liabilities	4	2	-	-	29	**35**	**34**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	-	-	-	-	**4**	**4**
Interest-bearing borrowings	253	165	537	2,310	1,005	**4,270**	**4,160**
Other liabilities*	2,440	157	209	139	22	**2,967**	**2,964**
Total undiscounted financial liabilities	**46,468**	**5,694**	**14,948**	**26,903**	**1,389**	**95,402**	**94,943**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	2,416	1,041	7,417	1,577	2,624	**15,075**	**15,077**
Other contingent liabilities	558	577	2,487	1,236	222	**5,080**	**5,080**
Total undiscounted off-balance sheet con-tingent liabilities and commitments	**2,974**	**1,618**	**9,904**	**2,813**	**2,846**	**20,155**	**20,157**
As of 31 December 2017 restated							
Liabilities							
Current accounts and deposits from banks	831	231	253	61	-	**1,376**	**1,371**
Current accounts and deposits from custom-ers	47,852	5,310	15,258	10,510	426	**79,356**	**78,827**
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	113	90	751	2,032	957	**3,943**	**3,816**
Other liabilities*	2,639	135	312	116	41	**3,243**	**3,242**
Total undiscounted financial liabilities	**51,440**	**5,768**	**16,576**	**12,731**	**1,426**	**87,941**	**87,278**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	3,436	792	5,198	2,139	2,677	**14,242**	**14,242**
Other contingent liabilities	635	812	2,254	1,214	247	**5,162**	**5,160**
Total undiscounted off-balance sheet con-tingent liabilities and commitments	**4,071**	**1,604**	**7,452**	**3,353**	**2,924**	**19,404**	**19,402**

* 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 2018**	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	1,174	1	164	146	-	**1,485**	**1,480**
Current accounts and deposits from customers	25,666	4,113	11,695	21,514	271	**63,259**	**63,042**
Derivative financial liabilities	4	-	-	-	-	**4**	**4**
Interest-bearing borrowings	24	41	288	2,015	758	**3,126**	**3,032**
Other liabilities*	893	68	165	36	22	**1,184**	**1,185**
Total undiscounted financial liabilities	**27,761**	**4,223**	**12,312**	**23,711**	**1,051**	**69,058**	**68,743**
Off-balance sheet contingent liabilities and commitments							
Undrawn lending commitments	984	717	5,579	1,199	2,624	**11,103**	**11,103**
Other contingent liabilities	394	394	1,830	852	138	**3,608**	**3,609**
Total undiscounted off-balance sheet contingent liabilities and commitments	**1,378**	**1,111**	**7,409**	**2,051**	**2,762**	**14,711**	**14,712**
As at 31 December 2017							
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**

* 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 2018 and 31 December 2017. 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 2018**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	18,442	-	**18,442**
Balances with the Croatian National Bank	-	4,698	**4,698**
Financial assets held for trading	49	779	**828**
Derivative financial assets	2	8	**10**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	9	**9**
Loans and advances to banks	7,632	152	**7,784**
Loans and advances to customers	19,745	46,943	**66,688**
Investment securities	7,023	3,534	**10,557**
Investments in subsidiaries and associates	-	69	**69**
Intangible assets	-	240	**240**
Property and equipment	-	1,337	**1,337**
Investment property	-	7	**7**
Non-current assets held for sale	334	-	**334**
Deferred tax assets	118	24	**142**
Other assets	670	70	**740**
Current tax assets	128	-	**128**
Total assets	**54,143**	**57,870**	**112,013**
Liabilities			
Current accounts and deposits from banks	1,799	44	**1,843**
Current accounts and deposits from customers	61,210	24,728	**85,938**
Derivative financial liabilities	5	29	**34**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	-	**4**
Interest-bearing borrowings	952	3,208	**4,160**
Subordinated liabilities	-	-	**-**
Other liabilities	1,994	-	**1,994**
Accrued expenses and deferred income	359	13	**372**
Provisions	390	126	**516**
Deferred tax liabilities	65	6	**71**
Current tax liability	11	-	**11**
Total liabilities	**66,789**	**28,154**	**94,943**
Net expected maturity gap	**(12,646)**	**29,716**	**17,070**

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 restated**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	18,984	-	**18,984**
Balances with the Croatian National Bank	-	4,246	**4,246**
Financial assets held for trading	23	527	**550**
Derivative financial assets	22	-	**22**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	1	**1**
Loans and advances to banks	2,051	364	**2,415**
Loans and advances to customers	19,860	45,309	**65,169**
Investment securities	4,499	4,832	**9,331**
Investments in subsidiaries and associates	-	69	**69**
Intangible assets	-	227	**227**
Property and equipment	-	1,378	**1,378**
Investment property	-	8	**8**
Non-current assets held for sale	457	-	**457**
Deferred tax assets	18	107	**125**
Other assets	969	81	**1,050**
Current tax assets	22	-	**22**
Total assets	**46,905**	**57,149**	**104,054**
Liabilities			
Current accounts and deposits from banks	1,311	60	**1,371**
Current accounts and deposits from customers	54,058	24,769	**78,827**
Derivative financial liabilities	13	-	**13**
Fair value changes of the hedged items in portfolio hedge of interest rate risk		9	**9**
Interest-bearing borrowings	952	2,864	**3,816**
Subordinated liabilities	1	-	**1**
Other liabilities	2,376	-	**2,376**
Accrued expenses and deferred income	352	11	**363**
Provisions	-	410	**410**
Deferred tax liabilities	-	86	**86**
Current tax liability	6	-	**6**
Total liabilities	**59,069**	**28,209**	**87,278**
Net expected maturity gap	**(12,164)**	**28,940**	**16,776**

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 2018**	Less than 12 months	Over 12 months	Total
Assets			
Cash and current accounts with banks	14,180	-	**14,180**
Balances with the Croatian National Bank	-	4,698	**4,698**
Financial assets held for trading	49	779	**828**
Derivative financial assets	1	-	**1**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	-	**-**
Loans and advances to banks	6,869	-	**6,869**
Loans and advances to customers	12,780	32,677	**45,457**
Investment securities	6,017	1,357	**7,374**
Investments in subsidiaries and associates	-	1,962	**1,962**
Intangible assets	-	186	**186**
Property and equipment	-	636	**636**
Investment property	-	1	**1**
Non-current assets held for sale	124	-	**124**
Deferred tax assets	95	-	**95**
Other assets	311	49	**360**
Current tax assets	123	-	**123**
Total assets	**40,549**	**42,345**	**82,894**
Liabilities			
Current accounts and deposits from banks	1,338	142	**1,480**
Current accounts and deposits from customers	41,257	21,785	**63,042**
Derivative financial liabilities	4	-	**4**
Interest-bearing borrowings	351	2,681	**3,032**
Subordinated liabilities	-	-	**-**
Other liabilities	601	-	**601**
Accrued expenses and deferred income	147	12	**159**
Provisions	347	46	**393**
Deferred tax liabilities	32	-	**32**
Current tax liability	-	-	**-**
Total liabilities	**44,077**	**24,666**	**68,743**
Net expected maturity gap	**(3,528)**	**17,679**	**14,151**

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 held for trading	25	525	**550**
Derivative financial assets	2	-	**2**
Fair value changes of the hedge items in portfolio hedge of interest rate risk	-	-	**-**
Loans and advances to banks	1,493	-	**1,493**
Loans and advances to customers	12,271	32,291	**44,562**
Investment securities	3,451	2,354	**5,805**
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**
Current tax assets	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**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	**-**
Interest-bearing borrowings	477	1,900	**2,377**
Subordinated liabilities	-	-	**-**
Other liabilities	677	-	**677**
Accrued expenses and deferred income	153	12	**165**
Provisions	-	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)

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)

	GROUP			BANK		
As at 31 December 2018	Assets	Liabilities	Off balance sheet liabilities	Assets	Liabilities	Off balance sheet liabilities
Geographic region						
Republic of Croatia	75,012	67,690	13,200	72,115	64,950	13,326
Other European Union members	27,135	20,364	5,453	8,561	2,156	1,179
Other countries	9,866	6,889	1,504	2,218	1,637	207
	112,013	**94,943**	**20,157**	**82,894**	**68,743**	**14,712**
Industry sector						
Citizens	35,984	58,552	7,907	25,062	43,204	6,092
Finance	21,342	12,440	981	17,793	7,668	818
Government	19,450	2,892	349	14,621	2,092	298
Commerce	3,915	3,449	2,748	1,955	2,445	1,381
Tourism	2,554	1,277	367	2,161	1,062	352
Agriculture	1,028	324	119	913	274	106
Other sectors	27,740	16,009	7,686	20,389	11,998	5,665
	112,013	**94,943**	**20,157**	**82,894**	**68,743**	**14,712**

(in HRK million)

	GROUP			BANK		
As at 31 December 2017 restated	Assets	Liabilities	Off balance sheet items	Assets	Liabilities	Off balance sheet items
Geographic region						
Republic of Croatia	72,936	62,040	12,752	69,616	58,244	12,844
Other European Union members	20,875	18,439	5,145	2,885	1,833	1,488
Other countries	10,243	6,799	1,505	2,996	1,665	303
	104,054	**87,278**	**19,402**	**75,497**	**61,742**	**14,635**
Industry sector						
Citizens	34,155	56,141	7,381	23,813	40,758	5,983
Finance	23,064	8,021	1,281	22,294	5,167	1,110
Government	18,723	2,974	104	13,041	2,230	102
Commerce	3,931	3,122	2,668	1,975	2,167	1,295
Tourism	2,457	1,219	154	2,102	1,010	118
Agriculture	994	361	161	901	323	151
Other sectors	20,730	15,440	7,653	11,371	10,087	5,876
	104,054	**87,278**	**19,402**	**75,497**	**61,742**	**14,635**

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 (2017: 19,010,136). 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	
	2018	Restated 2017	2018	2017
Profit attributable to equity holders of the Bank (in HRK million)	1,681	1,280	1,380	1,443
Weighted average number of ordinary shares	19,010,136	19,010,136	19,010,136	19,010,136
Basic and diluted earnings per share (in HRK per share)	**88.4**	**67.3**	**72.6**	**75.9**

Appendix 1 - Supplementary forms required by local regulation

This is the first year of presentation of the supplementary forms in the new format, accordingly amounts related to 2017 are only of a presentational nature.

The content of supplementary forms prepared in accordance with the CNB's Decision on the Structure and Content of the Annual Financial Statements of Credit Institutions (Official Gazette 42/18) does not prescribe separate categories for comparative financial information for financial instruments. Considering that comparative financial information have not been restated related to the first-time adoption of IFRS 9 Financial Instruments, financial instruments have been classified as follows: held-to-maturity financial assets are presented as financial assets at amortised cost and available-for-sale financial assets are presented as financial assets at fair value through other comprehensive income. The related classification has also been followed in income statement and cash flow statement as appropriate.

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 the Annual Financial Statements of credit institutions, dated 9 May 2018 (Official Gazette 42/18):

Form "Balance sheet"

(in HRK million)

	GROUP		BANK	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Assets				
Cash and deposits with the Croatian National Bank	16,008	17,365	14,178	15,442
Cash in hand	*3,219*	*2,611*	*1,770*	*1,616*
Deposits with the Croatian National Bank	*9,678*	*11,962*	*9,678*	*11,683*
Other deposits	*3,111*	*2,792*	*2,730*	*2,143*
Financial assets held for trading	830	553	829	552
Derivatives	*2*	*3*	*1*	*2*
Equity instruments	-	-	-	-
Debt securities	*828*	*550*	*828*	*550*
Loans and advances	-	-	-	-
Non-trading financial assets mandatorily at fair value through profit or loss	60	-	36	-
Equity instruments	*53*	-	*36*	-
Debt securities	-	-	-	-
Loans and advances	*7*	-	-	-
Financial assets designated at fair value through profit or loss	-	1,662	-	1,660
Debt securities	-	*1,662*	-	*1,660*
Loans and advances	-	-	-	-
Financial assets at fair value through other comprehensive income	9,963	7,667	6,807	4,145
Equity instruments	*168*	*211*	*62*	*92*
Debt securities	*9,795*	*7,456*	*6,745*	*4,053*
Loans and advances	-	-	-	-
Financial assets at amortised cost	82,761	73,706	57,960	50,533
Debt securities	*673*	*938*	*663*	*913*
Loans and advances	*82,088*	*72,768*	*57,297*	*49,620*
Derivatives – Hedge accounting	8	19	-	-
Fair value changes of the hedged items in portfolio hedge of interest rate risk	9	1	-	-
Investments in subsidiaries, joint ventures and associates	69	69	1,962	2,232

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

Form "Balance sheet"

(in HRK million)

	GROUP		BANK	
Assets	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Tangible assets	1,366	1,404	637	623
Intangible assets	259	246	204	181
Tax assets	270	147	218	83
Other assets	227	917	90	118
Non-current assets and disposal groups classified as held for sale	312	457	102	90
Total assets	**112,142**	**104,213**	**83,023**	**75,659**

(in HRK million)

	GROUP		BANK	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Liabilities				
Financial liabilities held for trading	4	8	4	7
Derivatives	*4*	*8*	*4*	*7*
Short positions	-	-	-	-
Deposits	-	-	-	-
Debt securities issued	-	-	-	-
Other financial liabilities	-	-	-	-
Financial liabilities designated at fair value through profit or loss	-	-	-	-
Deposits	-	-	-	-
Debt securities issued	-	-	-	-
Other financial liabilities	-	-	-	-
Financial liabilities measured at amortised cost	92,129	84,023	67,567	60,621
Deposits	*91,937*	*84,007*	*67,552*	*60,605*
Debt securities issued	-	-	-	-
Other financial liabilities	*192*	*16*	*15*	*16*
Derivatives – Hedge accounting	30	5	-	-
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4	8	-	-
Provisions	629	526	506	364
Tax liabilities	82	92	32	30
Share capital repayable on demand	-	-	-	-
Other liabilities	2,194	2,777	763	882
Liabilities included in disposal groups classified as held for sale	-	-	-	-
Total liabilities	**95,072**	**87,439**	**68,872**	**61,904**

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

Form "Balance sheet" (continued)

(in HRK million)

	GROUP		BANK	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
Equity				
Share capital	1,907	1,907	1,907	1,907
Share premium	1,570	1,570	1,570	1,570
Equity instruments issued other than capital	-	-	-	-
Other equity	-	-	-	-
Accumulated other comprehensive income	82	99	59	49
Retained earnings	10,687	10,579	8,939	8,566
Revaluation reserves	210	206	96	96
Other reserves	(25)	102	276	200
(-) Treasury shares	(76)	(76)	(76)	(76)
Profit or loss attributable to owners of the parent	1,681	1,280	1,380	1,443
(-) Interim dividends	-	-	-	-
Minority interests [Non-controlling interests]	1,034	1,051	-	-
Total equity	**17,070**	**16,718**	**14,151**	**13,755**
Total liabilities and equity	**112,142**	**104,157**	**83,023**	**75,659**
Total equity	**17,070**	**16,718**	**14,151**	**13,755**
Equity holders of the Bank	16,036	15,667	14,151	13,755
Non-controlling interests	1,034	1,051	-	-

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 2018

Assets **Per IFRS** **(in HRK million)**

GROUP CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	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	Investment securities	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	16,008	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**16,008**
Cash in hand	*3,219*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**3,219**
Deposits with the Croatian National Bank	*9,678*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**9,678**
Other deposits	*3,111*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**3,111**
Financial assets held for trading	-	-	828	2	-	-	-	-	-	-	-	-	-	-	-	-	**830**
Derivatives	-	-	-	*2*	-	-	-	-	-	-	-	-	-	-	-	-	**2**
Equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Debt securities	-	-	*828*	-	-	-	-	-	-	-	-	-	-	-	-	-	**828**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Non-trading financial assets mandatorily at fair value through profit or loss	-	-	-	-	-	-	7	53	-	-	-	-	-	-	-	-	**60**
Equity instruments	-	-	-	-	-	-	-	*53*	-	-	-	-	-	-	-	-	**53**
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Assets (continued)

Per IFRS **(in HRK million)**

GROUP **CNB schedules**	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	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	Investment securities	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**
Loans and advances	-	-	-	-	-	-	*7*	-	-	-	-	-	-	-	-	-	**7**
Financial assets designated at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Financial assets at fair value through other comprehensive income	-	-	-	-	-	-	-	9,963	-	-	-	-	-	-	-	-	**9,963**
Equity instruments	-	-	-	-	-	-	-	*168*	-	-	-	-	-	-	-	-	**168**
Debt securities	-	-	-	-	-	-	-	*9,795*	-	-	-	-	-	-	-	-	**9,795**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Assets (continued)

Per IFRS **(in HRK million)**

GROUP CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	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	In-vestment securities	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**
Financial assets at amortised cost	2,434	4,698	-	-	-	7,784	67,304	541	-	-	-	-	-	-	-	-	**82,761**
Debt securities	-	-	-	-	-	-	*132*	*541*	-	-	-	-	-	-	-	-	**673**
Loans and advances	*2,434*	*4,698*	-	-	-	*7,784*	*67,172*	-	-	-	-	-	-	-	-	-	**82,088**
Derivatives – Hedge accounting	-	-	-	8	-	-	-	-	-	-	-	-	-	-	-	-	**8**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	9	-	-	-	-	-	-	-	-	-	-	-	**9**
Investments in subsidiaries, joint ventures and associates	-	-	-	-	-	-	-	-	69	-	-	-	-	-	-	-	**69**
Tangible assets	-	-	-	-	-	-	-	-	-	-	1,337	7	22	-	-	-	**1,366**
Intangible assets	-	-	-	-	-	-	-	-	-	240	-	-	-	-	19	-	**259**
Tax assets	-	-	-	-	-	-	-	-	-	-	-	-	-	142	-	128	**270**
Other assets	-	-	-	-	-	-	(494)	-	-	-	-	-	-	-	721	-	**227**
Non-current assets and disposal groups classified as held for sale	-	-	-	-	-	-	-	-	-	-	-	-	312	-	-	-	**312**
Transfer to provisions	-	-	-	-	-	-	(129)	-	-	-	-		-	-	-	-	**(129)**
Total assets	**18,442**	**4,698**	**828**	**10**	**9**	**7,784**	**66,688**	**10,557**	**69**	**240**	**1,337**	**7**	**334**	**142**	**740**	**128**	**112,013**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Liabilities

Per IFRS **(in HRK million)**

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	**Total liabilities**
Financial liabilities held for trading	-	-	4	-	-	-	-	-	-	-	-	**4**
Derivatives	-	-	*4*	-	-	-	-	-	-	-	-	**4**
Short positions	-	-	-	-	-	-	-	-	-	-	-	-
Deposits	-	-	-	-	-	-	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	-	-
Financial liabilities designated at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	-
Deposits	-	-	-	-	-	-	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	-	-
Financial liabilities measured at amortised cost	1,843	85,938	-	-	4,160	-	188	-	-	-	-	**92,129**
Deposits	*1,843*	*85,761*	-	-	*4,160*	-	*173*	-	-	-	-	**91,937**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	-
Other financial liabilities	-	*177*	-	-	-	-	*15*	-	-	-	-	**192**
Derivatives – Hedge accounting	-	-	30	-	-	-	-	-	-	-	-	**30**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Liabilities

Per IFRS **(in HRK million)**

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	**Total liabilities**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	4	-	-	-	-	-	-	-	**4**
Provisions	-	-	-	-	-	-	-	-	629	-	-	**629**
Tax liabilities	-	-	-	-	-	-	-	-	-	71	11	**82**
Share capital repayable on demand	-	-	-	-	-	-	-	-	-	-	-	**-**
Other liabilities	-	-	-	-	-	-	1,806	372	16	-	-	**2,194**
Liabilities included in disposal groups classified as held for sale	-	-	-	-	-	-	-	-	-	-	-	**-**
Transfer from loans and advances to customers	-	-	-	-	-	-	-	-	(129)	-	-	**(129)**
Total liabilities	**1,843**	**85,938**	**34**	**4**	**4,160**	**-**	**1,994**	**372**	**516**	**71**	**11**	**94,943**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Equity

(in HRK million)

GROUP CNB schedules	Per IFRS 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**
Share premium	-	1,570	-	-	-	-	-	-	**1,570**
Equity instruments issued other than capital	-	-	-	-	-	-	-	-	**-**
Other equity	-	-	-	-	-	-	-	-	**-**
Accumulated other comprehensive income	-	-	-	-	82	-	-	-	**82**
Retained earnings	-	-	-	-	-	10,687	-	-	**10,687**
Revaluation reserves	-	-	-	210	-	-	-	-	**210**
Other reserves	-	-	-	1,189	-	-	(1,214)	-	**(25)**
(-) Treasury shares	-	-	(76)	-	-	-	-	-	**(76)**
Profit or loss attributable to owners of the parent	-	-	-	-	-	1,681	-	-	**1,681**
(-) Interim dividends	-	-	-	-	-	-	-	-	**-**
Minority interests [Non-controlling interests]	-	-	-	-	-	-	-	1,034	**1,034**
Total equity	**1,907**	**1,570**	**(76)**	**1,399**	**82**	**12,368**	**(1,214)**	**1,034**	**17,070**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Assets

Per IFRS **(in HRK million)**

BANK **CNB schedules**	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	Derivative financial assets	Fair value changes of the hedged items in portfolio hedge	Loans and advances to banks	Loans and advances to customers	Investment securities	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	14,178	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**14,178**
Cash in hand	*1,770*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**1,770**
Deposits with the Croatian National Bank	*9,678*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**9,678**
Other deposits	*2,730*	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**2,730**
Financial assets held for trading	-	-	828	1	-	-	-	-	-	-	-	-	-	-	-	-	**829**
Derivatives	-	-	-	*1*	-	-	-	-	-	-	-	-	-	-	-	-	**1**
Equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Debt securities	-	-	*828*	-	-	-	-	-	-	-	-	-	-	-	-	-	**828**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Non-trading financial assets mandatorily at fair value through profit or loss	-	-	-	-	-	-	-	36	-	-	-	-	-	-	-	-	**36**
Equity instruments	-	-	-	-	-	-	-	*36*	-	-	-	-	-	-	-	-	**36**
Debt securities	-	-	-	-	-	-	-		-	-	-	-	-	-	-	-	**-**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Assets (continued)

Per IFRS **(in HRK million)**

BANK CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	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	Investment securities	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**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets designated at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Debt securities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets at fair value through other comprehensive income	-	-	-	-	-	-	-	6,807	-	-	-	-	-	-	-	-	**6,807**
Equity instruments	-	-	-	-	-	-	-	*62*	-	-	-	-	-	-	-	-	**62**
Debt securities	-	-	-	-	-	-	-	*6,745*	-	-	-	-	-	-	-	-	**6,745**
Loans and advances	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Assets (continued)

Per IFRS **(in HRK million)**

BANK CNB schedules	Cash and current accounts with banks	Balances with the Croatian National Bank	Financial assets held for trading	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	Investment securities	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**
Financial assets at amortised cost	2	4,698	-	-	-	6,869	45,838	531	-	-	-	-	22	-	-	-	**57,960**
Debt securities	-	-	-	-	-	-	*132*	*531*	-	-	-	-	-	-	-	-	**663**
Loans and advances	*2*	*4,698*	-	-	-	*6,869*	*45,706*	-	-	-	-	-	*22*	-	-	-	**57,297**
Derivatives – Hedge accounting	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Investments in subsidiaries, joint ventures and associates	-	-	-	-	-	-	-	-	1,962	-	-	-	-	-	-	-	**1,962**
Tangible assets	-	-	-	-	-	-	-	-	-	-	636	1	-	-	-	-	**637**
Intangible assets	-	-	-	-	-	-	-	-	-	186	-	-	-	-	18	-	**204**
Tax assets	-	-	-	-	-	-	-	-	-	-	-	-	-	95	-	123	**218**
Other assets	-	-	-	-	-	-	(252)	-	-	-	-	-	-	-	342	-	**90**
Non-current assets and disposal groups classified as held for sale	-	-	-	-	-	-	-	-	-	-	-	-	102	-	-	-	**102**
Transfer to provisions	-	-	-	-	-	-	(129)	-	-	-	-	-	-	-	-	-	**(129)**
Total assets	**14,180**	**4,698**	**828**	**1**	**-**	**6,869**	**45,457**	**7,374**	**1,962**	**186**	**636**	**1**	**124**	**95**	**360**	**123**	**82,894**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Liabilities

Per IFRS **(in HRK million)**

BANK **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	**Total liabilities**
Financial liabilities held for trading	-	-	4	-	-	-	-	-	-	-	-	**4**
Derivatives	-	-	*4*	-	-	-	-	-	-	-	-	**4**
Short positions	-	-	-	-	-	-	-	-	-	-	-	**-**
Deposits	-	-	-	-	-	-	-	-	-	-	-	**-**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	**-**
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	-	**-**
Financial liabilities designated at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	**-**
Deposits	-	-	-	-	-	-	-	-	-	-	-	**-**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	**-**
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	-	**-**
Financial liabilities measured at amortised cost	1,480	63,042	-	-	3,030	-	15	-	-	-	-	**67,567**
Deposits	*1,480*	*63,042*	-	-	*3,030*	-	-	-	-	-	-	**67,552**
Debt securities issued	-	-	-	-	-	-	-	-	-	-	-	**-**
Other financial liabilities	-	-	-	-	-	-	*15*	-	-	-	-	**15**
Derivatives – Hedge accounting	-	-	-	-	-	-	-	-	-	-	-	**-**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Liabilities (continued)

Per IFRS **(in HRK million)**

BANK **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	**Total liabilities**
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	-	-	-	-	-	-	-	**-**
Provisions	-	-	-	-	-	-	-	-	506	-	-	**506**
Tax liabilities	-	-	-	-	-	-	-	-	-	32	-	**32**
Share capital repayable on demand	-	-	-	-	-	-	-	-	-	-	-	**-**
Other liabilities	-	-	-	-	2	-	586	159	16	-	-	**763**
Liabilities included in disposal groups classified as held for sale	-	-	-	-	-	-	-	-	-	-	-	**-**
Transfer from loans and advances to customers	-	-	-	-	-	-	-	-	(129)	-	-	**(129)**
Total liabilities	**1,480**	**63,042**	**4**	**-**	**3,032**	**-**	**601**	**159**	**393**	**32**	**-**	**68,743**

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

Balance sheet reconciliation as at 31 December 2018 (continued)

Equity

(in HRK million)

	Per IFRS								
BANK **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**
Share premium	-	1,570	-	-	-	-	-	-	**1,570**
Equity instruments issued other than capital	-	-	-	-	-	-	-	-	**-**
Other equity	-	-	-	-	-	-	-	-	**-**
Accumulated other comprehensive income	-	-	-	59	-	-	-	-	**59**
Retained earnings	-	-	-	-	-	8,939	-	-	**8,939**
Revaluation reserves	-	-	-	96	-	-	-	-	**96**
Other reserves	-	-	-	217	59	-	-	-	**276**
(-) Treasury shares	-	-	(76)	-	-	-	-	-	**(76)**
Profit or loss attributable to owners of the parent	-	-	-	-	-	1,380	-	-	**1,380**
(-) Interim dividends	-	-	-	-	-	-	-	-	**-**
Minority interests [Non-controlling interests]	-	-	-	-	-	-	-	-	**-**
Total equity	**1,907**	**1,570**	**(76)**	**372**	**59**	**10,319**	**-**	**-**	**14,151**

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

Form "Income statement"

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Interest income	3,198	3,442	2,444	2,690
(Interest expense)	(419)	(529)	(271)	(374)
(Expenses on share capital repayable on demand)	-	-	-	-
Dividend income	3	6	51	446
Fee and commission income	1.967	1.850	971	811
(Fee and commission expenses)	(449)	(348)	(293)	(126)
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	154	35	133	16
Gains or (-) losses on financial assets and liabilities held for trading, net	264	(26)	254	(29)
Gains or (-) losses on non-trading financial assets mandatorily at fair value through profit or loss, net	56	-	(6)	-
Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	-	(13)	-	(13)
Gains or (-) losses from hedge accounting, net	-	(1)	-	-
Exchange differences [gain or (-) loss], net	14	281	3	257
Gains or (-) losses on derecognition of non-financial assets, net	-	15	-	14
Other operating income	175	139	88	67
(Other operating expenses)	(487)	(292)	(230)	(82)
Total operating income, net	**4,476**	**4,559**	**3,144**	**3,667**
(Administrative expenses)	(1,917)	(2,010)	(1,239)	(1,369)
(Depreciation)	(197)	(196)	(132)	(111)
Modification gains or (-) losses, net	(12)	-	(12)	-
(Provisions or (-) reversal of provisions)	(55)	(17)	(28)	(11)
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	(402)	(732)	(253)	(504)
(Impairment or (-) reversal of impairment of investments in subsidiaries, joint ventures and associates)	-	-	-	-
(Impairment or (-) reversal of impairment on non-financial assets)	(20)	(20)	(5)	(8)
Negative goodwill recognised in profit or loss	-	-	-	-
Share of the profit or (-) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	14	14	-	-
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	5	-	-	-

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

Form "Income statement" (continued)

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Profit or (-) loss before tax from continuing operations	**1,892**	**1,598**	**1,475**	**1,674**
(Tax expense or (-) income related to profit or loss from continuing operations)	(172)	(303)	(95)	(231)
Profit or (-) loss before after from continuing operations	**1,720**	**1,295**	**1,380**	**1,443**
Profit or (-) loss after tax from discontinued operations	**-**	**-**	**-**	**-**
Profit or (-) loss before tax from discontinued operations	-	-	-	-
(Tax expense or (-) income related to discontinued operations)	-	-	-	-
Profit or (-) loss for the year	**1,720**	**1,295**	**1,380**	**1,443**
Attributable to minority interest [non-controlling interests]	**39**	**15**	**-**	**-**
Attributable to owners of the parent	**1,681**	**1,280**	**1,380**	**1,443**

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	
	2018	2017	2018	2017
Net profit for the year	**1,720**	**1,295**	**1,380**	**1,443**
Other comprehensive income	**-**	**-**	**-**	**-**
Items that will not be reclassified to profit or loss	**26**	**239**	**12**	**87**
Tangible assets	-	290	-	106
Intangible assets	-	-	-	-
Actuarial gains (losses) on defined benefit pensions plans	10	-	-	-
Non-current assets and disposal groups classified as held for sale	-	-	-	-
Share of other recognized revenues and costs from entities accounted by equity method	-	-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income	20	-	15	-
Gains or (-) losses from hedge accounting of equity instruments at fair value through other comprehensive income, net	-	-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income [hedged item]	-	-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income [hedging instrument]	-	-	-	-
Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in their credit risk	-	-	-	-
Income tax relating to items that will not be reclassified	(4)	(51)	(3)	(19)
Items that are or may be reclassified to profit or loss	**(126)**	**10**	**(23)**	**30**
Hedge of net investments in foreign operations [effective portion]	-	-	-	-
Foreign currency translation	(42)	(9)	-	-
Cash flow hedges [effective portion]	-	-	-	-
Hedging instruments [not designated elements]	-	-	-	-
Debt instruments at fair value through other comprehensive income	(99)	21	(28)	36
Non-current assets and disposal groups held for sale	-	-	-	-
Share of other recognised income and expense of Investments in subsidiaries, joint ventures and associates	-	-	-	-
Income tax relating to items that may be reclassified to profit or (-) loss	15	(2)	5	(6)
Total comprehensive income for the year	**1,620**	**1,544**	**1,369**	**1,560**
Attributable to:				
Equity holders of the Bank	1,607	1,490	1,369	1,560
Non-controlling interests	13	54	-	-
	1,620	1,544	1,369	1,560

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

Income statement reconciliation for the year ended 31 December 2018

PER EU IFRS **(in HRK million)**

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	Other operating income	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Interest income	3,198	-	-	-	-	-	-	-	-	-	-	-	-	-	**3,198**
(Interest expense)	-	(419)	-	-	-	-	-	-	-	-	-	-	-	-	**(419)**
(Expenses on share capital repayable on demand)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Dividend income	-	-	-	-	3	-	-	-	-	-	-	-	-	-	**3**
Fee and commission income	-	-	1,960	7	-	-	-	-	-	-	-	-	-	-	**1,967**
(Fee and commission expenses)	-	-	-	(395)	-	-	-	-	-	-	-	(54)	-	-	**(449)**
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	-	-	-	-	-	16	-	77	8	-	-	53	-	-	**154**
Gains or (-) losses on financial assets and liabilities held for trading, net	-	-	-	-	-	264	-	-	-	-	-	-	-	-	**264**
Gains or (-) losses on non-trading financial assets mandatorily at fair value through profit or loss, net	-	-	-	-	-	56	-	-	-	-	-	-	-	-	**56**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Other operating income	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Gains or (-) losses from hedge accounting, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Exchange differences [gain or (-) loss], net	-	-	-	-	-	14	-	-	-	-	-	-	-	-	**14**
Gains or (-) losses on derecognition of non-financial assets, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other operating income	-	-	-	-	-	-	137	-	-	-	(5)	43	-	-	**175**
(Other operating expenses)	-	-	-	-	-	-	-	-	-	-	-	(487)	-	-	**(487)**
Total operating income,net	**3,198**	**(419)**	**1,960**	**(388)**	**3**	**350**	**137**	**77**	**8**	**-**	**(5)**	**(445)**	**-**	**-**	**4,476**
(Administrative expenses)	-	-	-	-	-	-	-	-	-	(1,154)	-	(763)	-	-	**(1,917)**
(Depreciation)	-	-	-	-	-	-	-	-	-	-	(197)	-	-	-	**(197)**
Modification gains or (-) losses, net	-	-	-	-	-	-	-	(12)	-	-	-	-	-	-	**(12)**
(Provisions or (-) reversal of provisions	-	-	-	-	-	-	-	-	(55)	-	-	-	-	-	**(55)**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Other operating income	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	34	-	-	-	-	-	-	(436)	-	-	-	-	-	-	**(402)**
(Impairment or (-) reversal of impairment of investments in subsidiaries, joint ventures and associates)	-	-	-	-	-	-	-	-	(20)	-	-	-	-	-	**(20)**
(Impairment or (-) reversal of impairment on non-financial assets)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Negative goodwill recognised in profit or loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Share of the profit or (-) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	-	-	-	-	-	-	-	-	-	-	-	-	14	-	**14**
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	-	-	-	-	-	-	5	-	-	-	-	-	-	-	**5**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Other operating income	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Profit or (-) loss before tax from continuing operations	**3,232**	**(419)**	**1,960**	**(388)**	**3**	**350**	**142**	**(371)**	**(67)**	**(1,154)**	**(202)**	**(1,208)**	**14**	**-**	**1,892**
(Tax expense or (-) income related to profit or loss from continuing operations)	-	-	-	-	-	-	-	-	-	-	-	2	-	(174)	(172)
Profit or (-) loss after tax from continuing operations	**3,232**	**(419)**	**1,960**	**(388)**	**3**	**350**	**142**	**(371)**	**(67)**	**(1,154)**	**(202)**	**(1,206)**	**14**	**(174)**	**1,720**
Profit or (-) loss after tax from discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Profit or (-) loss before tax from discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
(Tax expense or (-) income related to discontinued operations)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Profit or (-) loss for the year	**3,232**	**(419)**	**1,960**	**(388)**	**3**	**350**	**142**	**(371)**	**(67)**	**(1,154)**	**(202)**	**(1,206)**	**14**	**(174)**	**1,720**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

PER EU IFRS **(in HRK million)**

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	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Interest income	2,444	-	-	-	-	-	-	-	-	-	-	-	-	-	**2,444**
(Interest expense)	-	(271)	-	-	-	-	-	-	-	-	-	-	-	-	**(271)**
(Expenses on share capital repayable on demand)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Dividend income	-	-	-	-	51	-	-	-	-	-	-	-	-	-	**51**
Fee and commission income	-	-	971	-	-	-	-	-	-	-	-	-	-	-	**971**
(Fee and commission expenses)	-	-	(91)	(148)	-	-	-	-	-	-	-	(54)	-	-	**(293)**
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	-	-	-	-	-	15	24	95	(1)	-	-	-	-	-	**133**
Gains or (-) losses on financial assets and liabilities held for trading, net	-	-	-	-	-	254	-	-	-	-	-	-	-	-	**254**
Gains or (-) losses on non-trading financial assets mandatorily at fair value through profit or loss, net	-	-	-	-	-	(6)	-	-	-	-	-	-	-	-	**(6)**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Gains or (-) losses from hedge accounting, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Exchange differences [gain or (-) loss], net	-	-	-	-	-	2	1	-	-	-	-	-	-	-	**3**
Gains or (-) losses on derecognition of non-financial assets, net	-	-	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Other operating income	-	-	-	-	-	-	66	-	15	-	-	7	-	-	**88**
(Other operating expenses)	-	-	-	-	-	-	(4)	(54)	(6)			(166)	-	-	**(230)**
Total operating income,net	**2,444**	**(271)**	**880**	**(148)**	**51**	**265**	**87**	**41**	**8**	**-**	**-**	**(213)**	**-**	**-**	**3,144**
(Administrative expenses)	-	-	-	-	-	-	-	9	-	(761)	-	(487)	-	-	**(1,239)**
(Depreciation)	-	-	-	-	-	-	-	-	-	-	(122)	(10)	-	-	**(132)**
Modification gains or (-) losses, net	-	-	-	-	-	-	-	(12)	-	-	-	-	-	-	**(12)**
(Provisions or (-) reversal of provisions	-	-	-	-	-	-	-	-	(28)	-	-	-	-	-	**(28)**

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	34	-	-	-	-	-	-	(259)	(28)	-	-	-	-	-	**(253)**
(Impairment or (-) reversal of impairment of investments in subsidiaries, joint ventures and associates)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
(Impairment or (-) reversal of impairment on non-financial assets)	-	-	-	-	-	-	-	-	(5)	-	-	-	-	-	**(5)**
Negative goodwill recognised in profit or loss	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Share of the profit or (-) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

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

Income statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

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	Net impairment loss on loans and advances to customers	Other impairment losses and provisions	Personnel expenses	Depreciation and amortization	Other operating expenses	Share of profits from associates	Income tax expense	**Total**
Profit or (-) loss before tax from continuing operations	**2,478**	**(271)**	**880**	**(148)**	**51**	**265**	**87**	**(221)**	**(53)**	**(761)**	**(122)**	**(710)**	**-**	**-**	**1,475**
(Tax expense or (-) income related to profit or loss from continuing operations)	-	-	-	-	-	-	-	-	-	-	-	2	-	(97)	**(95)**
Profit or (-) loss after tax from continuing operations	**2,478**	**(271)**	**880**	**(148)**	**51**	**265**	**87**	**(221)**	**(53)**	**(761)**	**(122)**	**(708)**	**-**	**(97)**	**1,380**
Profit or (-) loss after tax from discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Profit or (-) loss before tax from discontinued operations	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
(Tax expense or (-) income related to discontinued operations)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Profit or (-) loss for the year	**2,478**	**(271)**	**880**	**(148)**	**51**	**265**	**87**	**(221)**	**(53)**	**(761)**	**(122)**	**(708)**	**-**	**(97)**	**1,380**

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

Form "Cash flow statement"

(in HRK million)

	GROUP		BANK	
	2018	2017	2018	2017
Cash flow from operating activities				
Profit/(loss) before tax	1,894	1,599	1,477	1,674
Adjustments:		-	-	-
Impairment losses	466	727	272	522
Depreciation and amortization	197	196	132	111
Unrealised (gains)/losses on securities at fair value through profit or loss	6	13	6	13
(Gains)/losses from sale of tangible assets	(9)	(6)	(2)	(3)
Other (gains)/losses	-	-	-	-
Changes in assets and liabilities due to operating activities				
Deposits with the Croatian National Bank	(1,725)	(60)	(514)	(269)
Deposits with banking institutions and loans to financial institutions	(5,173)	1,230	(5,215)	100
Loans to other clients	(3,805)	(3,495)	(2,198)	(2,575)
Securities and other financial instruments at FVOCI	(2,364)	(3,384)	(2,650)	(3,775)
Securities and other financial instruments held for trading	(276)	(11)	(276)	(16)
Securities and other financial instruments at fair value through profit or loss which are not actively traded	-	-	-	-
Securities and other financial instruments mandatorily at FVTPL	1,621	3,892	1,618	3,784
Securities and other financial instruments at amortised cost	283	349	269	316
Other operating assets	278	(852)	154	(1,494)
Financial institutions deposits	652	(640)	417	(313)
Other clients demand deposits	6,504	5,425	4,329	3,376
Other clients savings deposits	3,464	1,453	3,428	1,517
Other clients term deposits	(1,610)	(2,195)	(1,765)	(1,014)
Derivative financial liabilities and other liabilities held for trading	(4)	(3)	(4)	2
Other liabilities	(368)	298	(111)	(23)
Interest received	3,284	3,136	2,460	2,708
Dividends received	-	-	-	-
Interest paid	(480)	(639)	(332)	(524)
(Income tax paid)	(300)	(457)	(232)	(389)
Net inflow/(outflow) of cash from operating activities	**2,535**	**6,576**	**1,263**	**3,728**

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

Form "Cash flow statement" (continued)

(in HRK million)

	GROUP 2018	GROUP 2017	BANK 2018	BANK 2017
Investing activities				
Cash receipts from/(payments to acquire) tangible and intangible assets	(181)	(301)	(166)	(193)
Cash receipts from the disposal of/(payments for the investment in) subsidiaries, associates and joint ventures	(152)	(1,103)	(152)	(152)
Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity	-	-	-	-
Dividends received	3	6	51	446
Other receipts from/(payments for) investments	-	-	269	-
Net cash flow from investing activities	**(330)**	**(1,398)**	**2**	**101**
Financing activities				
Net increase/(decrease) in received loans	377	(499)	656	(371)
Net increase/(decrease) in issued debt securities	-	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-	-
Proceeds from issue of share capital	-		-	-
(Dividends paid)	(304)	(482)	(289)	(482)
Other proceeds/(payments) from financing activities			-	-
Net cash flow from financing activities	**73**	**(981)**	**367**	**(853)**
Net increase/(decrease) in cash and cash equivalents	**2,278**	**4,197**	**1,632**	**2,976**
Cash and cash equivalents at the beginning of the year	20,565	16,388	16,972	14,016
Effect of foreign exchange differences on cash and cash equivalents	(3)	(20)	(3)	(20)
Cash and cash equivalents at the end of the year	**22,840**	**20,565**	**18,601**	**16,972**

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

Cash flow statement reconciliation for the year ended 31 December 2018

(in HRK million)

	GROUP			BANK		
	CNB schedules	per IFRS	Differences	CNB schedules	per IFRS	Differences
Cash flow from operating activities						
Profit before income tax	1.894	1.894	-	1.477	1.477	-
Impairment losses on loans and advances to customers	-	371	371	-	221	221
Other impairment losses and provisions	-	66	66	-	53	53
Impairment losses	466	-	(466)	272	-	(272)
Gain on disposal of property and equipment and intangible assets	(9)	(15)	(6)	(2)	(3)	(1)
Depreciation and amortisation	197	203	6	132	122	(10)
Net losses from securities at fair value throught profit or loss	6	(63)	(69)	6	-	(6)
Share of profits from associates	-	(14)	(14)	-	-	-
Net interest income	-	(2.813)	(2.813)	-	(2.207)	(2.207)
Net gain/loss on disposal of available-for-sale securities	-	(20)	(20)	-	(20)	(20)
Dividend income	-	(3)	(3)	-	(51)	(51)
Cash flow from operating activities before changes in operating assets	**2.554**	**(394)**	(2.948)	**1.885**	**(408)**	(2.293)
(Increase)/decrease in operating assets						
Balances with the Croatian National Bank	(1.725)	(442)	1.283	(514)	(484)	30
Loans and advances to banks	(5.173)	(2.532)	2.641	(5.215)	(2.444)	2.771
Loans and advances to customers	(3.805)	(2.756)	1.049	(2.198)	(1.602)	596
Financial assets at fair value through profit or loss and financial assets available for sale	-	(1.477)	(1.477)	-	(1.807)	(1.807)
Securities and other financial instruments at FVOCI	(2.364)	-	2.364	(2.650)	-	2.650
Securities and other financial instruments held for trading	(276)	-	276	(276)	-	276
Securities and other financial instruments mandatorily at FVTPL	1.621	-	(1.621)	1.618	-	(1.618)
Securities and other financial instruments at amortised cost	283		(283)	269		(269)
Other assets	278	296	18	154	151	(3)
Net (increase)/decrease in operating assets	***(11.161)***	***(6.911)***	4.250	***(8.812)***	***(6.186)***	2.626
Increase/(decrease) in operating liabilities						
Current accounts and deposits from banks	652	472	(180)	417	416	(1)
Current accounts and deposits from customers		7.168	7.168		5.662	5.662
Other clients demand deposits	6.504	-	(6.504)	4.329	-	(4.329)
Other clients savings deposits	3.464	-	(3.464)	3.428	-	(3.428)
Other clients term deposits	(1.610)	-	1.610	(1.765)	-	1.765
Derivative financial liabilities and other liabilities held for trading	(4)	-	4	(4)	-	4
Other liabilities	(368)	(421)	(53)	(111)	(111)	-

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

Cash flow statement reconciliation for the year ended 31 December 2018 (continued)

(in HRK million)

	GROUP			BANK		
	CNB schedules	per IFRS	Differences	CNB schedules	per IFRS	Differences
Net increase/(decrease) in operating liabilities	***8.638***	***7.219***	(1.419)	***6.294***	***5.967***	(327)
Interest received	3.284	3.284	-	2.460	2.460	-
Interest paid	(480)	(480)	-	(332)	(332)	-
Dividends received	-	17	17	-	51	51
Net cash flow from operating activities	**2.835**	**2.735**	(100)	**1.495**	**1.552**	57
(Income tax paid)	(300)	(300)	-	(232)	(232)	-
Net inflow/(outflow) of cash from operating activities	**2.535**	**2.435**	(100)	**1.263**	**1.320**	57
Investing activities			-			-
Purchase of property and equipment and intangible assets	(181)	(206)	(25)	(166)	(161)	5
Disposal of property and equipment and intangible assets	-	30	30	-	3	3
Cash paid from sale of non-current assets held for sale	-	128	128	-	-	-
Cash paid for the aquisition of Veneto bank	(152)	(152)	-	(152)	(152)	-
Cash Acquired on Merger of Veneto banka	-	-	-	-	-	-
Dividends received	3	-	(3)	51	-	(51)
Other receipts from/(payments for) investments	-	-	-	269	-	(269)
Net cash flow from investing activities	**(330)**	**(200)**	130	**2**	**(310)**	(312)
Financing activities						
Dividends paid	(304)	(304)	-	(289)	(289)	-
Increase in interest-bearing borrowings	377	347	(30)	656	641	(15)
Net cash flow from financing activities	**73**	**43**	(30)	**367**	**352**	(15)
Cash Acquired on Merger of Veneto banka	-	-	-	-	**270**	270
Net increase/(decrease) in cash and cash equivalents	**2,278**	**2,278**	**-**	**1,632**	**1,632**	**-**
Cash and cash equivalents as at 1 January	**20,565**	**20,565**	**-**	**16,972**	**16,972**	**-**
Effect of exchange rate fluctuations on cash held	(3)	(3)	-	(3)	(3)	-
Cash and cash equivalents at the end of the year	**22,840**	**22,840**	**-**	**18,601**	**18,601**	**-**

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

Form "Statement of changes in equity"

(in HRK million)

Group **CNB schedules**	Capital	Share premium	Equity instruments issued other than Capital	Other equity	Accumulated other comprehensive income	Retained earnings	Revaluation reserves	Other reserves	(-) Treasury shares	Profit or (-) loss atributable to owners of the parent	(-) Interim dividends	Accumulated Other Comprehensive Income	Other items	**Total**
Opening balance [before restatement]	**1,907**	**1,570**	**-**	**-**	**99**	**10,579**	**206**	**160**	**(76)**	**1,280**	**-**	**15**	**1,036**	**16,776**
(Effects of changes in accounting policies	-	-	-	-	**34**	**(889)**	-	-	-	-	-	-	(15)	**(870)**
Opening balance [current period]	**1,907**	**1,570**	**-**	**-**	**133**	**9,690**	**206**	**160**	**(76)**	**1,280**	**-**	**15**	**1,021**	**15,906**
Dividends	-	-	-	-	-	-	-	-	-	(289)	-	-	(15)	**(304)**
Equity increase or (-) decrease resulting from business combinations	-	-	-	-	-	-	-	(152)	-	-	-	-	-	**(152)**
Other increase or (-) decrease in equity	-	-	-	-	-	997	4	(10)	-	(991)	-	-	-	**-**
Total comprehensive income for the year	-	-	-	-	(51)	-	-	(23)	-	1,681	-	(26)	39	**1,620**
Closing balance [current period]	**1,907**	**1,570**	**-**	**-**	**82**	**10,687**	**210**	**(25)**	**(76)**	**1,681**	**-**	**(11)**	**1,045**	**17,070**

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

Form "Statement of changes in equity" (continued)

(in HRK million)

Bank **CNB schedules**	Capital	Share premium	Equity instruments issued other than Capital	Other equity	Accumulated other comprehensive income	Retained earnings	Revaluation reserves	Other reserves	(-) Treasury shares	Profit or (-) loss atributable to owners of the parent	(-) Interim dividends	Accumulated Other Comprehensive Income	Other items	**Total**
Opening balance [before restatement]	**1,907**	**1,570**	**-**	**-**	**49**	**8,566**	**96**	**200**	**(76)**	**1,443**	**-**	**-**	**-**	**13,755**
(Effects of changes in accounting policies	-	-	-	-	21	(684)	-	-	-	-	-	-	-	**(663)**
Opening balance [current period]	**1,907**	**1,570**	**-**	**-**	**70**	**7,882**	**96**	**200**	**(76)**	**1,443**	**-**	**-**	**-**	**13,092**
Dividends	-	-	-	-	-	-	-	-	-	(289)	-	-	-	**(289)**
Equity increase or (-) decrease resulting from business combinations	-	-	-	-	-	(97)	-	76	-	-	-	-	-	**(21)**
Other increase or (-) decrease in equity	-	-	-	-	-	1,154	-	-	-	(1,154)	-	-	-	-
Total comprehensive income for the year	-	-	-	-	(11)	-	-	-	-	1,380	-	-	-	**1,369**
Closing balance [current period]	**1,907**	**1,570**	**-**	**-**	**59**	**8,939**	**96**	**276**	**(76)**	**1,380**	**-**	**-**	**-**	**14,151**

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

Main differences between statutory financial report and supplementary forms required by local regulation

The main differences between the Statements of financial position captions disclosed in the statutory financial statements, and those prescribed by the CNB Decision relate to the following categories:

- Loans and advances are separated to customers and banks in statutory financial statements, while in CNB schedule there is only aggregated category Loans and advances
- Other assets in statutory financial statements contain accrued fees, receivables from debtors, receivables from card business, prepaid expenses and advanced payments, while in CNB schedule Other assets comprise only from nonfinancial items
- Obligatory reserve is disclosed within Balances with CNB in statutory financial statements and within Loans and advances in CNB schedule

The main differences between the Income statement captions disclosed in the statutory financial statements, and those prescribed by the CNB Decision relate to the following categories:

- Effects arising from unwinding of discount related to loss allowance (“time value”) are disclosed as interest income in statutory financial statements, while in CNB schedule are presented within Impairment of financial assets not measured at fair value.
- Positions Gains or losses on derecognition of financial assets and liabilities not measured at FVTPL, gains or losses on financial assets and liabilities held for trading and gains or losses on non-trading financial assets mandatorily measured at fair value from CNB schedule are disclosed aggregately in statutory financial statements on position Net trading income and translation of monetary assets and liabilities.
- Administrative expenses in CNB schedule contain Personnel expenses and Other operating expenses from statutory financial statements.

Appendix 2 - Supplementary financial statements in EUR (unaudited)

Income statement

As at 31 December

(in EUR million)

	GROUP		BANK	
	2018	Restated 2017	2018	2017
Interest income calculated using the effective interest method	425	456	331	362
Other interest income	11	14	3	7
Interest expense	(57)	(71)	(37)	(50)
Net interest income	**379**	**399**	**297**	**319**
Fee and commission income	264	248	119	109
Fee and commission expense	(52)	(47)	(20)	(17)
Net fee and commission income	**212**	**201**	**99**	**92**
Dividend income	-	1	7	60
Net trading income/(expense) and net gains/(losses) on translation of monetary assets and liabilities	47	32	36	29
Fair value adjustment in hedge accounting	-	-	-	-
Other operating income	19	26	12	13
Total operating income	**657**	**659**	**451**	**513**
Net impairment loss on loans and advances to customers	(49)	(114)	(30)	(82)
Other impairment losses and provisions	(9)	(3)	(7)	-
Personnel expenses	(156)	(149)	(104)	(99)
Depreciation and amortization	(27)	(27)	(16)	(16)
Other operating expenses	(163)	(153)	(95)	(92)
Share of profits from associates	2	2	-	-
Profit before income tax	**255**	**215**	**199**	**224**
Income tax expense	(23)	(41)	(13)	(31)
Profit for the year	**232**	**174**	**186**	**193**
Attributable to:				
Equity holders of the Bank	227	172	186	193
Non-controlling interests	5	2	-	-
	232	**174**	**186**	**193**

The income statement items were translated from the measurement currency (HRK) to the Euro at the average exchange rate in 2018 (1 EUR = 7.4141 HRK) and in 2017 (1 EUR = 7.4601 HRK).

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

Statement of financial position

As at 31 December

(in EUR million)

	GROUP		BANK	
Assets	2018	Restated 2017	2018	2017
Cash and current accounts with banks	2,486	2,527	1,912	2,058
Balances with the Croatian National Bank	633	565	633	557
Financial assets held for trading	112	73	112	73
Derivative financial assets	1	3	-	-
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	-	-	-
Loans and advances to banks	1,049	321	926	199
Loans and advances to customers	8,991	8,673	6,128	5,931
Investment securities	1,423	1,242	994	773
Investments in subsidiaries and associates	9	9	265	261
Intangible assets	32	30	25	22
Property and equipment	180	183	86	83
Investment property	1	1	-	-
Non-current assets held for sale	45	61	17	12
Deferred tax assets	19	17	13	11
Other assets	100	140	49	69
Current tax assets	17	3	17	1
Total assets	**15,099**	**13,848**	**11,177**	**10,050**

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 2018 (1 EUR = 7.417575 HRK) and as at 31 December 2017 (1 EUR = 7.513648 HRK).

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

Statement of financial position (continued)

As at 31 December

(in EUR million)

	GROUP		BANK	
Liabilities	2018	Restated 2017	2018	2017
Current accounts and deposits from banks	248	182	200	142
Current accounts and deposits from customers	11,586	10,491	8,499	7,609
Derivative financial liabilities	5	2	1	1
Fair value changes of the hedged items in portfolio hedge of interest rate risk	1	1	-	-
Interest-bearing borrowings	561	508	409	316
Other liabilities	269	316	81	90
Accrued expenses and deferred income	50	48	21	22
Provisions for liabilities and charges	70	55	53	33
Deferred tax liabilities	10	11	4	4
Current tax liability	1	1	-	-
Subordinated liabilities	-	-	-	-
Total liabilities	**12,801**	**11,615**	**9,268**	**8,217**
Equity				
Share capital	250	250	250	250
Share premium	206	206	206	206
Treasury shares	(10)	(10)	(10)	(10)
Other reserves	199	187	64	48
Fair value reserve	11	13	8	7
Retained earnings	1,667	1,578	1,391	1,332
Merger reserve	(164)	(133)	-	-
Total equity attributable to equity holders of the Bank	**2,159**	**2,091**	**1,909**	**1,833**
Non-controlling interests	139	142	-	-
Total equity	**2,298**	**2,233**	**1,909**	**1,833**
Total liabilities and equity	**15,099**	**13,848**	**11,177**	**10,050**

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 2018 (1 EUR = 7,417575 HRK) and as at 31 December 2017 (1 EUR = 7,513648 HRK).