



# CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

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**Annual financial statements for 2018**

Zagreb, March 2019

18

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# ANNUAL REPORT OF THE CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT GROUP FOR 2018

Zagreb, March 2019

This version of the Annual Financial Statements is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the annual report and financial statements takes precedence over translation.

#### STATEMENT OF PERSONS RESPONSIBLE FOR THE PREPARATION OF THE ANNUAL REPORT

To the best of our knowledge the 2018 Annual Report contains a truthful development of events and business results as well as the position of the Croatian Bank for Reconstruction and Development and the Group and the description of the most significant risks and contingencies the Croatian Bank for Reconstruction and Development and the Group are exposed to.

President of the Management Board



Tamara Perko, MSc

Member of the Management Board



Hrvoje Čuvalo, MSc



Zagreb, 25 March 2019

## MANAGEMENT REPORT FOR 2018

The Annual Report includes the summary of financial information, description of operations and audited Annual Financial Statements with the Independent auditor's report for the year ended 31 December 2018. Audited Financial Statements are shown for the Croatian Bank for Reconstruction and Development Group and the Croatian Bank for Reconstruction and Development.

### Legal status

The Annual Report includes the annual financial statements prepared in accordance with the International Financial Reporting Standards and the Accounting Act and audited in accordance with the International Standards on Auditing. The compliance of the Annual Report with the Annual Financial Statements has been confirmed by auditors, through the procedures required by the Accounting Act.

### Establishment

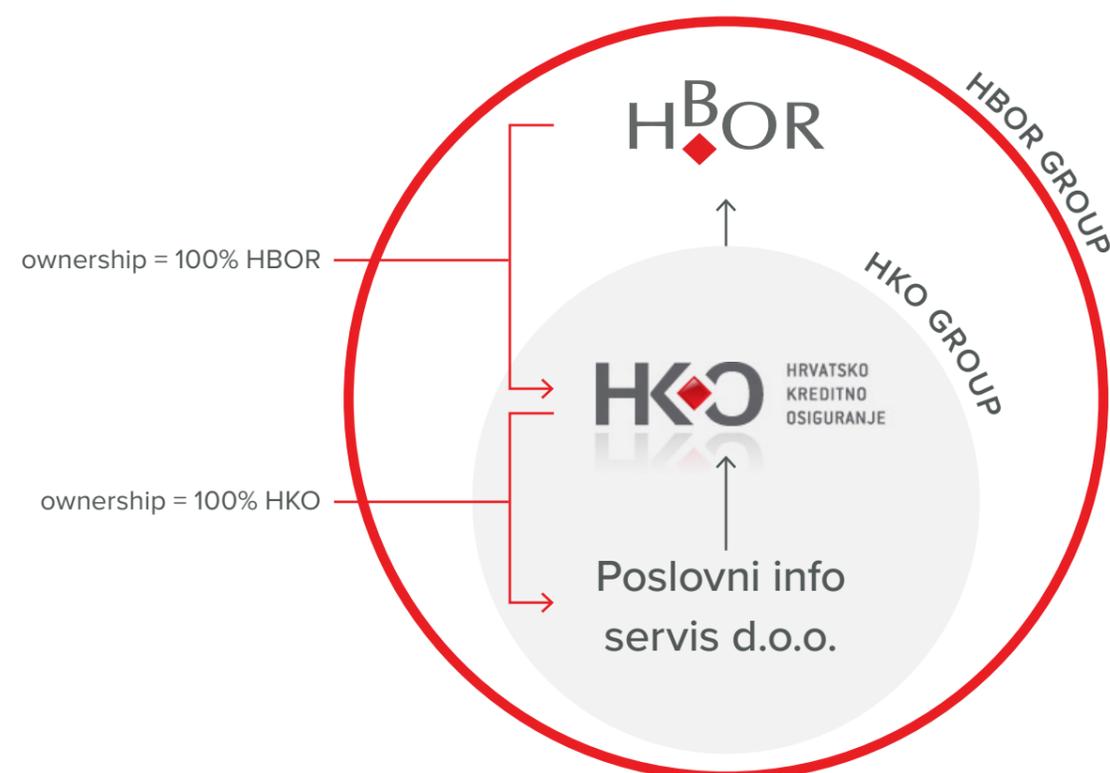
Hrvatska banka za obnovu i razvitak was established on 12 June 1992 by the Act on Hrvatska kreditna banka za obnovu (HKBO). The Bank was renamed Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development) by changes and amendments to the above Act in December 1995. In December 2006, the Croatian Parliament passed a new Act on HBOR, which came into force on 28 December 2006. On 15 February 2013, the Croatian Parliament passed the Act on Amendments to the Act on the Croatian Bank for Reconstruction and Development, whereby the Supervisory Board of HBOR was amended and increased by one member – the Minister of Regional Development and EU Funds, and now consists of ten members.

## Hrvatska banka za obnovu i razvitak Group

Hrvatska banka za obnovu i razvitak (HBOR) is the parent company of the HBOR Group that was formed in 2010. The Group consists of the parent company, Hrvatsko kreditno osiguranje d.d. (HKO) and Poslovni info servis d.o.o. (PIS).

Name	Role within the group	% of participation	Headquarters	Business activities
Hrvatsko kreditno osiguranje d.d.	Subsidiary company, direct equity participation	100% HBOR	Republic of Croatia	Insurance for company's foreign and domestic short-term receivables, regarding shipments of goods and services
Poslovni info servis d.o.o.	Subsidiary company, indirect equity participation	100% HKO	Republic of Croatia	Providing analysis, credit risk assessment and information on creditworthiness

### Illustration of the HBOR Group structure



## Strategic goals

In its operations, and within the framework of its powers and authorisations, HBOR promotes systematic, sustainable and balanced economic and social development pursuant to the overall strategic goals of the Republic of Croatia.

### Priority activity areas

- Promoting start-ups and the development of SMEs
- Promoting exports
- Developing tourism
- Financing innovation and development of new technologies
- Financing the development of agriculture
- Promoting the EU funds utilisation
- Financing projects of environmental protection, energy efficiency and renewable energy resources

### Breakdown of the most significant financial information for HBOR

In HRK million

	2014	2015	2016	2017	2018
Total assets	25,777.05	25,540.78	27,374.92	28,055.80	27,198.93
Gross loans	24,721.41	24,722.82	26,343.12	26,332.99	26,243.12
Total equity	9,430.13	9,662.45	10,037.98	10,268.83	10,054.01
Total income	918.13	917.11	924.00	919.36	791.25
Total expense	(749.79)	(711.88)	(610.47)	(758.58)	(586.92)
Profit	168.34	205.23	313.53	160.78	204.33
Interest income	903.57	872.61	870.34	866.20	731.71
Interest expense	(490.16)	(474.53)	(452.67)	(390.46)	(356.07)
Net interest income	413.41	398.08	417.67	475.74	375.64

## Credit rating as at 31 December 2018

- Ba2 by Moody's
- BB+ by Standard & Poor's

## Regional offices

- Regional office for Slavonia and Baranja
- Regional office for Dalmatia
- Regional office for Istria
- Regional office for Lika
- Regional office for Primorje and Gorski kotar

## Number of employees

On 31 December 2018, there were 370 employees in HBOR.

On 31 December 2018, there were 390 employees in HBOR Group.

## Exchange rate

For the purpose of converting amounts in foreign currencies into HRK, the following middle exchange rates of the Croatian National Bank have been applied:

31 December 2018	EUR 1 = HRK 7.417575	USD 1 = HRK 6.469192
31 December 2017	EUR 1 = HRK 7.513648	USD 1 = HRK 6.269733

## STATEMENT ON THE CODE OF CORPORATE GOVERNANCE APPLICATION

### Hrvatska banka za obnovu i razvitak (HBOR)

HBOR applies HBOR's Code of Corporate Governance (hereinafter: the Code) dated February 2013, adopted by the Management Board and the Supervisory Board and published on HBOR's web pages.

The Code contains the basic principles determined by the Decision on Passing the Code of Corporate Governance in Companies with Shares or Participations owned by the Republic of Croatia (Official Gazette of the Republic of Croatia No. 112/2010) (hereinafter: the Decision) and the principles determined in the EBA (The European Banking Authority Guidelines on Internal Governance GL 44, September/2011) (hereinafter: the Guidelines).

The principles stated in the Guidelines are implemented by HBOR voluntarily to a degree to which they are applicable due to the fact that the Guidelines relate to credit institutions and are not fully applicable to HBOR as a special financial institution.

A new Decision on Passing the Code of Corporate Governance in Companies in which the Republic of Croatia owns Shares or Stakes (Official Gazette of the Republic of Croatia No. 132/17) that is applied to HBOR came into force on 6 January 2018.

Also, as a measure of good corporate governance in terms of strengthening the transparency and determining the criteria for the selection of members of the Management Board of HBOR, in 2018, the Decree on the Criteria for the Implementation of Procedures for Selection and Appointment of Presidents and Members of Management Boards of Companies and Other Legal Entities of Strategic and Special Interest for the Republic of Croatia was applied to HBOR.

Compliance of operations with laws and regulations and adherence to internal rules are the basis of responsible corporate governance and a necessary condition for sustainable business success. HBOR continuously monitors legislation and best practices in the field of corporate governance and integrates corporate governance principles in its operations pursuant to sound banking practices.

The Code of Corporate Governance establishes the standards of corporate governance and the transparency and upgrading of HBOR's operations for effective and responsible management of public capital, as well as the activities of special social significance for the development of the Croatian economy. In order to achieve the standard of corporate

governance, HBOR's Code describes the relationships with governing bodies and stakeholders, as well as the adopted business principles aimed at mitigating the risks of operating in adverse market conditions.

The Code of Conduct of HBOR prescribes specific values and rules for the prevention of corruption and assurance of professional conduct, and provides for the possibility of filing a report on the grounds of violation of the Code. The report form, the e-mail address for filing reports and the description of the filing are available on HBOR's websites. The person in charge of compliance monitoring reports annually on reports filed and proceedings initiated in respect of reports filed on the grounds of violation of the Code of Conduct.

In accordance with the principles of public business, in the reporting period the financial statements of the Bank and the Group were published on the web sites of HBOR and the Luxembourg Stock Exchange. HBOR's annual financial statements on a separate and consolidated basis are confirmed by the Supervisory Board and submitted to the Croatian Parliament for approval. HBOR's rating is assessed annually by two international independent rating agencies (Standard & Poor's and Moody's). Pursuant to the Freedom of Information Act, HBOR submits a report on the implementation of this act to the Public Relations Commissioner.

In the reporting period, the duties, responsibilities and powers of the members of the Management Board and the Supervisory Board were regulated by the Act on HBOR (Official Gazette of the

Republic of Croatia, No. 138/06) and by the Act on Amendments to the Act on HBOR (Official Gazette of the Republic of Croatia, No. 25/13) and further elaborated in the By-laws of HBOR. The Management Board and the Supervisory Board successfully co-operate through open discussions; the timely submission of thorough written reports to the Supervisory Board represents the basis for this co-operation. The Act on HBOR, the By-laws of HBOR and decisions made by the Supervisory Board determine the activities that HBOR may perform only with the prior consent of the Supervisory Board.

**The Supervisory Board** determines the principles of operating policy and strategy, supervises the business activities of the Bank, adopts HBOR's lending policies, adopts the Annual Financial Statements, and examines the Internal Audit reports and reports drafted by external independent auditors and by the State Audit Office. The Supervisory Board also monitors and controls the legality of the business activities of the Management Board, and appoints and dismisses the President and the members of the Management Board. According to the Act, the Supervisory Board consists of ten members: six ministers in the Government of the Republic of Croatia, three Members of Parliament, and the President of the Croatian Chamber of Economy.

In 2018, the members of the Supervisory Board were as follows:

- Zdravko Marić, DSc, Minister of Finance, President of the Supervisory Board,
- Martina Dalić, DSc, Deputy Prime Minister of the Republic of Croatia

and Minister of the Economy, Entrepreneurship and Trade, Vice President of the Supervisory Board (until 16 May 2018),

- Darko Horvat, Minister of the Economy, Entrepreneurship and Trade, Vice President of the Supervisory Board (since 30 May 2018),
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning,
- Gabrijela Žalac, Minister of Regional Development and EU Funds,
- Gari Cappelli, Minister of Tourism,
- Tomislav Tolušić, Deputy Prime Minister of the Republic of Croatia and Minister of Agriculture,
- Luka Burilović, President of the Croatian Chamber of the Economy,
- Boris Lalovac, MSc, Member of the Croatian Parliament,
- Božica Makar, Member of the Croatian Parliament,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament.

**The Management Board** represents HBOR, conducts HBOR's business and administers its assets, and is obliged and authorised to undertake all actions and pass all resolutions it considers necessary for the legal and successful conduct of business. The powers of the Management Board also include adopting normative acts that determine the manner of operations and the internal organisation of HBOR, adopting loan programmes, making individual loan approval decisions and decisions on other financial transactions, making decisions on the appointment and dismissal of employees with special

powers, making decisions on the rights and obligations of employees and reporting to the Supervisory Board.

Members of the Management Board of HBOR in 2018:

- Tamara Perko, MSc, President of the Management Board,
- Hrvoje Čuvalo, MSc, Member of the Management Board.

On the basis of HBOR's Code of Corporate Governance and the Audit Act, the Audit Committee of HBOR has been established pursuant to a decision of the Supervisory Board. The Audit Committee is comprised of three members, one of whom is appointed from among the members of the Supervisory Board of HBOR and the other two, at least one of whom must be an independent member, are appointed by the Supervisory Board. The President is appointed by the Supervisory Board from among the independent members of the Audit Committee.

Members of the Audit Committee of HBOR are:

- Prof.DSc. Lajoš Žager, Full Professor, Department of Accounting, Faculty of Economics and Business of the University of Zagreb, Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, Vice Chairman of the Audit Committee,
- Aurora Volarević, Director of Internal Controls, Audit and Risk in Hrvatski Telekom d.d., member of the Audit Committee.

In order to ensure as effective and as high-quality risk management as possible and reduce the risks to the lowest level possible, the following committees operate under the Management Board: the Assets and Liabilities Management Committee, the Credit Risk Evaluation and Measurement Committee, the Information System Management Committee and the Business Change Management Committee.

The internal control system of HBOR is organised through independent organisational units as follows:

- Independent organisational unit for risk management conducts the identification, assessment, measurement, supervision and control of all risks that HBOR is exposed or may be exposed to within the framework of its operations
- HBOR's Internal Audit, as an independent organisation unit, is in charge of verifying the adequacy of the risk management procedures and the internal control system, including risk control function and compliance function, as well as implementing the internal policies and procedures, and activities related to the prevention of money laundering
- Independent compliance function organizes, coordinates and directs the activities concerning compliance at the level of HBOR, advises on matters of compliance, controls measures taken to minimize compliance risk, incorporates information on compliance monitoring, identifies and assesses the risks of compliance and provides regular reports. The main tasks of the compliance function are to limit the non-compliance risk and

its possible negative effects, ensure compliance of all internal documents and business processes with the relevant regulations and promote the principles of ethical business.

## Hrvatsko kreditno osiguranje d.d. (HKO, the Company)

The internal control system of Hrvatsko kreditno osiguranje d.d. is organised through the following independent functions:

- compliance function
- risk management function
- internal audit function and
- actuarial function.

HKO has established an adequate internal control system on the basis of the internal regulation, the Ordinance on the Internal Control System, thus increasing the probability of timely detecting fraud and contributing to the reduction of unjustified costs, the reduction of abuse and error, the prevention of inappropriate acts and the reduction of risks related to compliance with the legislative framework. In proportion to its size, to the type, scope and complexity of operations and in accordance with its risk profile, the Company establishes permanent and effective controls that are independent from the business processes and activities in which risks arise and which they monitor and supervise.

Legal status, organisation and management of HKO as well as other issues important for the operations of the Company are determined by the Statutes of the Company pursuant to the provisions of the Companies Act and the Insurance Act.

The Company management bodies are the Management Board, the Supervisory Board and the Shareholders' Meeting. HKO is managed by the two-member Management Board that makes its decision in accordance with the Statute of the Company and Rules of Procedure for the Management Board. All decisions are made by following the "double check principle" ("four eyes principle") supported by the suitable system of authorisation.

HKO has not adopted the Code of Corporate Governance, however, to the extent adequate to the size and development status of the Company, it voluntarily applies the principles of corporate governance code on its operations that have been prepared by the Croatian Financial Services Supervisory Agency (HANFA) and Zagrebačka burza d.d. (Zagreb Stock Exchange).

This Statement is considered to be part of the Annual Report of the HBOR Group for the period from 1 January to 31 December 2018.

# DESCRIPTION OF OPERATIONS OF HBOR GROUP IN 2018

## OPERATIONS OF CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

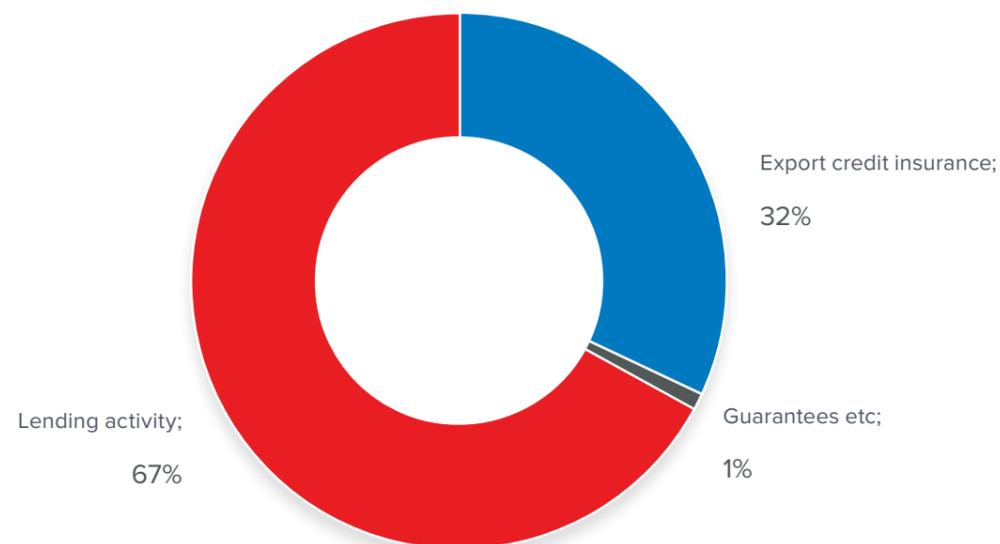
HBOR's operations in 2018 were characterised by a marked shift towards encouraging entrepreneurs to make use of the available EU funds and the introduction of new products that were not present in the market. Therefore, the year was marked by activities for the implementation of financial instruments out of the European Structural and Investment Funds and the preparation for introducing new manners of finance.

The development and enhancement of co-operation with financial intermediaries, primarily with the aim of providing easier

access to funds to small and medium-sized enterprises (framework loans with commercial banks and leasing companies), the implementation of measures for reducing interest rates and loan application processing fees, as well as the improvement of conditions for public sector investment, were continued.

In 2018, HBOR supported 2,650 projects through lending, issuing of guarantees and insurance of export receivables with the total amount of HRK 8.40 billion, a 13 percent higher amount than the one approved in 2017.

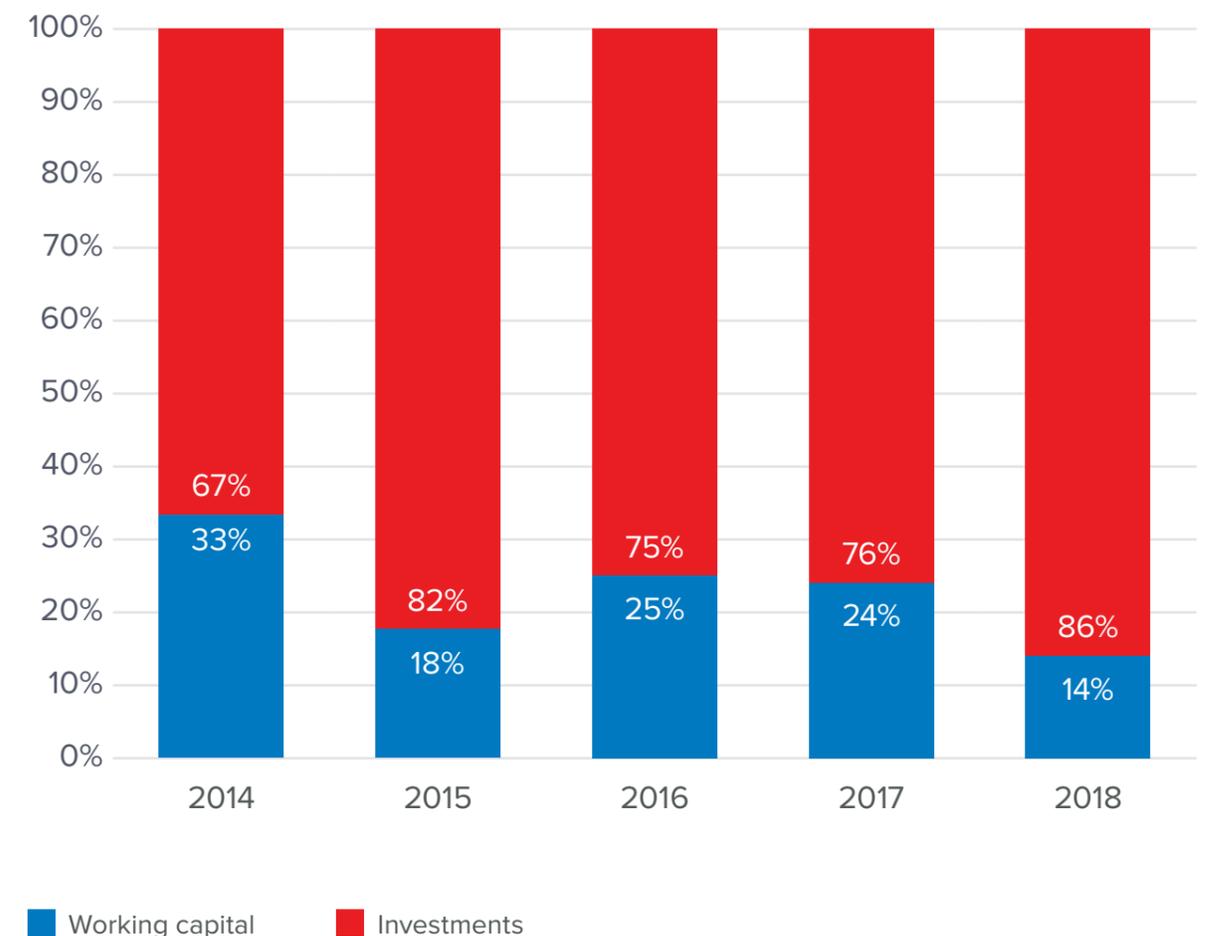
*Business activity in 2018*



The major part of approvals related to lending activity: in the reporting year, 1,970 projects were supported with an amount exceeding HRK 5.61 billion, i.e. an increase of 9 percent in comparison with the previous year. This increase is for

the major part the result of financing the projects co-financed from the EU funds, for which during 2018, HRK 859 million were approved, i.e. 5 times higher amount than that approved in 2017.

*Structure of approved funds by purpose from 2014 to 2018*



During 2018, out of the total loans approved, 86 percent were approved for capital investments, whereas for working capital 14 percent.

Beside the lending activity, export credit insurance business through which 654 export transactions were insured in the total amount of HRK 2.69 billion, had a significant impact on the total volume of operations.

## SMALL AND MEDIUM-SIZED ENTERPRISES – MOST OF THE BORROWERS

Most of HBOR's borrowers in 2018 were small and medium-sized companies, to which 1,853 loans were approved, i.e. 94 percent of the total number of approved loans in the amount of HRK 1.96 billion.

In 2018, loans were extended to small and medium-sized enterprises under 24 loans programmes that were implemented either directly or via commercial banks and leasing companies. Due to simple and efficient procedure of framework loan approval, in 2018, the largest number of projects was supported via framework loans to leasing companies and commercial banks – 1,577 projects in the amount of HRK 672.3 million. The co-operation with leasing companies facilitated the approval of 1,211 contracts on financial leasing in the total amount exceeding HRK 281.56 million through this distribution channel.

In July 2018, a Business Co-operation Agreement was signed with the County of Osijek-Baranja, based on which HBOR (or commercial banks) will approve loans under the loan programmes Youth Entrepreneurship and Female Entrepreneurship, while the County will subsidize 2 percentage points of the interest rate during the entire life of the loan. At the beginning of 2019, this measure was extended to the loan programme for the development of small and medium-sized entrepreneurship and business start-ups.

### *ESIF Growth and Expansion Loans*

During 2018, small and medium-sized companies started to use the proceeds of „ESIF Growth and Expansion Loans“. Through this financial instrument, small and medium-sized companies have at their disposal favourable funds for long-term investments loans with repayment periods of up to 12 years, i.e. up to 17 years for the tourism sector. Loans under this financial instrument are approved via commercial banks in the manner that 50 percent of the loan is financed at 0 percent interest rate, and 50 percent out of the commercial banks' sources at market interest rate that is determined by the commercial bank. Such manner of financing means that the final interest rate for entrepreneurs is only the half of the interest rate that would be charged if no ESIF funds were utilised. Through co-operation with financial intermediaries and extensive network of their branches, the financial instrument is available in the whole territory of the Republic of Croatia. In 2018, loans in the amount of HRK 173.76 million were approved for investments of small and medium-sized companies, i.e. HRK 347.52 million in total, when the commercial banks' funds are included.

### *Investment Loans for Rural Development*

In 2018, the Financing Agreement was signed between the Ministry of Agriculture, the Paying Agency for Agriculture, Fisheries and Rural Development and the Croatian Bank for Reconstruction and Development for the implementation of financial instrument „Investment Loans for Rural Development“. The goal of this financial instrument is to support investments of eligible final recipients from the agriculture, manufacturing and forestry sectors. Loans will be approved via commercial banks selected by HBOR through a public procurement procedure for the implementation of this financial instrument. Loans will be available in the market in the second half of 2019. Through this financial instrument, loan funds in the total amount of HRK 510 million will be available to final beneficiaries.

### *Capped Portfolio Guarantee Instrument from European Structural and Investment Funds*

As a continuation of long-term business co-operation between HAMAG BICRO and HBOR, within the framework of which many projects of small and medium-sized companies were supported and realised, in October 2018, the Co-operation Agreement for Implementing the Capped Portfolio Guarantee Instrument from European Structural and Investment Funds was signed. The respective Agreement represents a framework for the continuation of co-operation with the aim of supporting small and medium-sized companies via HBOR loan funds and guarantees of HAMAG BICRO.

Also, in the last quarter of 2018, HAMAG BICRO initiated the realisation of programme of issuing individual ESIF guarantees for rural development by the invitation to commercial banks to express interest for their participation in the programme. HBOR, together with 13 commercial banks, met the prescribed criteria. In the first quarter of 2019, the Business Co-operation Agreement was signed, the purpose of which is to facilitate additionally access to favourable sources of funding to entrepreneurs in the agriculture sector.

### *Reducing interest rates for youth employment and innovative projects*

During 2018, small and medium-sized enterprises had the possibility to use reduced interest rates within the framework of the Jobs for Youth Initiative of the European Investment Bank (EIB), through which investments of small and medium-sized companies into education, skills and employment of young people are financed. The main feature of this Initiative is reducing the interest rate by 0.20 percentage points for entities employing or training young persons. The reduction of interest rate was also made possible under the InnovFin Programme in co-operation with the European Investment Fund (EIF).

During 2018, the measure of reducing interest rates for youth employment was extended to mid-cap companies, and within the framework of the InnovFin programme, the restrictions of individual activities and loan amounts were eliminated, and a grace period longer than 3 years was made possible.

## INFRASTRUCTURE – MORE THAN HRK 1.3 BILLION APPROVED

In 2018, HBOR financed 66 investment projects for infrastructure, energy efficiency, environmental protection and renewable energy resources in an amount exceeding HRK 1.34 billion.

Investments in business and tourist infrastructure create the preconditions for better development of individual regions and further investments of private sector as well as the creation of new jobs, and units of local and regional government (ULRGs) are essential in withdrawing the proceeds from the EU funds.

For the purpose of promoting such investments, in 2018, HBOR reduced interest rate from 2.5 to 2 or 1.75 percent for financing projects of units of local and regional government, agencies and institutions in their majority ownership and/or majority-owned by the Republic of Croatia, depending on the area in which the project is implemented. Also, the measure of non-charging the commitment fee to the borrowers was continued.

During 2018, the public sector used the proceeds of the following financial instruments: „ESIF Loans for Energy Efficiency“ and „ESIF Loans for Public Lighting“.

### *ESIF Loans for Energy Efficiency*

„ESIF Loans for Energy Efficiency in Public Sector Buildings“ is a financial instrument, for which exceptionally favourable financing of investments in energy efficiency is made possible, as well as promoting the use of renewable energy resources in public sector buildings for the purpose of achieving energy savings. Such savings will result in the reduction of energy consumption for cooling/heating at year level of at least 50 percent. Loans are approved directly by HBOR with the maturity period of up to 14 years at exceptionally favourable interest rates of 0.1, 0.25 or 0.5 p.a., depending on the development stage of investment area and with no customary banking fees payable. Projects that have received a Decision on Financing by the Ministry of Construction and Physical Planning for grant tenders are co-financed under the instrument.

### *ESIF Loans for Public Lighting*

„ESIF Loans for Public Lighting“ is a financial instrument introduced with the aim of financing investments in energy efficiency of public lighting system through the implementation of energy renovation of the existing systems. Investments resulting in energy savings of at least 50 percent in comparison with the existing situation are eligible for financing.

Loans are approved directly by HBOR with a maturity period of up to 10 years at exceptionally favourable interest rates of 0.1, 0.25 or 0.5 percent p.a., depending on the level of development of the investment area with no customary banking fees payable.

## FINANCING OF PROJECTS CO-FINANCED OUT OF THE EU FUNDS – INTEREST RATES REDUCED FOR ALL SECTORS

Beside the implementation of the mentioned financial instruments, interest rate reduction was continued for borrowers under the Loan Programme for the Financing of EU Private Sector Projects, Loan Programme for the Financing of EU Rural Development, Fisheries and Wine Envelope Projects and the Loan Programme for the Financing of EU Public Sector Projects.

Such reduced interest rates enabled the financing of the EU private sector projects and the EU rural development, fisheries and wine envelope projects at an interest rate as low as 1.7 percent for repayment periods of up to 10 years, i.e. 1.9 percent in case of longer repayment terms. EU public sector projects are financed at the reduced interest rate of 1.75 or 2 percent, respectively, depending on the investment area.

Under these loan programmes, the completion of the funding plan of the entire investment is made possible. Financing is implemented either via commercial banks or through a direct placement.

In certain cases, grant proceeds can be used for the reduction of loan principal, and in case of direct lending, HBOR allows up to 70 percent of grant proceeds as borrower's own share in the project. Beside the mentioned, HBOR also offers the possibility of using advance payment guarantees to beneficiaries of grants from the EU funds, i.e. for direct borrowers that plan to use an EU advance payment.

## INVESTMENT IN EQUITY

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### ESIF Venture capital fund – for innovative companies in early stages of development

Funds for this financial instrument amount to EUR 35 million and will be financed out of the European Structural and Investment Funds. Venture capital is intended primarily for investments directed towards technological sectors with high-growth potential, and the target group of companies includes innovative companies in the early stages of development (seed and start-up).

HBOR expressed its intention to invest an amount of up to EUR 7.5 million in the Venture Capital fund to be established in 2019 pursuant to the Financing Agreement signed between the Ministry of Regional Development and EU Funds (the Ministry) and the European Investment Fund (EIF).

By the Financing Agreement, the Ministry delegated to EIF the implementation of the financial instrument ESIF Venture capital fund as well as the selection and supervision of work of the ESIF Venture capital fund manager. EIF has implemented the process of selecting the fund management company that will, along with the EU funds, attract also private capital and invest in start-up companies.

### NPI Equity platform

The European Commission, in co-operation with EIF and national promotional institutions (NPI) launched the NPI equity platform for the purpose of developing the market of investments in private equity funds. HBOR participates in the work of two platform bodies – the General Forum and the Consultative Forum, the work of which is focused on exchange of experience and knowledge aimed at strengthening the private equity industry.

Further to the Memorandum of Understanding signed between EIF and HBOR, during 2018, negotiations were continued that resulted in signing of the agreement, by which at the beginning of 2019, the Croatian Growth Investment Programme (CROGIP) was launched. CROGIP is an initiative that will stimulate capital investments in small and medium-sized companies as well as mid-cap companies in the total amount of at least EUR 70 million. The signed agreement is a precondition for joint investment of funds of EIF

and HBOR, each committing EUR 35 million to invest into private equity funds. The funds will be managed by companies to be selected by EIF pursuant to its methodologies. HBOR does not participate in the selection of companies, however, the investment parameters set by HBOR will be taken into account by EIF. All funds assessed as eligible by EIF will be acceptable for HBOR, provided that the following is prescribed in their investment strategy: at least 70 percent of total investments of a fund will be invested in companies that are established in Croatia and perform the majority of their business operations in Croatia and/or companies that will start their long-term operations in Croatia and employ a significant number of workers from Croatia.

## CROATIAN EXPORTS – SUPPORTED WITH AN AMOUNT OF HRK 5.63 BILLION

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By implementing its export finance programmes, HBOR contributes to the increase in competitiveness and value of Croatian exports and improvement of the recognisability and quality of Croatian products and services in the foreign market.

Within the framework of its export promotion task, HBOR, through its loan programmes, issuing of performance-related bank guarantees at the request of an exporter and insurance of loans, performance-related guarantees and export receivables, provides support to exporters in all stages of an export transaction, starting from negotiations until the final payment for an export transaction. HBOR, as the Croatian export bank and export credit agency, developed a system of providing exporters with financial support like that of other export banks and export-credit agencies in order to provide Croatian exporters with equal competitive conditions in international markets.

Along with the programmes intended for export transactions exclusively, HBOR supports exporters through short-term and long-term credit lines at favourable interest rates. Investment loans are also available to exporters intended for expansion and modernisation of the production, construction of new plants, but also various loans for working capital that are not necessarily tied to export transaction exclusively. The utilisation of such funds is intended to increase the competitiveness of entrepreneurs, which is a precondition for the realisation of successful entry into foreign markets.

In 2018, Croatian exporters were backed by HBOR with the total amount of HRK 5.63 billion: under all loan programmes, exporters were approved 293 loans totalling HRK 2.88 billion, through export credit insurance policies export turnover insured amounted to HRK 2.69 billion and 15 bank guarantees at the request of exporters in the total amount of HRK 57.70 million were issued.

## EXPORT CREDIT INSURANCE

Export credit insurance and reinsurance activities are performed as mandate activities in HBOR.

In 2018, HBOR marked 20 years of performance of its export credit insurance activities, proving that its role in the financial market in the Republic of Croatia is justified and that it is a reliable partner to Croatian business entities operating with partners abroad.

HBOR is an important support provider to already exporting business entities, but also to small entrepreneurs that are just in the phase of preparation of an export transaction. Beside with entrepreneurs, HBOR also co-operates closely with banks that use insurance policies issued by HBOR as collateral for placements. Placements approved by banks and insured by HBOR may be approved to exporters or their buyers abroad, by which financing of production and sale of goods or services is made possible.

Through its programmes intended for exporters, HBOR assumes a portion of risk of non-payment for export receivables. Through the programmes for banks supporting exporters, it is possible to transfer a portion of risk of loan non-repayment to HBOR. Banks are also provided a guarantee insurance programme, based on which they can protect themselves against the risk of call for payment under the guarantees related to export transactions. Through the programme of reinsurance of short-term export receivables, HBOR enables private credit insurers to take risks that cannot be reinsured in the private market.

As an institution in Croatia which is dealing with insuring export transactions that cannot be insured in the private market, in 2018, HBOR very often participated in the coverage of export transactions in riskier markets.

Through HBOR's export credit insurance programmes, Croatian exporters are enabled to:

- Sell their goods or services more safely with deferred payment,
- Sell capital equipment with longer payment periods or with a financial loan with longer maturity,
- Finance the production of their goods and services for exports,
- Obtain a performance-related guarantee by a bank for the requirements of participation in international tenders or for contracting an export transaction.

In 2018, the European Commission approved to HBOR the continuation of support providing for the segments of insurance and reinsurance of short-term export receivables against temporarily non-market risks. The respective approval relates to the period of next six years, i.e. until the end of 2024, and is in compliance with the EU regulations.

This will allow HBOR to provide insurance to exporters that are unable to insure their short-term receivables in the private insurance market. Based on the European Commission's approval, HBOR will be able to further reinsure private credit insurers that may not contract the reinsurance of short-term export receivables in the private market.

### *Summary of results by export credit insurance transactions*

In HRK million

Description	2016	2017	2018
Total approved sum insured	759.52	1,002.32	1,787.58
Total insured export turnover	1,442.40	1,727.86	2,692.00
Gross exposure as at 31 December	1,655.96	2,128.97	2,959.73
Insurance premium	16.46	14.18	17.48
Paid indemnities	8.81	30.04	0.21
Recourse collections from debtors	1.50	0.04	40.66
Balance of Guarantee fund as at 31 December	332.36	327.95	387.74

As at 31 December 2018, HBOR's gross exposure under export credit insurance transactions amounted to HRK 2.96 billion, an increase of 39 percent in comparison with the same period in 2017. The increase in gross exposure was to the largest extent influenced by the growth of exposure under the buyer credit insurance and pre-export credit insurance programmes, within the framework of which the export of capital goods was supported.

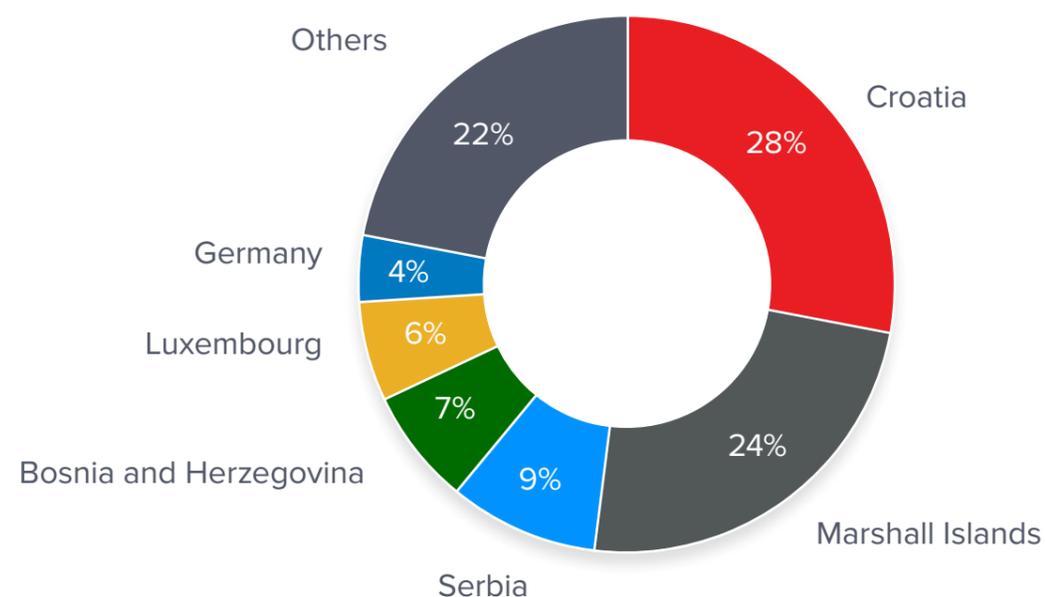
## EXPORT TURNOVER INSURED

In 2018, HBOR provided a record amount of insurance for export turnover and the mentioned result would not have been possible without synergy with commercial banks and exporters.

In 2018, HBOR through its export credit insurance programmes supported exports of Croatian goods and services to 51 countries worldwide and insured export transactions in the total amount of HRK 2.69 billion, i.e. an increase of 56 percent in comparison with 2017.

In 2018, HBOR approved coverage to Croatian exporters and banks that support exporters in the total amount of HRK 1.79 billion, an increase of 78 percent in comparison with 2017.

*Insured turnover in 2018 by countries*



Under the programme for insurance of buyer credit, in 2018, credit insurance was approved in the amount of HRK 716.42 million, an increase of 157 percent in comparison with 2017.

In 2018, through the Pre-Export Financing Insurance Programme, coverage for loans in the amount of HRK 752.28 million was approved to banks, i.e. an increase of 147 percent in comparison with 2017, thus enabling them to finance working capital of exporters in the phase of manufacturing of export goods, while exporters are enabled to obtain loans that otherwise would not be possible due to the lack of collateral.

Through the programme of insurance of short-term export receivables, HBOR insures short-term receivables of exporters against non-market and temporarily non-market risks.

In 2018, HBOR provided insurance for export turnover in the amount of HRK 456.85 million, an increase of 44 percent on 2017. Under the programme for the insurance of short-term export receivables, the exporters that were mainly supported were engaged in the production of freight wagons, wood products, pharmaceutical products, solar panels and rubber products.

The largest export turnover with insurance coverage was realised for buyers in Germany, France, Luxembourg, Ukraine, the Netherlands and Italy.

The programme for the insurance of short-term export receivables for small exporters is intended for medium-sized and small exporters with an annual export turnover of up to EUR 2 million and for those starting to export their goods and services to foreign markets.

In 2018, the volume of approved insurance for this category of exporters totalled HRK 6.45 million, an increase of 17 percent on 2017. The majority of insured transactions related to the export of goods and services by processing industry entities, among which particularly export of sanitary equipment, seafood, air conditioning units and ventilation systems, project services, lighting fixtures and wines.

The largest export turnover with insurance coverage was realised for buyers in Italy, Slovenia, Bosnia and Herzegovina, Spain and France.

Under the programme of insuring direct deliveries of goods and services in 2018, under which insurance is provided mainly for the export of capital goods at longer payment collection deadlines, the insured export turnover amounted to HRK 26.81 million, an increase of 96 percent on 2017. Under the programme, insurance was provided for the export of telecommunications equipment and services to the market of Cuba and for the delivery of transformer station to the market of Lithuania.

Under the programme of insuring export performance-related guarantees, the insured guarantees related to the extended validity of guarantees under export contracts executed in previous years and also to newly issued bid guarantees for tenders in Ukraine relating to the energy industry and performance guarantees for a road construction project in Slovenia. The volume of approved insurance totalled HRK 131.04 million.

## REINSURED EXPORT TURNOVER

Under the programme for the reinsurance of short-term export receivables in 2018, HBOR reinsured the export turnover in the amount of HRK 602.11 million, an increase of 7 percent on 2017. The majority of insured transactions related to the export of goods and services by processing industry entities, of which particularly export of glass packaging, heating and cooling products, pharmaceutical products and recycled paper. The largest reinsured export turnover was realised for buyers in Serbia, Bosnia and Herzegovina, Macedonia, Montenegro and Kosovo.

## INDEMNITIES PAID

In 2018, two indemnities were paid in the total amount of HRK 213 thousand, one under the programme for the insurance of short-term receivables due to non-payment on the part of a buyer in Russia and the other under the programme for the short-term reinsurance due to non-payment on the part of a buyer in Israel.

In 2018, the amount of HRK 400 thousand was paid to the insured as compensation for costs incurred for the purpose of reducing possible damage or for the purpose of enforced collection.

Even though a relatively small number of indemnities was paid in 2018, a higher number of overdue on the part of debtors was recorded and 16 debtor non-payment notifications were received mostly relating to the territory of Croatia, Bosnia and Herzegovina and France.

## RECOVERIES FROM DEBTORS

In 2018, HBOR scored a record year in terms of the amount of recoveries as, in the reporting year, the amount of recoveries under previously paid indemnities stood at HRK 40.66 million. This amount represents almost 80 percent of all recoveries collected since HBOR started these operations. The share of 98 percent of the stated amount of recoveries relates to the recovery from a public debtor from Bosnia and Herzegovina, whereas the other recoveries relate to the debtors from Croatia (under the guarantee insurance programme and the pre-export finance insurance programme) and to the recovery under the activities of short-term reinsurance of a debtor from Serbia.

## RISK MANAGEMENT

Pursuant to the Act on HBOR, the Bank is obliged to reduce risks in its operations to the lowest level possible by applying the principles of banking operations. In the risk management process, the Bank continuously identifies, assesses, measures, monitors, contains and controls risks it is or may be exposed to in its operations. The manner, procedures and frequency of measurements and assessments in risk management are prescribed by the Bank's general documents. In the Bank's day-to-day operations, credit risk, liquidity risk, interest rate risk in the banking book, currency risk, operational risk and outsourcing risk are managed through policies, procedures, methodologies, ordinances, limits and controls.

The Bank has a functionally and organisationally separate and independent organisational unit for controlling business risks that is directly responsible to the Management Board. This organisational unit is responsible for the identification, assessment, measurement, supervision and control of risks the Bank is or may be exposed to in its operations. The Risk Management Unit performs its function also by analysing and giving suggestions and recommendations for adequate management of exposure to credit and non-credit risks, by developing risk-related policies, ordinances, procedures and methodologies, by recommending exposure limits and monitoring the adherence to the adopted exposure limits as well as by risk-related reporting to the Management Board and the risk management committees.

When assessing and measuring risks, the Bank takes into account historical data, business plans, current and expected market conditions and specific features of the Bank as a special financial institution. The results of measurements/assessments and analyses conducted in the field of risks are reported to the risk management committees, the Management Board and the Supervisory Board. A system of limits has been established for the purpose of managing, monitoring and controlling credit risk, liquidity risk, interest

rate risk in the banking book and currency risk. The Bank performs sensitivity analyses and scenario analyses by assuming changes in one or more risk factors in regular and stressful circumstances of operations and it reports on the results of such analyses to HBOR's bodies in charge. Systems of proactive risk management are continuously developed for the purpose of mitigating potential future risks.

The Management Board of HBOR is responsible for the implementation of the risk management strategy and for the establishment and implementation of an effective and reliable system for the management of all risks. For the purpose of accomplishing its function, the Management Board has delegated its powers to four risk management committees:

- Asset and Liability Management Committee – manages liquidity risk, interest rate risk in the banking book and currency risk through the prescribed policies, ordinances and procedures that regulate this area
- Credit Risk Assessment and Measurement Committee – manages credit risk through the prescribed policies, ordinances, procedures and other internal documents that are related to credit risk
- HBOR Information System Management Committee – manages the resources of the information system and adequately manages the risks that arise from the use of information technology
- Business Change Management Committee – manages business changes (co-ordination of the procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce the risks associated with the implementation of business changes.

The risk management strategy aims to achieve and maintain a good and efficient system of risk management in line with the local and international banking practices and the recommendations of the Croatian National Bank (HNB), the European regulations and the Basel Committee recommendations applicable to HBOR as a special financial institution.

## Credit risk

The Bank controls credit risk through credit policies, ordinances and prescribed procedures that determine the internal control systems with an objective to act preventively.

HBOR's Management Board conducts a conservative credit risk management policy. The credit risk management system represents the most important part of HBOR's business policy and an important factor of its business strategy. Therefore, this area is regulated by a separate document called the Credit Risk Management Ordinance that applies to all phases of the credit process (from the development of new banking products, to loan

applications, client monitoring and final loan repayments). The Credit Risk Management Ordinance represents a comprehensive document comprised of separate methodologies aiming to evaluate various client target groups.

In order to mitigate credit risk and reduce operating costs, the Bank, in accordance with the HBOR Act, on-lends part of its placements via commercial banks that assume the risk of collecting repayments from final borrowers. For the purpose of facilitating access to HBOR's funds, the Bank on-lends part of its placements through risk-sharing models. Generally, all direct placements and placements through the risk-sharing models are secured by mortgages on immovable property, and, if possible, the Bank requires guarantees issued by HAMAG BICRO and also other types of guarantees and warranties as collateral. The Bank has determined the required ratio between placement value and collateral value according to the type of collateral, the loan programme, the general terms and conditions of security and the decision of the body in charge.

The Bank's development loan programmes cover the entire territory of the Republic of Croatia with a focus on the areas of special state concern. Credit risk is diversified by geographical regions, activities, sectors and loan programmes. The Bank aims to prevent the excessive concentration of credit risk and, by providing more favourable terms and conditions and creating new loan programmes (products), to promote the development of less developed regions of the Republic of Croatia in accordance with the state development strategy for individual activities.

## LIQUIDITY RISK, CURRENCY RISK AND INTEREST RATE RISK IN THE BANKING BOOK

The Bank ensures quality management of liquidity, currency and interest rate risks in the banking book through the Asset and Liability Management Committee. The management of these risks implies a reduction of interest rate risk, currency risk and liquidity risk to the lowest possible level. The majority of the Bank's organisational units are included, directly and indirectly, in the operations of the Asset and Liability Management Committee in order to ensure a high-quality, integrated and comprehensive system for the management of these risks.

### LIQUIDITY RISK

The basic principles for managing HBOR's liquidity risk are defined in internal documents as well as in the decisions and conclusions made by the Supervisory Board, the Management Board and the Asset and Liability Management Committee.

For the purposes of managing liquidity risk, the Bank has established a system of limits. The Bank monitors and verifies that the limits are obeyed. It maintains the necessary level of liquidity reserves, continuously monitors current and planned liquidity and provides sufficient kuna and foreign currency funds necessary for the timely settlement of obligations and disbursements under committed loans and planned commitments. The Bank monitors and strives to achieve compatibility of the existing and planned placements and sources in terms of maturity. The Bank does not take deposits from citizens and is therefore not exposed to wide daily fluctuations in liquidity. The Bank monitors liquidity risk also through scenario analyses and sensitivity analyses both under regular business conditions and under stress. Early warning signals and procedures for liquidity crisis indication or occurrence are determined in the Liquidity Risk Management Ordinance.

### INTEREST RATE RISK IN THE BANKING BOOK

The basic principles for managing the Bank's interest rate risk are defined in separate internal documents and in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. For the purpose of measuring and monitoring interest rate risk, the Bank analyses the interest rate gap. The interest rate gap is analysed with respect to specific periods in terms of possible changes in interest rates and it illustrates the sensitivity of the Bank to such changes in interest rates. Interest rates are elaborated in detail per currency, type and level of interest rates, and projections of developments in average weighted interest rates on sources and placements are prepared. In addition to adjustment of interest rates applied on sources and placements, current market conditions and development projections for basic market indicators are also monitored.

### CURRENCY RISK

The basic principles for HBOR's currency risk management are defined in internal documents as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. The methods for the measurement/assessment, monitoring and management of currency risk have been established, the limits and procedures in the case of crisis indication or occurrence have been determined, and the reports necessary for overall currency risk containment have been defined.

For the measurement of exposure to currency risk, the Bank monitors the open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the preparing of its development projections, the Bank uses the VAR model as an auxiliary model for the purpose of assessing and measuring currency risk. The Bank

regularly reports on the maximum possible losses under major currencies to the bodies in charge. Scenario analyses and sensitivity analyses are conducted both under regular business conditions and under stress.

### OPERATIONAL RISK

The basic principles for operational risk management are determined in the umbrella document, the Operational Risk Management Policies. The system structure of management and responsibility has been set up, the approach to the calculation of capital requirements for operational risk has been defined and the reporting system has been established.

Information System Management Committee has been formed with the task of monitoring and supervising IT system performance. Its purpose is to manage the IT resources and to set up the appropriate level of efficiency and security of IT system in order to provide, among other things, appropriate management of risks arising from IT technology utilisation. The supervision of the IT system security is covered by the IT system security control function. Within this function, a system for the management of HBOR's business continuity has been set up.

### OUTSOURCING RISK

The Bank manages the outsourcing risk on the basis of internal documents that are in compliance with the regulations prescribed by the Croatian National Bank applicable to the Bank as a special financial institution. The internal documents that determine the management of this risk determine also the procedures for the outsourcing of activities, the rules for the management of relations with the service providers and the obligation to reduce the risk to the lowest level.

The central records of outsourced activities have been established. Reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on an annual basis.

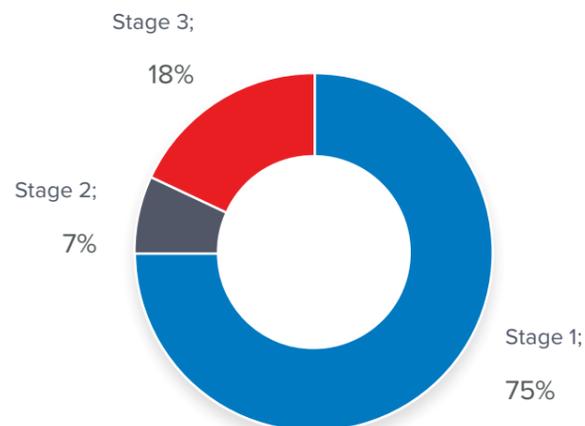
## ASSET QUALITY OF HBOR

In 2018, HBOR implemented the International Financial Reporting Standard 9 for the impairment of financial instruments.

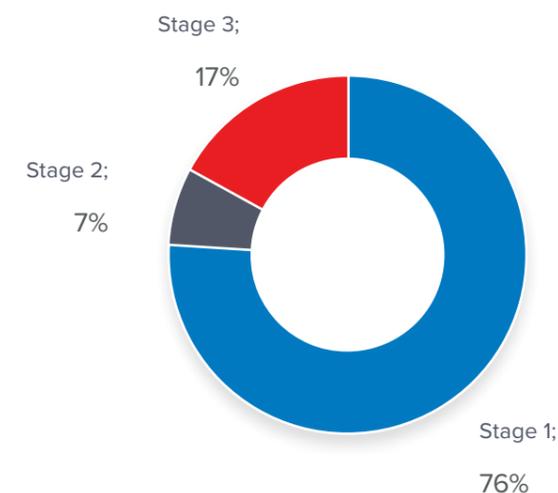
As at 31 December 2018, HBOR's total portfolio amounted to approximately HRK 35,808.1 million. Of the total portfolio, 74.6 percent was allocated to Stage 1, 6.9 percent was allocated to Stage 2 and 18.5 percent was allocated to Stage 3.

Due to the fact that gross loans account for 73 percent of the total portfolio, there is no significant difference in quality between total portfolio and total loans. 76.5 percent of total loans were allocated to Stage 1, 6.9 percent were allocated to Stage 2 and 16.6 percent were allocated to Stage 3.

*Total portfolio by degrees of credit risk  
as at 31 December 2018*



*Total loans by degrees of credit risk  
as at 31 December 2018*



## INTERNAL AUDIT

The Internal Audit unit is part of HBOR's supervision system. It is in charge of monitoring the overall operations on the basis of the principles of legality and HBOR's internal regulations by applying the internal audit standards. The organisational unit of Internal Audit carries out its tasks independently and determines the manner of operating and reporting as well as preparing its findings, opinions and recommendations on its own. It is administratively responsible to the Management Board and functionally to the Audit Committee and the Supervisory Board of HBOR, to which reports are submitted semi-annually. Based on the audit report and according to the recommendations of the Internal Audit unit, the Management Board makes the necessary decisions to take corrective measures and activities.

## COMPLIANCE MONITORING FUNCTION

The function of monitoring compliance has been established as an independent and permanent function. Compliance monitoring activities include the identification and assessment of compliance risks to which HBOR is or might be exposed as well as the provision of advice to the Management Board and other responsible persons on the manner of applying relevant legislation, standards and rules, including the information on the latest news regarding these issues.

The compliance monitoring function evaluates the impacts that the amendments to the relevant regulations will have on the operations of HBOR, assesses the compliance of new products or new procedures with the relevant laws and regulations and with the amendments to the regulations, provides advice during the preparation of compliance-related training programmes, provides advice and training relating to ethical behaviour, participates in the management of procedures pertaining to complaints and reported irregularities and supervises the implementation and fulfilment of the provisions of the Code of Conduct. The compliance monitoring function submits periodical reports to the Management Board, the Audit Committee and the Supervisory Board of HBOR.

## HUMAN RESOURCES

In 2018, HBOR renewed the Employer Partner Certificate that is awarded by Selectio d.o.o. for excellence in human resource management. Since 2006, when HBOR joined the project, permanent growth and development have been observed in all aspects of human resource management.

In 2018, HBOR achieved 87 percent of total scores, thus retaining the high standard across all 45 human resource management processes under certification.

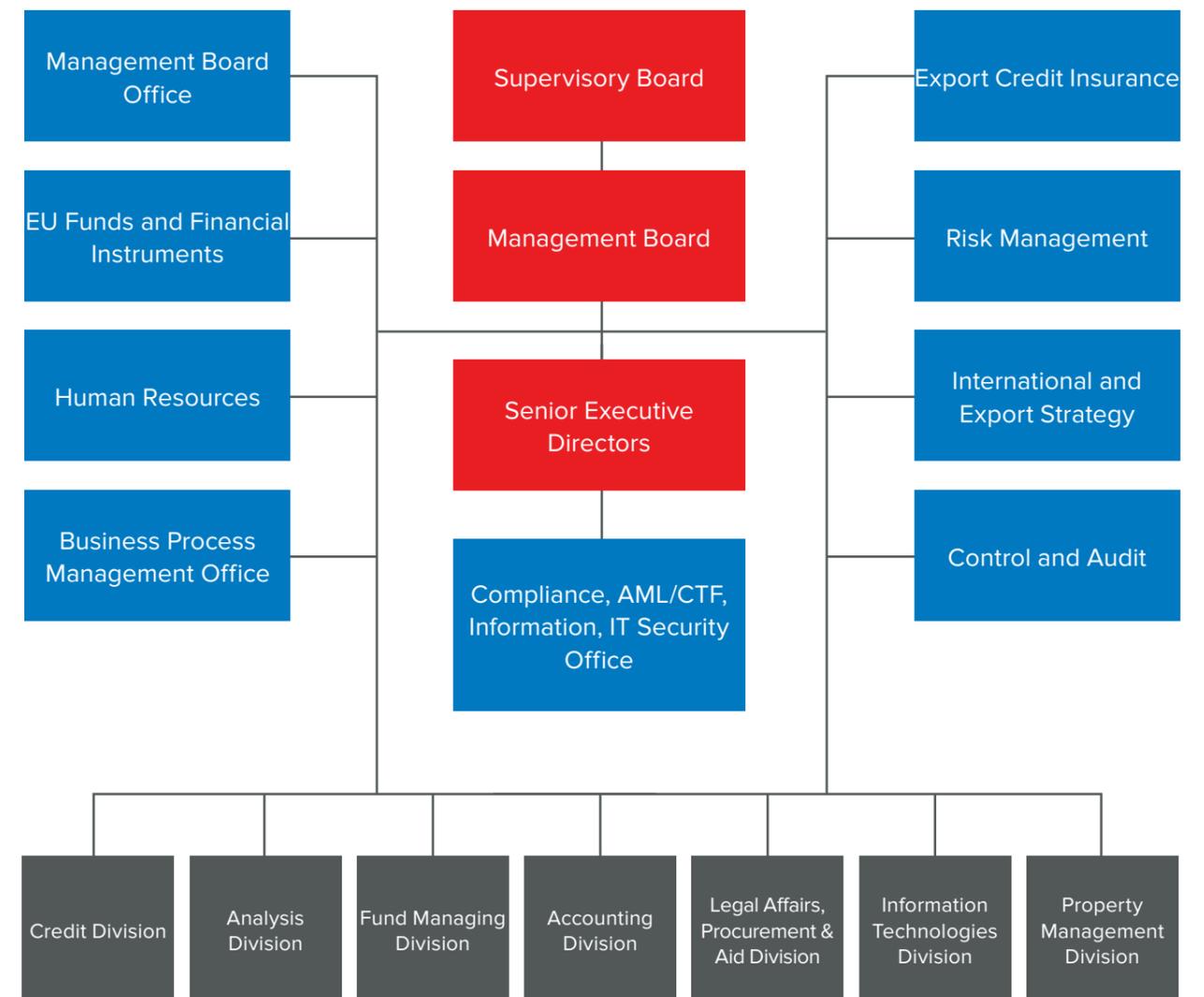
Such a result was attained due to the established processes in all five areas assessed and owing to continuous efforts of the Bank in the development of employee management process aimed at meeting the needs of both the bank and the market.

The goal of the human resource management process is to select quality employees and ensure permanent development of their potential and continuous upgrading of their competences as the only way to achieve excellence in work. Regular processes and activities related to the management of human resources cover the entire career of an employee in the organisation and provide support to the management in the area of human resource management: selection and employment of candidates, management of employees' goals and competences, remuneration as well as development of employees' skills. After employment, that is carried out on the basis of clear selection criteria, new employees are introduced to business through in-house training programmes. Success at work of all employees is monitored and documented on a quarterly basis, whereas individual interviews take place on an annual basis. Training and development of competences considered crucial in the activities that are performed by employees are organised through in-house workshops and through participation in individual external training programmes.

As at 31 December 2018, there were altogether 370 employees, of which 324, i.e. 88 percent, holding a university degree. The average age of employees was 43. The share of women in the total number of employees was 66 percent and the share of men 34 percent.

## Organisational structure of HBOR as at 31 December 2018

HBOR's macro-organization scheme



## OTHER ACTIVITIES

In order to fulfil its development role, improve business processes and effectiveness and to respond to new market challenges in the best possible way, HBOR started to implement a project of developing a medium-term operating and development strategy of the Bank. The basis for the preparation of the strategy is the analysis of existing internal and external business conditions, the analysis of business processes, market demands and gaps. Funds for the implementation of this projects have been provided under the Structural Reform Support Programme (SRSP) of the European Commission. Consultant to implement this project has been selected by the European Commission.

In June 2018, HBOR published its Social Responsibility Report for 2017, i.e. HBOR's ninth report on the manner of and progress in the implementation of the UN Global Compact principles in the areas of human rights, labour standards, environment and anti-corruption.

In 2018, HBOR announced the public invitation called "WE CREATE EQUAL OPPORTUNITIES" earmarked for projects implemented in areas with fewer opportunities that have an impact on a quality of life and/or health upgrade and promote social inclusion in the community.

Grants were awarded to 11 projects totalling slightly above HRK 480 thousand. Data on all grant recipients were published on HBOR's websites.

## International co-operation and internationalisation

HBOR pays special attention to the establishment and maintenance of successful relations with international financial institutions, development banks, export-credit agencies, associations and clubs such as the European Association of Public Banks (EAPB), the Network of European Financial Institutions for SMEs (NEFI), the Banking Association for Central and Eastern Europe (BACEE), the Berne Union, the United Nations Environment Programme Finance Initiative (UNEP FI), the UN Global Compact, the International Development Finance Club (IDFC), the China-CEEC Inter-Bank Association, numerous bilateral chambers of commerce and, as an establishing member, the European Long Term Investors association (ELTI). Memberships of the above associations are a means for developing business and upgrading knowledge as well as for effectively exchanging best practices and specific expertise among members on various business issues.

In June 2018, HBOR hosted the EAPB CEO Conference and General Assembly, on the occasion of which Ms Tamara Perko, President of HBOR's Management Board, was elected to the EAPB Board for a two-year term of office. The appointment of Tamara Perko to the EAPB Board was an expression of confidence in, and of acknowledgement of, both HBOR and the Republic of Croatia for being, as a development institution and an EU member state, an important factor in the implementation of common European policies.

In 2018, the Memorandum of Cooperation was signed between national development banks of South-East Europe (Bulgaria, Hungary, Croatia, Macedonia), the Black Sea Trade and Development Bank and the International Investment Bank, the main focus of which is the promotion of infrastructure projects in the area of South-East Europe, the identification and financing of projects of key significance for the region. Within the framework of the activities related to the China-CEEC Inter-Bank Association, two agreements were signed: the Cooperation Action Agenda for 2018-2020 of the China-CEEC Inter-Bank Association and the Cooperation Agreement on Capacity-Building and Experience-Sharing among Member Banks of the China-CEEC Inter-Bank Association.

In cooperation with the Ministry of Finance, preparations were started for the Croatian presidency of the Council of the European Union in 2020, during which HBOR will take the role of Deputy Chairman of the Export Credits Group.

Cooperation was continued with the Croatian Exporters Association, and the internationalisation of the economy was supported also by the participation in economic delegations to foreign countries and in economic fora taking place in the Republic of Croatia.

In order to strengthen the competitiveness of the Croatian businessmen, increase exports and improve business conditions in general, HBOR focused on the co-operation with the foreign embassies in the Republic of Croatia and particularly with the foreign chambers of commerce in Croatia through the participation of HBOR's representatives in the activities of the committees relevant for HBOR and Croatian businessmen.

In October 2018, HBOR's 17th International Conference on Export Promotion took place under the auspices of the Government of the Republic of Croatia. The Conference gathered numerous foreign and domestic partners. A Memorandum of Understanding was signed between HBOR and Atradius Dutch State Business, the Dutch state agency for export credit insurance. This cooperation additionally widens the institutional framework of cooperation with an objective of providing effective support to Croatian exporters.

## GENERAL DATA PROTECTION REGULATION

General Data Protection Regulation (GDPR) covers the protection of personal data of the citizens of the European Union. The purpose of the GDPR is to enable the citizens of the EU to control their personal data as well as to create a high and balanced level of data protection in the European Union. With the support from external consultants, HBOR's task force established the measures required for the alignment with the Regulation and determined the implementation deadlines. On the basis of the established measures, within the determined deadlines, key issues of harmonisation with the Regulation were addressed, i.e. HBOR's Personal Data Protection Policy and Personal Data Protection Ordinance were adopted, Privacy Policy and Information for Data Subjects were adopted and published, Personal Data Processing Register and Records were prepared, Personal Data Protection Officer was appointed, and Consent Management Application was developed. By adopting internal documents and by the public disclosure of documentation, HBOR provided the main preconditions for the compliance with the Regulation and the implementing Act. The new internal documents in the area of personal data protection provided for the manner, the responsible people and the time schedule for the education and raising of employees' awareness about personal data protection as well as for the training of new employees in this field. Consequently, basic education of all employees in the area of personal data protection was organised in 2018.

## REGIONAL OFFICES

The network of five regional offices, HBOR has been developing since 2003, is focused on the promotion of HBOR's regional presence and the increase in the visibility of the Bank particularly in the SME sector. HBOR's regional offices are particularly targeted at providing consultancy and information to entrepreneurs about HBOR as the source of funding for the start-up, growth and development of their businesses.

HBOR's regional offices cover the territory of 14 counties and, therefore, more than 120 thousand active companies and crafts businesses (i.e. 62 percent of the total number of business entities in the country) are oriented towards them.

In 2018, the regional offices organised altogether 315 workshops and education events, including those called "In 7 Steps to a Loan". This workshop is intended to strengthen the financial literacy of both potential and existing entrepreneurs.

Individual consultancy services to entrepreneurs, both start-up and experienced ones, are provided through info-days that are organised in co-operation with offices for the

economy at local government units, with chambers of commerce, entrepreneurial centres or development agencies or local action groups. In 2018, regional offices as part of HBOR's distribution network initiated a significant number of loan applications both directly and through financial institutions with which HBOR cooperates.

## PUBLIC DISCLOSURE OF ACTIVITIES

HBOR puts a special focus on providing information to the public about its goals and about the measures for their attainment as well as about the results of its activities by simultaneously following the principle of bank secrecy and its function. Therefore, through various forms of providing information, HBOR regularly informed the public about all its important activities in 2018.

In the reporting year, HBOR published 18 press releases informing the public about the operations, attained results, new loan programmes and amendments to the existing ones. All business information can be accessed on HBOR's websites, except for the information subject to the bank secrecy provisions of the Credit Institutions Act.

During the reporting period, 27 public procurement procedures were published in the Electronic Public Procurement Classifieds. Since 1 July 2017, simple procurements procedures have also been published on HBOR's websites.

In 2018, altogether 39 requests for access to information pursuant to the Act on the Right of Access to Information were received.

# OPERATIONS OF HRVATSKO KREDITNO OSIGURANJE GROUP

## HRVATSKO KREDITNO OSIGURANJE D.D. AND POSLOVNI INFO SERVIS D.O.O.

Hrvatsko kreditno osiguranje d.d. (HKO) is a joint-stock insurance company specialised in the insurance of short-term receivables (payment terms of up to 2 years) arisen from the sale of goods or services among business entities. The insurance covers political and commercial risks.

In 2018, HKO offered the following insurance products: insurance of domestic and export receivables.

In October 2010, HKO established the company called Poslovni info servis d.o.o. and started to operate as the Hrvatsko kreditno osiguranje Group (HKO Group) and to prepare consolidated financials. Within the HKO Group, Poslovni info servis d.o.o. (PIS) is in charge of analysing and assessing credit risks relating to insurance transactions.

As at 31 December 2018, there were 20 employees at HKO Group, of which 15 were employed with Hrvatsko kreditno osiguranje d.d. and 5 with PIS. Seventeen employees have university degrees and three have secondary school education.

### Ownership structure

HKO is 100% owned by the Croatian Bank for Reconstruction and Development.

### Management

Legal status, organisation and management of the Company, all other issues important for the operations of the Company as well as all harmonisation issues provided for in the Companies Act and the Insurance Act are determined by the Statutes of the Company. Company management bodies are: Management Board, Supervisory Board and Shareholders' Meeting.

### People authorised to represent

#### Management Board in 2018

- Zvonimir Samodol, Chairman of the Management Board
- Ružica Adamović, Member of the Management Board

#### Supervisory Board of HKO

In 2018, the membership of the Supervisory Board of HKO was as follows:

- Tamara Perko, Chairman of the Supervisory Board,
- Marko Topić, Deputy Chairman of the Supervisory Board,
- Ante Artuković, Member of the Supervisory Board,
- Marija Jerkić, Member of the Supervisory Board until 25 September 2018,
- Vedran Jakšić, Member of the Supervisory Board since 25 September 2018,
- Andreja Mergeduš, Member of the Supervisory Board.

#### Poslovni info servis d.o.o.

Jelena Boromisa performed the function of the Manager of PIS in 2018. Ivana Paić has been the authorised representative of the Company.

## HKO Audit Committee

In 2018, the membership of the Audit Committee of HKO was as follows:

- Ante Artuković, Chairman of the Audit Committee,
- Andreja Sekušak, Member of the Audit Committee,
- Marija Jerkić, Deputy Chairman of the Audit Committee until 25 September 2018,
- Vedran Jakšić, Deputy Chairman of the Audit Committee since 25 September 2018.

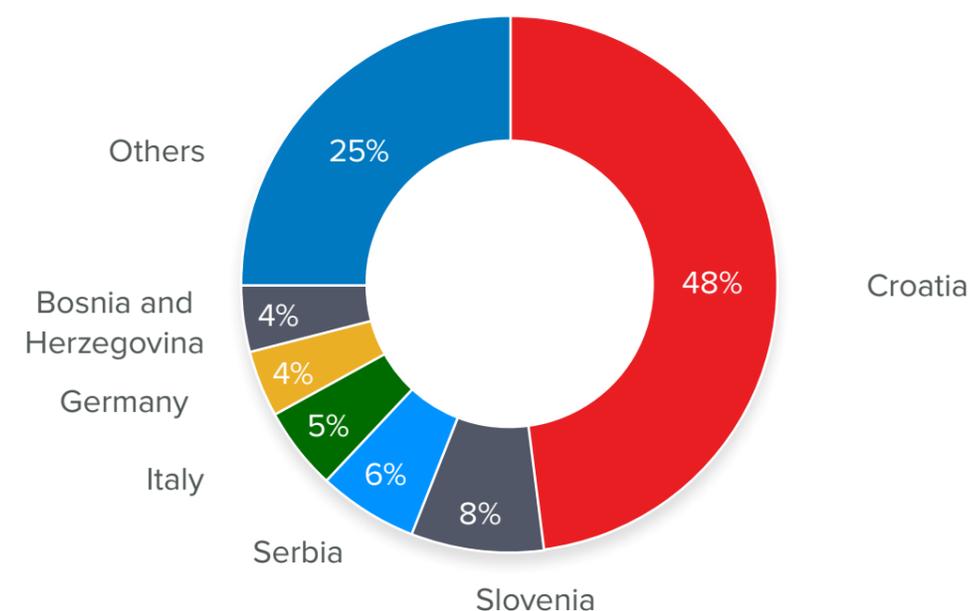
## Reporting to the supervisory bodies

In 2018, the Company provided regular reports to the supervisory bodies on all relevant facts and changes in the Company pursuant to the Insurance Act, the ordinances of the Croatian Financial Services Supervisory Agency and other regulations in force. The Company regularly met all requirements of the supervisory bodies in terms of control of operations and submission of the Company's data.

## OPERATIONS IN 2018

In 2018, Hrvatsko kreditno osiguranje d.d. concluded 156 insurance contracts. A total of 4,615 credit limits were covered by the insurance, i.e. an increase of 9.80 percent on the previous year. Within the total structure of limits, 3,134 credit limits were related to domestic receivables, and 1,481 credit limits were related to export receivables towards 66 countries of the world.

## Exposure by countries according to limit amounts as at 31 December 2018



The total volume of insured transactions in 2018 amounted to HRK 4.17 billion, whereas in 2017 it amounted to HRK 3.90 billion, an increase of 6.92 percent.

In 2018, the total charged premium amounted to HRK 10.46 million, a decrease of 1.26 percent on 2017 when it stood at HRK 10.59 million.

In the reporting period, the Company paid 17 indemnities. In 2018, the total amount of paid indemnities amounted to HRK 9.78 million, whereas the amount of paid indemnities in the previous year equalled HRK 6.21 million. The paid indemnities were related to buyers in Croatia, Serbia, Slovenia and Israel.

## Insurance business indicators

HRK thousand

	2016	2017	2018
Volume of insured receivables	3,798.540.23	3,904,430.83	4,169,288.73
Exposure as at 31 December	1,709.409.46	1,886,028.64	2,091,809.54
Gross premium charged	11,814.18	10,594.00	10,460.82
Amount of paid indemnities	1,717.33	6,212.88	9,777.21
Number of active limits as at 31 December	3,026	4,203	4,615

Acquisition costs, marketing costs, administration costs and other operating expenses of the HKO Group in 2018 amounted to HRK 6.69 million, whereas, at the Company level, they amounted to HRK 5.61 million.

The business year 2018 is the eighth full year of operations. Prior to consolidation with the parent's financial statements, the HKO Group recorded profit before taxes for the year in the amount of HRK 293 thousand, whereas 2017 ended with a profit of HRK 756 thousand.

As at 31 December 2018, the total assets of the HKO Group amounted to HRK 56.23 million, an increase of 0.35 percent on the previous year. As at 31 December 2018, the total capital amounted to HRK 40.81 million and technical reserves to HRK 10.71 million net.

## CURRENT ECONOMIC SITUATION AND ITS IMPACT ON THE BANK

In 2018, the Croatian economy grew at a broadly steady pace with real GDP growth rate estimated at 2.8 percent\*, which is only slightly lower than in 2017. Growth was increasingly driven by private consumption.

It is expected that private consumption will remain the main driver of growth, supported by improving labour market conditions, positive consumer sentiment, low interest rates and subdued inflation.

Furthermore, the projected pick-up in disbursements from EU funds should provide a boost to public investment, which will nevertheless stay well below pre-recession level. Overall, real GDP growth is forecast to continue moderating to 2.7 percent\* in 2019 and further to 2.6 percent\* in 2020.

In view of the anticipated slowdown in Croatia's main trading partners in the EU, exports of goods are likely to grow more slowly than in recent years. However, exports of services are expected to continue performing well on the account of an increasingly extended tourist season and sizeable investment in higher-end hotels in recent years. Bolstered by high domestic demand, imports of goods are set to remain strong, slowing only slightly over the forecast horizon and driving the good trade balance increasingly negative.

In 2019, HBOR will continue to use financial instruments from the European Structural and Investment Funds (ESIF), an effective manner of using financial resources available in the Republic of Croatia. Financial instruments facilitate the mobilisation of additional public or private co-investment and can be used in the form of loans, guarantees or other mechanisms.

In order to place the funds in loans for all planned activities, settle the liabilities assumed and maintain the necessary liquidity reserves, the Bank has provided for the funds and the sufficient level of liquidity.

\*Source: European Commission: Winter 2019 Economic Forecast: growth moderates amid global uncertainties, [https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/winter-2019-economic-forecast-growth-moderates-amid-global-uncertainties\\_en](https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/winter-2019-economic-forecast-growth-moderates-amid-global-uncertainties_en)

## PRINCIPLES OF FINANCIAL REPORTING

The HBOR Group prepares:

1. Separate financial statements of the parent company – HBOR,
2. Consolidated financial statements that include HBOR and companies under its control – subsidiary companies.

When preparing and presenting its annual financial statements, the HBOR Group (the parent company and subsidiary companies) applies the International Financial Reporting Standards (IFRS).

Financial statements are prepared and presented in order to provide information on the financial position, success in operations and changes in the financial position of HBOR and the HBOR Group in order to enable their users to make appropriate economic decisions and in order to give financial information about how that strategy of the HBOR Group is carried out.

For the purpose of financial reporting and disclosures, the HBOR Group applies the following principles:

- **Transparency in disclosure** in order to enhance its users' understanding of the presented information,
- **Consistency in presentation** within each reporting period and between reporting periods,
- **Simplicity in disclosure** in order to allow the users to gain an easier understanding of the financial position, business performance and changes in financial position, as well as to ease decision-making,
- **Focusing on legal requirements** in order to ensure compliance,
- **Application of the best presentation practices** appropriate to the Group's activities with respect to up-to-date international trends in financial reporting as well as market requirements.

## OVERVIEW OF FINANCIAL PERFORMANCE IN 2018

The financial statements include both separate financial statements of HBOR and consolidated financial statements of the HBOR Group.

In the text to follow, an overview of the financial performance and operations is given separately for the HBOR Group and HBOR, as the parent company and the entity subject to this report.

The separate and consolidated Annual Financial Statements of HBOR for 2018, which can be found enclosed, have been audited by the audit company KPMG d.o.o. that expressed an unqualified opinion in the Independent Auditor's Report.

## OVERVIEW OF FINANCIAL OPERATIONS OF HBOR GROUP

Having in mind the size of the subsidiary companies and the volume of their operations compared with the operations of the parent company, their financial data are not significant so as to be particularly highlighted within the framework of the consolidated financial statements. Consequently, they do not have a material effect on the consolidated financial statements in comparison with the separate statements of HBOR as the parent company.

The HKO Group represents only 0.21 percent of the parent company's assets.

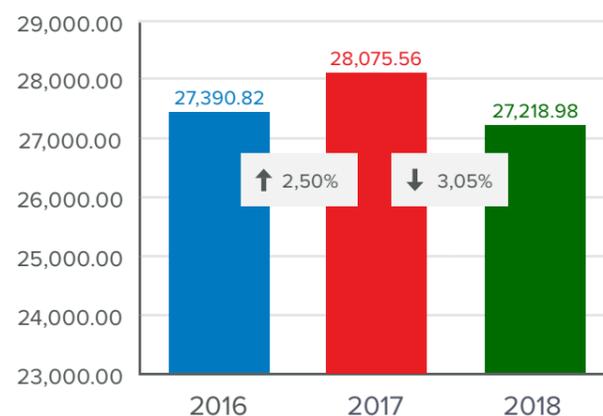
## BREAKDOWN OF THE MOST SIGNIFICANT FINANCIAL INFORMATION OF HBOR GROUP

In HRK million

	2016	2017	2018
Total assets	27,390.82	28,075.56	27,218.98
Gross loans	26,343.12	26,332.99	26,243.12
Total equity	10,042.70	10,275.78	10,061.10
Total income	933.67	930.81	801.40
Total expense	(618.83)	(768.61)	(596.67)
Profit	314.84	162.20	204.73
Interest income	871.98	867.83	733.08
Interest expense	(452.67)	(390.46)	(356.07)
Net interest income	419.31	477.37	377.01

## TOTAL ASSETS

In HRK million



## GROSS LOANS

In HRK million



## TOTAL INCOME, TOTAL EXPENSE AND PROFIT

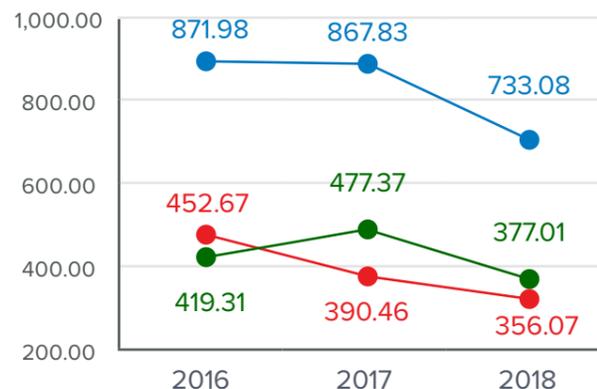
In HRK million



- Total income
- Total expense
- Profit

## INTEREST INCOME, INTEREST EXPENSE AND NET INTEREST INCOME

In HRK million



- Interest income
- Interest expense
- NET interest income

## Results of the HBOR Group

The effects of application of IFRS 9 were recognised at the expense of retained earnings and reserves as at 1 January 2018 in the amount of HRK 469.97 million.

In 2018, the HBOR Group generated profit after tax in the amount of HRK 204.73 million. The recorded profit is by 26.22 percent higher as compared to the previous year, and the reasons are stated in the description of HBOR's financial performance.

Pursuant to the provisions of the Act on HBOR, the parent company is exempt from income tax and income tax liabilities arise exclusively from the activities of the other members of the HBOR Group.

In 2018, total income on consolidated basis amounted to HRK 801.40 million, whereas total expenses amounted to HRK 596.67 million.

In the structure of income of the HBOR Group, the largest portion, i.e. 91.47 percent, relates to interest income as a result of operation of the parent company.

The major part of total expenses, i.e. 59.68 percent, relates to interest expenses as a result of operation of the parent company.

The consolidated operating expenses in 2018 amounted to HRK 170.90 million and consisted of general and administrative expenses and other operating expenses.

There were 390 employees in the HBOR Group on 31 December 2018, whereas there had been 386 employees in the HBOR Group at the end of 2017.

## Assets and liabilities of the HBOR Group

Total assets of the HBOR Group on consolidated basis amount to HRK 27,218.98 million, a decrease of 3.05 percent compared with the beginning of the year. The reasons for such tendency are given in the description of financial operations of HBOR.

In the structure of assets, the major portion relates to the lending activities of the parent company, i.e. net loans account for 83.57 percent of total assets.

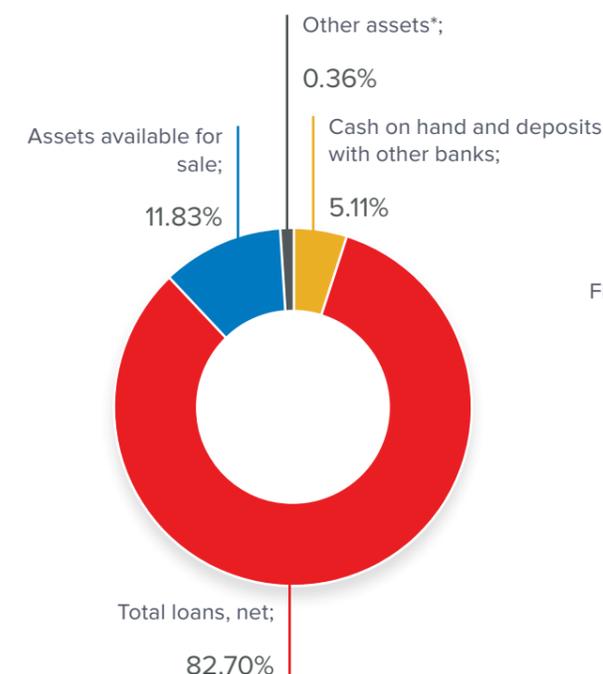
Total liabilities and total equity as at 31 December 2018 amount to HRK 27,218.98 million and, out of this amount, total liabilities amount to HRK 17,157.88 million, i.e. 63.04 percent.

In total liabilities and total equity of the HBOR Group, the major portion, i.e. 58.89 percent, consists of borrowings and bonds payable of the parent company.

At the end of the reporting period, total equity on consolidated basis amounted to HRK 10,061.10 million and accounted for 36.96 percent of total liabilities and total equity of the HBOR Group.

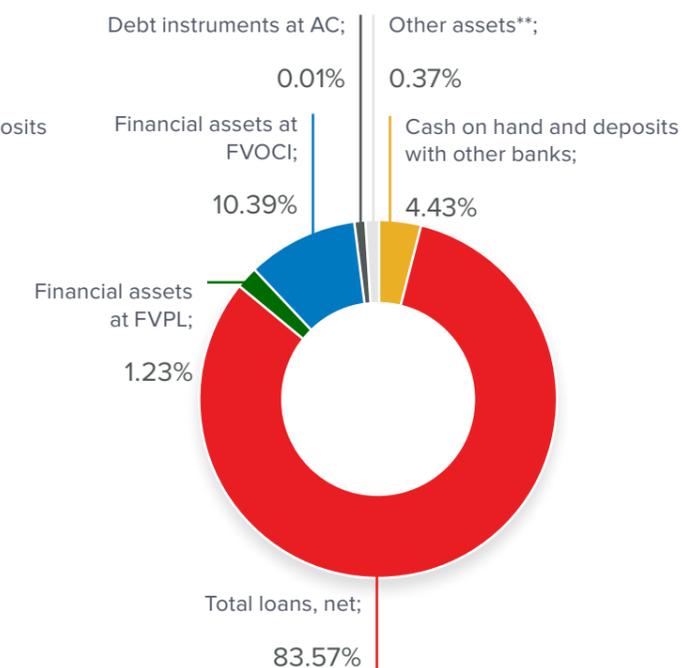
### TOTAL ASSETS

31 December 2017



### TOTAL ASSETS

31 December 2018

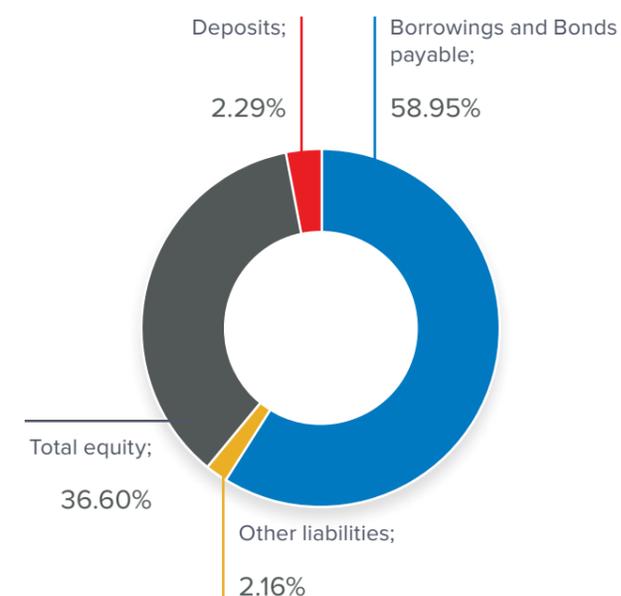


\*Financial assets at fair value through profit or loss, Assets held to maturity, Property, plant and equipment and intangible assets, Foreclosed assets and Other assets.

\*\*Property, plant and equipment and intangible assets, Foreclosed assets and Other assets.

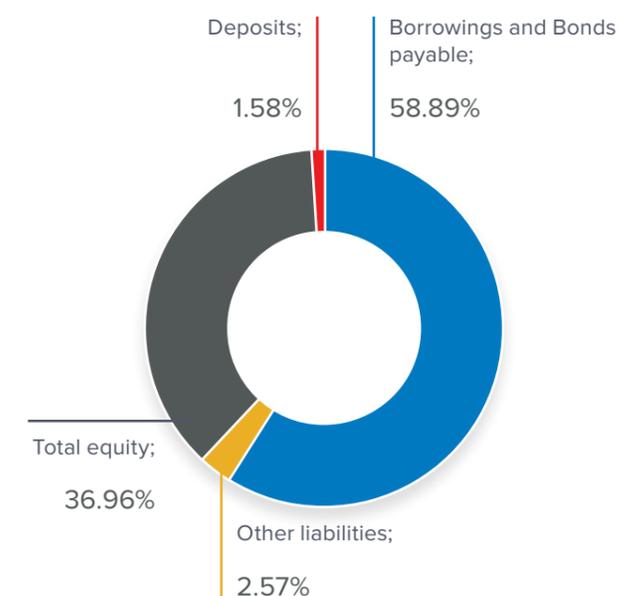
### TOTAL LIABILITIES AND TOTAL EQUITY

31 December 2017



### TOTAL LIABILITIES AND TOTAL EQUITY

31 December 2018



## OVERVIEW OF FINANCIAL PERFORMANCE OF HBOR

The following text gives an overview and explanation of the significant changes in financial position and operating performance in the reporting period.

Since 1 January 2018, the Bank has applied the International Financial Reporting Standard (IFRS) 9 Financial Instruments and has not reversed comparative data for 2017, as allowed by the standard. Pursuant to the mentioned, the results for 2018 are based on IFRS 9 „Financial instruments“, whereas the results for 2017 are based on the International Accounting Standard (IAS) 39, Financial Instruments: Recognition and Measurement, and comparative data for 2017 are not comparable with the information presented in 2018.

### Financial performance

The effects of application of IFRS 9 were recognised at the expense of retained earnings and reserves as at 1 January 2018 in the amount of HRK 469.66 million.

In 2018, HBOR generated total income of HRK 791.25 million, expenses in the amount of HRK 586.92 million and profit in the amount of HRK 204.33 million. HBOR's profit generated in 2018 increased by HRK 43.55 million compared with the profit generated in 2017, i.e. by 27.09 percent.

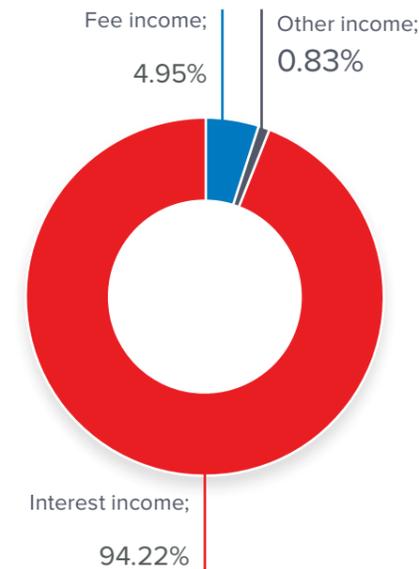
The circumstances which resulted in the higher profit generated in 2018 compared to the profit generated in 2017 are as follows:

- Decrease in interest income of HRK 134.49 million,
- Decrease in interest expenses of HRK 34.39 million,
- Increase in operating expenses of HRK 11.73 million,
- Net gains from financial activities in the amount of HRK 9.51 million, whereas in 2017, net losses from financial activities in the amount of HRK 20.63 million were recorded,
- Decrease in losses from impairment and provisions of HRK 129.01 million in comparison with 2017,
- Decrease in fee income of HRK 3.75 million.

A detailed description of trends is given for each category separately in the following text.

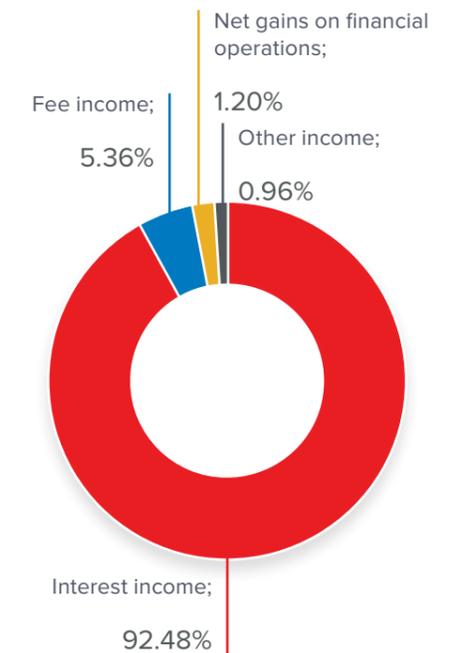
### TOTAL INCOME

1 January - 31 December 2017



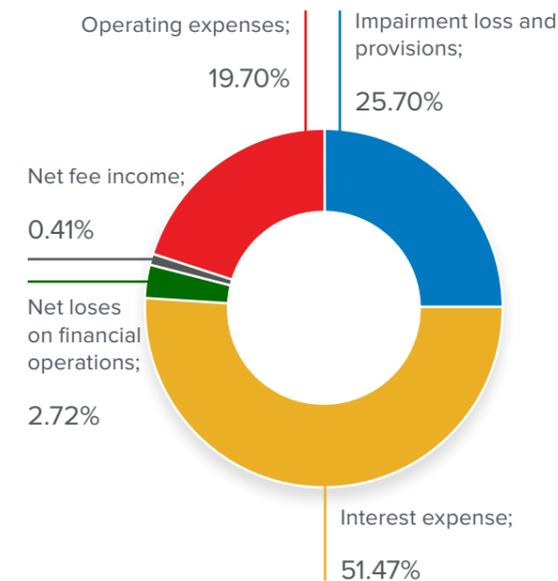
### TOTAL INCOME

1 January - 31 December 2018



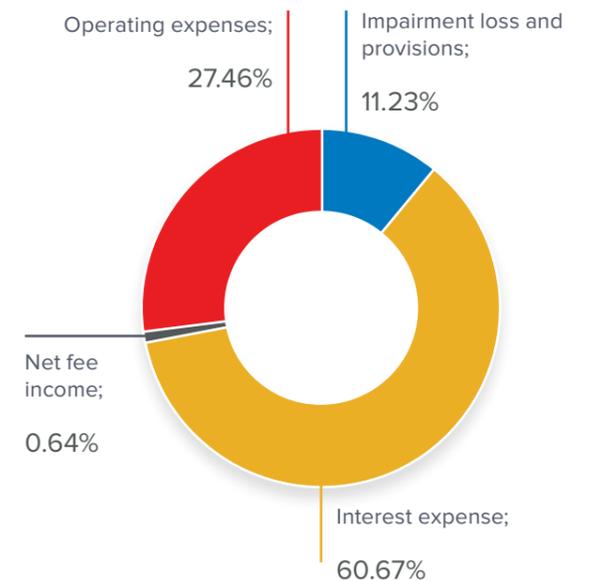
### TOTAL EXPENSE

1 January - 31 December 2017



### TOTAL EXPENSE

1 January - 31 December 2018



### Net interest income

Net interest income amounted to HRK 375.64 million, a decrease of 21.04 percent on the same period of the previous reporting year.

Interest income calculated on the basis of the effective interest rate method amounted to HRK 731.71 million, a decrease of 15.53 percent on the same reporting period last year due to decreased interest income from long-term loans due to the long-term implementation of measures of interest rate reduction, significant amounts of premature loan repayments in 2017 continued also in 2018, implemented restructurings and the manner of recording of interest income from exposures classified to stage 3 and POCI assets (unwinding).

The application of IFRS 9 affects the comparability of interest income in 2018 and in 2017, as follows:

- as of 1 January 2018, interest from the previous periods (except for default interest for clients of risk level 3) directly excluded from off-balance sheet records are transferred to the statement on financial position. Due to the mentioned, income from the collection of directly excluded interest income from previous years cannot be compared, because in the current year, no separate records of this income are kept;
- for the purpose of calculation of interest income for exposures allocated to stage 3 or for assets classified as purchased or originated credit-impaired financial assets, the concept of time value of money is used (unwinding). Unwinding, i.e. interest income for the mentioned exposures is calculated after the date of transfer of exposure to stage 3 or after the date of classification of assets as POCI and is recorded as provisions for the financial instrument with simultaneous decrease of interest income. On this basis, interest income was reduced by HRK 57.36 million in 2018.

Interest expenses amounted to HRK 356.07 million, a decrease of 8.81 percent on the same reporting period last year, which was mostly affected by the repayment of bonds issued that were contracted at high interest rate in 2017 and the utilisation of credit lines of special financial institutions at favourable interest rates.

Having in mind the described trends in interest income and interest expenses, net interest margin decreased by 0.36 percentage points compared with the same reporting period last year and stood at 1.36 percent.

### Net fee income

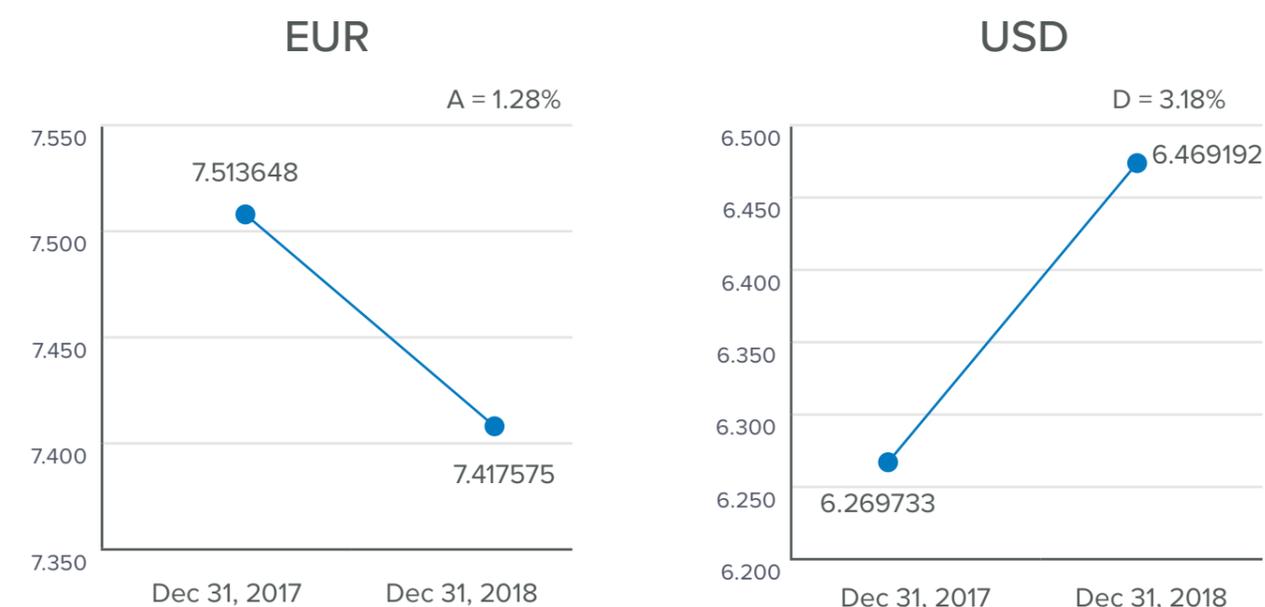
Net fee income amounted to HRK 38.65 million, a decrease of 8.84 percent compared with the previous year due to a lower volume of guarantees issued in 2018 as well as due to payments under the calls for guarantees issued, by which the exposure under guarantees issued has decreased.

### Net gains/(losses) from financial activities

Net gains/(losses) from financial activities are comprised of net foreign exchange gains/(losses) on the principal amount of receivables and liabilities, net revenues or expenditures arising out of the loan contracts with embedded “call option”, gains/(losses) arising out of value adjustment of assets stated at fair value through profit or loss and realised gains/(losses) arising out of assets stated at fair value through other comprehensive income.

In the reporting period, net gains from financial activities amounted to HRK 9.51 million, whereas, in the previous year, net losses amounted to HRK 20.63 million.

A breakdown of changes in the exchange rate of HRK against the EUR and the USD:



Note:

A = HRK appreciation 2018/2017

D = HRK depreciation 2018/2017

Foreign currency and foreign currency indexed assets and sources of funds are converted by HBOR into HRK equivalent value by applying the middle exchange rate of the Croatian National Bank at the reporting date.

Foreign currency revenues and expenditures are converted in accordance with the exchange rate at the transaction date. The resulting foreign exchange gains or losses are recorded in the Statement of Profit or Loss in net figures.

## Operating expenses

Operating expenses that include general and administrative expenses and other operating expenses stood at HRK 161.16 million, an increase of 7.85 percent compared with the previous year due to an increase in other expenses of 97.22 percent. This increase is a result of an increase in recalculation under financial products of 148.31 percent.

The total number of employees at the end of 2018 stood at 370 (366 employees as at 31.12.2017), of which 4 employees were replacement of employees on maternity leave and long-term sick leave and return from unpaid leave.

## Impairment loss and provisions

As of 1 January 2018, HBOR has applied the International Financial Reporting Standard 9 (IFRS 9) Financial Instruments, which resulted in significant changes in terms of impairment loss compared with the previous manner of presenting impairment in accordance with IAS 39.

For instruments measured at amortised cost and fair value through other comprehensive income (non-equity instruments), the model was introduced that was based on the “expected losses concept” replacing the “incurred losses concept” in accordance with IAS 39.

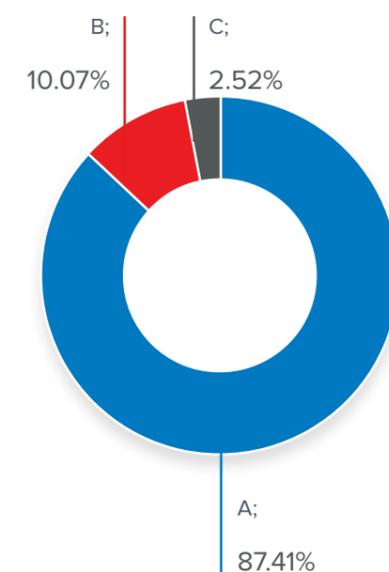
Pursuant to the above, the effects of the implementation of IFRS 9 were, as at 1 January 2018, recognised directly in HBOR’s retained earnings and reserves in the amount of HRK 469.66 million.

In the reporting period, net impairment loss stood at HRK 65.91 million.

The following text contains a breakdown of the quality of portfolio:

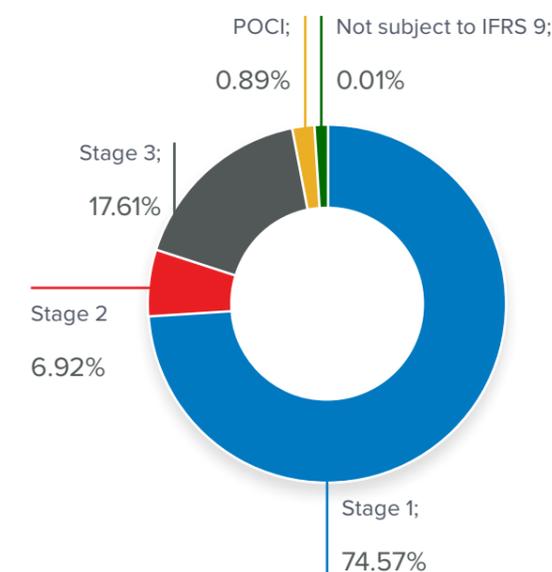
## TOTAL GROSS PORTFOLIO

31 December 2017\*



## TOTAL GROSS PORTFOLIO

31 December 2018



\*The published financial statements as at and for the year ended 31 December 2017 included investment in investment funds under these items.

	2017		2018	
	HRK million	Structure (percent)	HRK million	Structure (percent)
<b>Total gross portfolio</b>	<b>36,039.89</b>	<b>100.00</b>	<b>35,808.08</b>	<b>100.00</b>
Out of which:				
- financial institutions	14,374.59	39.89	13,194.50	36.85
- direct	21,665.30	60.11	22,613.58	63.15
<b>Total provisions</b>	<b>3,201.97</b>	<b>100.00</b>	<b>3,795.63</b>	<b>100.00</b>
Out of which:				
- financial institutions	259.82	8.11	122.62	3.23
- direct	2,942.15	91.89	3,673.01	96.77
<b>Provisions/gross portfolio</b>	<b>8.88 percent</b>	<b>-</b>	<b>10.60 percent</b>	<b>-</b>

## Significant changes in the financial position

Total assets of HBOR as at 31 December 2018 amounted to HRK 27,198.93 million, a decrease of 3.05 percent compared to 2017, mostly due to prepayments of loans, the volume of which in 2018 amounted to HRK 2,418.81 million. In addition, a significant effect had the application of IFRS 9 from 1 January 2018 due to an increase in the provisions for financial instruments of HRK 469.66 million.

## Classification of financial assets

By the application of IFRS 9 since 1 January 2018, all financial assets are classified based on the allocation of financial assets to business models and SPPI test as assets measured subsequently at:

1. amortised cost, if both conditions are fulfilled:
  - financial assets are allocated to the business model whose objective is the holding of assets for the purpose of collecting the contracted cash flows, and
  - SPPI test generated positive results – for financial assets, cash flows are established that are solely payment of principal and interest on unsettled principal amount.
2. fair value through other comprehensive income, if both conditions are fulfilled:
  - - financial assets are allocated to the business model whose objective is the collecting of the contracted cash flows and the selling of financial assets, and
  - - SPPI test generated positive result – for financial assets, cash flows are established that are solely payment of principal and interest on unsettled principal amount.
3. fair value through profit or loss

Financial assets are subsequently measured at fair value through profit or loss if not subsequently measured at amortised cost or at fair value through other comprehensive income. As an exception, for investments in equity instruments that would otherwise be measured at fair value through profit or loss, at the initial recognition there is a possibility of irrevocable option of stating the changes in fair value through other comprehensive income. In such a case, the reserves recognised under other comprehensive income will never be transferred to the statement of profit or loss, even if a financial instrument is derecognised (financial assets valued at fair value through other comprehensive income without recycling). The Bank has used this possibility for a portion of equity instruments.

### *Cash on hand and deposits with other banks*

At the end of 2018, cash on hand and deposits with other banks amounted to HRK 1,203.00 million representing 4.42 percent of total assets, a decrease of 15.89 percent compared with the previous year as a result of reallocation of liquidity reserve funds.

### *Loans to financial institutions and other customers*

Total net loans decreased by 2.04 percent compared with the previous year and amounted to HRK 22,745.68 million at the end of 2018 representing 83.63 percent of total assets.

Total gross loans amounted to HRK 26,243.12 million and remained at the previous year's level. Gross loans to other customers increased by 4.14 percent compared with the beginning of the year, which is mostly due to the payments under the export promotion programmes and the loan programmes for the financing of reconstruction and development of infrastructure in the Republic of Croatia. Gross loans to financial institutions decreased by 6.52 percent compared with the previous year as a result of premature repayments of loans.

At the end of 2018, the ratio between gross loans on-lent through financial institutions and direct loans stood at 39.45 percent : 60.55 percent.

### *Financial assets at fair value through profit or loss*

Loans at fair value (HBOR has determined that mezzanine loans are classified here), investments in investment funds and a part of equity instruments are classified to these assets. As at 31 December 2018, the total amount of these assets was HRK 330.80 million representing 1.22 percent of total assets.

### *Financial assets at fair value through other comprehensive income*

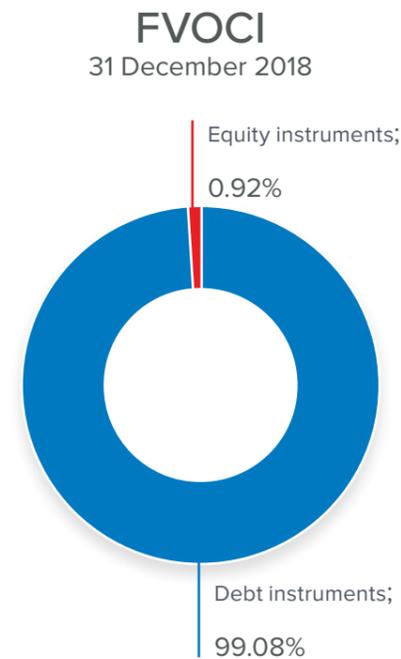
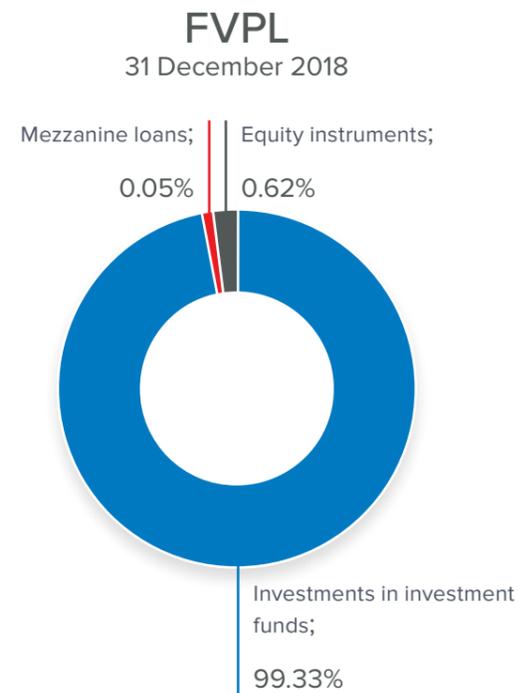
#### a. Debt instruments

Bonds of the Republic of Croatia and companies as well as treasury bills of the Ministry of Finance as part of liquidity reserve are classified to these assets. As at the reporting date, they amounted to HRK 2,766.36 million, representing 10.17 percent of total assets. The impairment of these financial assets is calculated through the application of the model of expected credit losses in the manner that provisions are recognised in the accounts of other comprehensive income, thus not reducing the carrying amount of these financial assets in the statement on financial position. As at the reporting date, they amounted to HRK 6.46 million in other reserves.

## b. Equity instruments

Equity instruments (shares of companies) that HBOR does not intend to sell and to which irrevocable option of subsequent measurement of fair value through other comprehensive income without recycling is applied are classified to these assets, i.e. reserves recognised under other comprehensive income will never be transferred to profit or loss.

As at the reporting date, these assets amounted to HRK 25.71 million, representing 0.10 percent of total assets.



## Total liabilities

At the end of 2018, total liabilities amounted to HRK 17,144.92 million, which represents 63.04 percent of total liabilities and total equity. The major part of total liabilities consists of HBOR's foreign borrowings and bonds payable in the total amount of HRK 16,028.55 million.

Borrowings and bonds payable decreased by 3.15 percent compared with the beginning of the year, whereas changes in these liabilities are shown in the following table:

(in HRK million)

- Draw-down of funds borrowed under previously contracted funds of special financial institutions	2,284.76
- Repayments of borrowings	(2,658.94)
- Foreign exchange gains or losses	(176.60)
- Other calculations*	29.75
<b>Total changes</b>	<b>(521.03)</b>

\*Other calculations relate to the changes in discount, amount of interest not due and deferred fees.

In 2018, HBOR continued to raise funds for specified purposes from special financial institutions and, on 6 March 2018, entered into a EUR 15.00 million Natural Capital Financing Facility (NCFF) deal with the European Investment Bank. NCFF is the financial instrument that combines the funds of the EIB and the funds of the European Commission under the LIFE Programme (Programme for the Environment and Climate Action) with an objective of providing support to projects expected to have a favourable impact on biodiversity and/or adaptation to climate change.

Furthermore, on 11 September 2018, the second contract was executed with the European Investment Bank in the amount of EUR 40.00 million for the financing of a project in the tourism industry.

### Total equity

Total equity amounted to HRK 10,054.01 million, representing 36.96 percent of total liabilities and total equity.

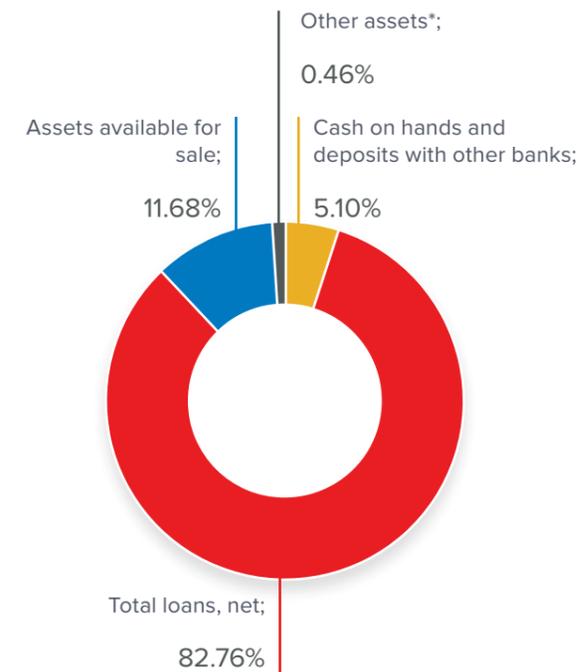
Total equity of HBOR is comprised of founder's capital contributed from the budget of the Republic of Croatia, retained earnings from the profits generated in the previous years, other reserves, guarantee fund and profits for the current period.

In the reporting period, the amount of HRK 50.00 million was contributed from the budget of the Republic of Croatia into the founder's capital, and the total amount of capital contributed from the budget of the Republic of Croatia amounted to HRK 6,633.00 million at the end of 2018. The remaining amount to be contributed to the founder's capital up to the total amount of HRK 7,000.00 million set by the HBOR Act is HRK 367.00 million.

Pursuant to the provisions of the Act on HBOR, the entire profit of the reporting period of the Bank is allocated to reserves.

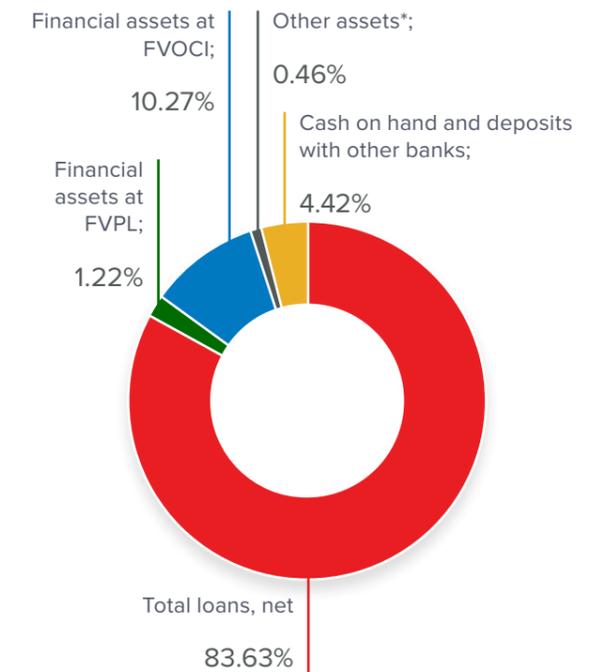
### TOTAL ASSETS

31 December 2017



### TOTAL ASSETS

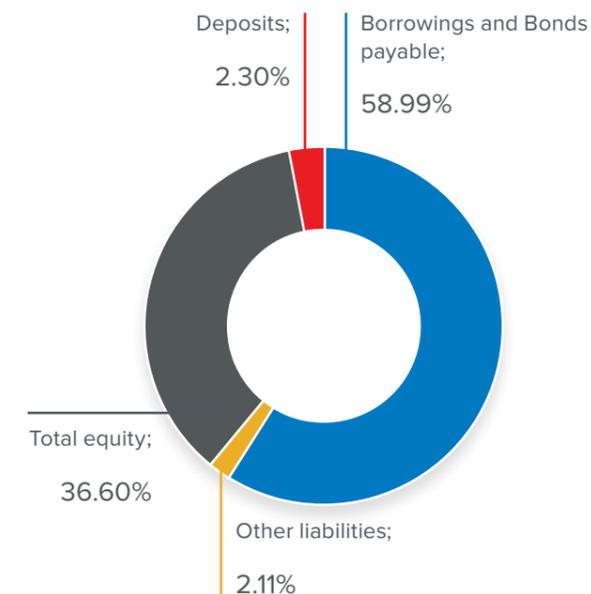
31 December 2018



\*Investments in subsidiaries, Property, plant and equipment and intangible assets, Foreclosed assets and Other assets.

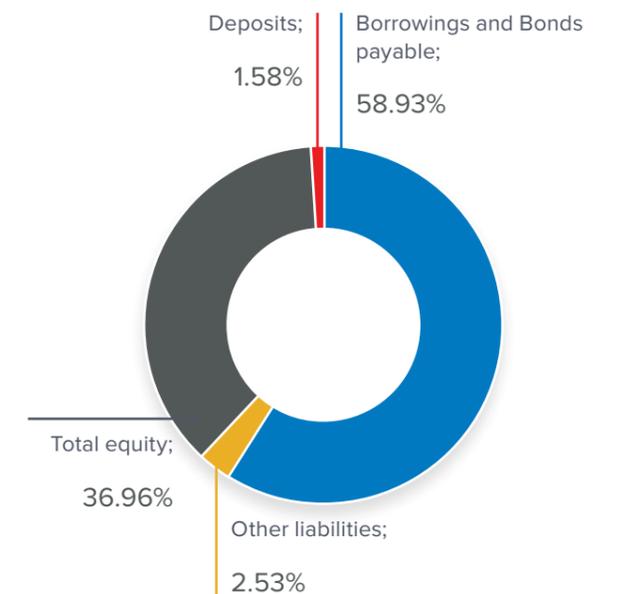
### TOTAL LIABILITIES AND TOTAL EQUITY

31 December 2017



### TOTAL LIABILITIES AND TOTAL EQUITY

31 December 2018





## ANNUAL FINANCIAL STATEMENTS FOR 2018

Zagreb, March 2019

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## Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual report

The Management Board of the Croatian Bank for Reconstruction and Development ("HBOR" or "the Bank") is required to prepare separate and consolidated financial statements for each financial year which give a true and fair view of the financial position of the Bank and Group of the Croatian Bank for Reconstruction and Development ("the Group") and of the results of their operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such 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 judgments 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 responsible for submission of its Annual Report to the Supervisory Board, after which the Supervisory Board submits them for approval to the Parliament of the Republic of Croatia.

The separate and consolidated financial statements set out on pages 62 to 228 were authorised by the Management Board on 25 March 2019 for issue to the Supervisory Board and are signed below to signify this.

The Management Board is also responsible for the preparation and content of the Management Report and Statement on the Code of Corporate Governance Application as required by the Croatian Accounting Law, and other information (together "other information"). The Management Report presented on pages 4 to 7, Statement on the Code of Corporate Governance Application presented on pages 8 to 12 and other information presented on pages 13 to 51 were approved by the Management Board on 25 March 2019.

Signed on behalf of the Croatian Bank for Reconstruction and Development

  
Vedran Jakšić, MSc  
Senior Executive Director

  
Tamara Perko, MSc  
President of the Management Board



  
Marin Pranjić  
Accounting Division Executive Director

  
Hrvoje Čuvalo, MSc  
Member of the Management Board

Zagreb, 25 March 2019



## Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development

### Report on the Audit of the Financial Statements

#### Opinion

We have audited the separate financial statements of Croatian Bank for Reconstruction and Development ("the Bank") and the consolidated financial statements of the Bank and its subsidiary ("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 income statements, statements of profit or loss and 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 those requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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## Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (continued)

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

#### 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 to other customers

As at 31 December 2018, in the financial statements of the Group and the Bank, gross loans to other customers: HRK 16,891 million, related loss allowances: HRK 3,360 million and loss allowance release in the income statement for the year then ended: HRK 211 million (31 December 2017: gross loans to other customers: HRK 16,269 million, loss allowance: HRK 2,876 million, loss allowance recognized in the income statement for the year then ended: HRK 338 million).

Please refer to note 4 Summary of significant accounting policies, note 6 Transition to IFRS 9, note 11 Impairment loss and provisions, note 16 Loans to other customers, and credit risk section of the note 38 Risk management).

#### Key audit matter

Loss allowances represent the Management Board's best estimate of the expected credit losses within the loans to other customers at the reporting date. We focused on this area as the determination of loss 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.

Following the initial application of IFRS 9, impairment allowances for performing exposures (Stage 1 and Stage 2 in the IFRS 9 hierarchy) and non-performing exposures (Stage 3) up to HRK 1.5 million individually are determined by modelling techniques ("collective impairment allowance"). Historical experience, identification of exposures with a significant deterioration in credit quality, forward-looking information and management judgment are incorporated into the model assumptions.

For non-performing exposures exceeding HRK 1.5 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 loss allowances are determined on an individual basis by means of a discounted cash flows analysis.

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#### How our audit addressed the matter

Our audit procedures in this area included, among others:

- Inspecting the Bank's and the Group's IFRS 9-based impairment provisioning methodology and assessing its compliance with the relevant requirements of IFRS 9. 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 factors;
- Inquiring of the risk management and information technology (IT) personnel as well as reading conclusions of the Bank's external expert documentation to obtain an understanding of the provisioning process, IT applications used therein, 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;
- Assessing and testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of loss events and default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the loss allowances;



## Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (continued)

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

#### Key Audit Matters (continued)

#### Key audit matter

For the above reasons, impairment of loans to other 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.

#### How our audit addressed the matter

- With respect to the impairment accounting under 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;
  - Testing completeness and accuracy of input data used for establishing the impairment model's risk parameters (probability of default (PD), loss given default (LGD), exposure at default (EAD) and obtaining explanations for exceptions where necessary;
  - Obtaining the relevant forward-looking information and macroeconomic forecasts used in the Bank's and the Group's ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board and inspecting publicly available information;
  - Assessing whether the definition of default and the new standard's staging criteria were consistently applied. Also analyzing whether the definition of default applied for each segment/portfolio is appropriate based on the requirements of the new standard;
  - Performing an analysis of ECL-based loss allowances as at the standard's initial application date, to those calculated in accordance with IAS 38, and assessing their reasonableness based on inquiries of the credit risk management personnel.

#### For loss allowances 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 loans with significant change in the provision coverage;

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**Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (continued)**

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

**Key Audit Matters (continued)**

**Key audit matter**

**How our audit addressed the matter**

- 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 as at 31 December 2016;
- For those loans where triggers for classification in Stage 3 were identified, challenging key assumptions applied in the Management Board's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral value and realization period, and performing respective independent recalculations, where relevant, with the assistance of our own valuation specialists.

**For loss allowances calculated on a collective basis:**

- In addition to testing of the model, as described above, for collective loss allowance, independently estimating the key ECL model parameters, as follows:
  - Obtaining the relevant forward looking information and macroeconomic forecasts used in the ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board;
  - For a sample of exposures, agreeing EAD data on exposures back to source system and contractual data;
  - Challenging LGD and PD parameters, assessed as significant, by performing back-testing of historical default and by reference to historical realized losses on defaults;
  - 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.

**For loss allowances in totality:**

- 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 owner of Croatian Bank for Reconstruction and Development (continued)**

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

**Other Information**

Management is responsible for the other information. The other information comprises the Management Report, Corporate Governance Statement and other information included in the Annual Report of the Bank and the Group, but does not include the financial statements and our auditor's report thereon.

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

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

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

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

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

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

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

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## Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (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.
- 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.

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## Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (continued)

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

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

- 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

We were appointed by those charged with governance on 14 March 2018 to audit the financial statements of the Bank and the Group for the year ended 31 December 2018. Our engagements so far covered the period ending 31 December 2018.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 22 March 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.

KPMG Croatia d.o.o. za reviziju  
Croatian Certified Auditors  
Eurotower, 17th floor  
Ivana Lučića 2a  
10000 Zagreb  
Croatia

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

25 March 2019

  
Katarina Kacko  
Director, Croatian Certified Auditor

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Consolidated Financial Statements of the Group  
Income Statement  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Notes	2018 HRK '000	2017 HRK '000
Interest income calculated using the effective interest method	6	733,083	867,825
Interest expense	7	(356,066)	(390,460)
<b>Net interest income</b>		<b>377,017</b>	<b>477,365</b>
Fee and commission income	8	44,983	48,125
Fee and commission expense	8	(3,778)	(3,144)
<b>Net fee and commission income</b>		<b>41,205</b>	<b>44,981</b>
Net gains/(losses) on financial operations	9	9,234	(20,716)
Other income		14,098	14,860
		<b>441,554</b>	<b>516,490</b>
Employee expenses	10 a)	(93,845)	(90,055)
Depreciation and amortization	10 b)	(6,329)	(7,539)
Other expenses	10 c)	(70,726)	(61,406)
Impairment loss and provisions	11	(65,891)	(195,187)
<b>Profit before income tax</b>		<b>204,763</b>	<b>162,303</b>
Income tax	12	(26)	(102)
<b>Profit for the year</b>		<b>204,737</b>	<b>162,201</b>
<b>Attributable to:</b>			
<b>Owner of the Bank</b>		<b>204,737</b>	<b>162,201</b>

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated Financial Statements of the Group  
Statement of Profit or Loss and Other Comprehensive Income  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2018 HRK '000	2017 HRK '000
<b>Profit for the year</b>	<b>204,737</b>	<b>162,201</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Unrealized actuarial losses	(144)	(579)
Deferred tax-adjustment for previous period	(17)	-
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>(161)</b>	<b>(579)</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Net changes in financial assets at fair value through other comprehensive income	(2,734)	n/a
Net foreign exchange on equity instruments	(325)	(154)
Net changes in assets available for sale	n/a	21,861
Deferred tax – other comprehensive income	(23)	(178)
<b>Total items that may be reclassified subsequently to profit or loss</b>	<b>(3,082)</b>	<b>21,529</b>
<b>Other comprehensive income after income tax</b>	<b>(3,243)</b>	<b>20,950</b>
<b>Total comprehensive income after income tax</b>	<b>201,494</b>	<b>183,151</b>
<b>Attributable to:</b>		
<b>Owner of the Bank</b>	<b>201,494</b>	<b>183,151</b>

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated Financial Statements of the Group  
Statement of Financial Position  
as of 31 December

(All amounts are expressed in HRK thousand)

	Notes	2018 HRK '000	2017 HRK '000
<b>Assets</b>			
Cash on hand and current accounts with banks	13	944,417	1,403,680
Deposits with other banks	14	261,925	29,138
Loans to financial institutions	15	10,234,988	10,836,141
Loans to other customers	16	12,510,686	12,383,623
Financijska imovina po fer vrijednosti kroz dobit ili gubitak	17	336,266	291
Financial assets at fair value through other comprehensive income	18	2,829,470	n/a
Debt instruments at amortised cost	19	1,363	n/a
Assets available for sale	20	n/a	3,321,564
Assets held to maturity	21	n/a	1,399
Investments in associates	23	-	-
Property, plant and equipment and intangible assets	24	50,832	53,557
Foreclosed assets	25	25,330	16,697
Other assets	26	23,704	29,471
<b>Total assets</b>		<b>27,218,981</b>	<b>28,075,561</b>
<b>Liabilities</b>			
Deposits from customers	27	429,096	644,741
Borrowings	28	14,877,987	15,387,881
Debt securities issued	29	1,150,557	1,161,699
Other liabilities	30	700,234	605,453
<b>Total liabilities</b>		<b>17,157,874</b>	<b>17,799,774</b>
<b>Equity</b>			
Founder's capital	31	7,059,632	7,009,632
Retained earnings and reserves		2,717,118	2,996,968
Other reserves		67,474	94,683
Profit for the year		204,737	162,201
Guarantee fund	32	12,146	12,303
<b>Total equity</b>		<b>10,061,107</b>	<b>10,275,787</b>
<b>Total liabilities and total equity</b>		<b>27,218,981</b>	<b>28,075,561</b>

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated Financial Statements of the Group  
Statement of Cash Flows  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Notes	2018 HRK '000	2017 HRK '000
<b>Operating activities</b>			
Profit before income tax		204,763	162,303
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>			
Depreciation and amortization		6,329	7,539
Income tax		26	102
Impairment loss and provisions		65,891	195,187
Accrued interest		34,720	(59,664)
Deferred fees		(1,832)	(39,093)
Other changes in assets at fair value		11,712	(4,618)
Operating profit before working capital changes		321,609	261,756
<i>Changes in operating assets and liabilities:</i>			
Net increase in deposits with other banks, before impairment		(233,822)	(5,349)
Net decrease in loans to financial institutions, before impairment		711,348	1,175,203
Net increase in loans to other customers, before loss impairment		(571,291)	(1,186,871)
Net loss/(gain) on financial assets at fair value through profit or loss		66	(7)
Decrease of discount in debt securities issued		3,702	4,092
Net (increase)/decrease in foreclosed assets		(8,476)	7
Net increase in other assets, before impairment		(21,803)	(22,991)
Net (decrease)/increase in deposits from banks and companies		(215,645)	501,897
Net decrease in other liabilities, before provisions		(84,038)	(83,617)
<b>Net cash from operating activities</b>		<b>(98,350)</b>	<b>644,120</b>
<b>Investment activities</b>			
Net purchase of assets available for sale		n/a	(2,141,579)
Sale of assets available for sale		n/a	2,226,277
Purchase of financial assets at fair value through profit or loss		(1,500)	-
Sale of financial assets at fair value through profit or loss		474,578	-
Purchase of financial assets at fair value through other comprehensive income		(1,860,561)	n/a
Sale of financial assets at fair value through other comprehensive income		1,522,138	n/a
Net purchase of property, plant and equipment and intangible assets		(3,540)	(3,727)
<b>Net cash provided from investment activities</b>		<b>131,115</b>	<b>80,971</b>
<b>Financing activities</b>			
Increase in founder's capital		50,000	50,000
Increase in borrowings – withdrawn funds		2,284,763	3,849,787
Decrease in borrowings – repayments of principal		(2,658,936)	(1,729,575)
Decrease in debt securities issued – repayment		-	(1,852,051)
Other		1,093	-
<b>Net cash (used in)/provided from financing activities</b>		<b>(323,080)</b>	<b>318,161</b>
<b>Effect of foreign currency to cash and cash equivalents</b>			
Net foreign exchange		(168,138)	(133,039)
<b>Net effect</b>		<b>(168,138)</b>	<b>(133,039)</b>
Net (decrease)/increase in cash and cash equivalents		(458,453)	910,213
Balance as of 1 January, before impairment		1,404,538	494,325
Net (decrease)/increase in cash and cash equivalents		(458,453)	910,213
<b>Balance as of 31 December before impairment</b>	<b>13</b>	<b>946,085</b>	<b>1,404,538</b>
<b>Additional note - Operational cash flows</b>			
Interest paid		336,550	462,104
Interest received		651,445	691,738

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Consolidated Financial Statements of the Group  
Statement of Changes in Equity  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Founder's capital	Retained earnings and reserves	Other reserves	Profit for the year	Guarantee fund	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Balance as of 1 January 2017</b>	<b>6,959,632</b>	<b>2,682,127</b>	<b>73,733</b>	<b>314,841</b>	<b>12,375</b>	<b>10,042,708</b>
Profit for the year	-	-	-	162,201	-	<b>162,201</b>
Other comprehensive income	-	-	20,950	-	-	<b>20,950</b>
Total comprehensive income	-	-	20,950	162,201	-	<b>183,151</b>
Net foreign exchange - Guarantee fund	-	-	-	-	(72)	<b>(72)</b>
Capital paid-in from the State Budget	50,000	-	-	-	-	<b>50,000</b>
Transfer of profit 2016 to retained earnings	-	314,841	-	(314,841)	-	-
<b>Balance as of 31 December 2017</b>	<b>7,009,632</b>	<b>2,996,968</b>	<b>94,683</b>	<b>162,201</b>	<b>12,303</b>	<b>10,275,787</b>
The effect of first time adoption of IFRS 9 as at 1 January 2018	-	(469,974)	-	-	-	<b>(469,974)</b>
The effect of reclassification of financial assets under IFRS 9 <sup>1</sup>	-	28,254	(23,966)	-	-	<b>4,288</b>
Other adjustments	-	(331)	-	-	-	<b>(331)</b>
<b>Balance as of 1 January 2018</b>	<b>7,009,632</b>	<b>2,554,917</b>	<b>70,717</b>	<b>162,201</b>	<b>12,303</b>	<b>9,809,770</b>
Profit for the year	-	-	-	204,737	-	<b>204,737</b>
Other comprehensive income	-	-	(3,243)	-	-	<b>(3,243)</b>
Total comprehensive income	-	-	(3,243)	204,737	-	<b>201,494</b>
Net foreign exchange - Guarantee fund	-	-	-	-	(157)	<b>(157)</b>
Capital paid-in from the State Budget	50,000	-	-	-	-	<b>50,000</b>
Transfer of profit 2017 to retained earnings	-	162,201	-	(162,201)	-	-
<b>Balance as of 31 December 2018</b>	<b>7,059,632</b>	<b>2,717,118</b>	<b>67,474</b>	<b>204,737</b>	<b>12,146</b>	<b>10,061,107</b>

The accompanying accounting policies and notes are an integral part of these financial statements.

<sup>1</sup> The effect of reclassification of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through profit or loss, due to which the effect was transferred from Other reserves (fair value reserve) to Retained Earnings.

Separate Financial Statements of the Bank  
Income Statement  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Notes	2018	2017
		HRK '000	HRK '000
Interest income calculated using the effective interest method	6	731,708	866,198
Interest expense	7	(356,066)	(390,460)
<b>Net interest income</b>		<b>375,642</b>	<b>475,738</b>
Fee and commission income	8	42,428	45,539
Fee and commission expense	8	(3,778)	(3,144)
<b>Net fee and commission income</b>		<b>38,650</b>	<b>42,395</b>
Net gains/(losses) on financial operations	9	9,506	(20,625)
Other income		7,596	7,627
		<b>431,394</b>	<b>505,135</b>
Employee expenses	10 a)	(90,469)	(86,518)
Depreciation and amortization	10 b)	(6,284)	(7,482)
Other expenses	10 c)	(64,407)	(55,432)
Impairment loss and provisions	11	(65,906)	(194,920)
<b>Profit before income tax</b>		<b>204,328</b>	<b>160,783</b>
Income tax	12	-	-
<b>Profit for the year</b>		<b>204,328</b>	<b>160,783</b>
<b>Attributable to:</b>			
<b>Owner of the Bank</b>		<b>204,328</b>	<b>160,783</b>

The accompanying accounting policies and notes are an integral part of these financial statements.

Separate Financial Statements of the Bank  
Statement of Profit or Loss and Other Comprehensive Income  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2018	2017
	HRK '000	HRK '000
<b>Profit for the year</b>	<b>204,328</b>	<b>160,783</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Unrealized actuarial losses	(144)	(579)
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>(144)</b>	<b>(579)</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Net changes in financial assets at fair value through other comprehensive income	(2,860)	n/a
Net foreign exchange on equity instruments	(325)	(154)
Net changes in assets available for sale	n/a	20,873
<b>Total items that may be reclassified subsequently to profit or loss</b>	<b>(3,185)</b>	<b>20,719</b>
<b>Other comprehensive income after income tax</b>	<b>(3,329)</b>	<b>20,140</b>
<b>Total comprehensive income after income tax</b>	<b>200,999</b>	<b>180,923</b>
<b>Attributable to:</b>		
<b>Owner of the Bank</b>	<b>200,999</b>	<b>180,923</b>

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Separate Financial Statements of the Bank  
Statement of Financial Position  
as of 31 December

(All amounts are expressed in HRK thousand)

	Notes	2018	2017
		HRK '000	HRK '000
<b>Assets</b>			
Cash on hand and current accounts with banks	13	941,071	1,401,146
Deposits with other banks	14	261,925	29,138
Loans to financial institutions	15	10,234,988	10,836,141
Loans to other customers	16	12,510,686	12,383,623
Financial assets at fair value through profit or loss	17	330,803	-
Financial assets at fair value through other comprehensive income	18	2,792,072	n/a
Assets available for sale	20	n/a	3,277,194
Investments in subsidiaries	22	36,124	36,124
Investments in associates	23	-	-
Property, plant and equipment and intangible assets	24	50,764	53,514
Foreclosed assets	25	25,330	16,697
Other assets	26	15,164	22,226
<b>Total assets</b>		<b>27,198,927</b>	<b>28,055,803</b>
<b>Liabilities</b>			
Deposits from customers	27	429,096	644,741
Borrowings	28	14,877,987	15,387,881
Debt securities issued	29	1,150,557	1,161,699
Other liabilities	30	687,275	592,651
<b>Total liabilities</b>		<b>17,144,915</b>	<b>17,786,972</b>
<b>Equity</b>			
Founder's capital	31	7,059,632	7,009,632
Retained earnings and reserves		2,715,028	2,995,656
Other reserves		62,878	90,457
Profit for the year		204,328	160,783
Guarantee fund	32	12,146	12,303
<b>Total equity</b>		<b>10,054,012</b>	<b>10,268,831</b>
<b>Total liabilities and total equity</b>		<b>27,198,927</b>	<b>28,055,803</b>

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Separate Financial Statements of the Bank  
Statement of Cash Flows  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

Notes	2018 HRK '000	2017 HRK '000
<b>Operating activities</b>		
Profit before income tax	204,328	160,783
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>		
Depreciation and amortization	6,284	7,482
Impairment loss and provisions	65,906	194,920
Accrued interest	34,626	(59,702)
Deferred fees	(1,832)	(39,093)
Other changes in assets at fair value	11,533	(5,031)
<i>Operating profit before working capital changes</i>	<i>320,845</i>	<i>259,359</i>
<i>Changes in operating assets and liabilities:</i>		
Net increase in deposits with other banks, before impairment	(233,822)	(5,349)
Net decrease in loans to financial institutions, before impairment	711,348	1,175,203
Net increase in loans to other customers, before impairment	(571,291)	(1,186,871)
Decrease of discount in debt securities issued	3,702	4,092
Net (increase)/decrease in foreclosed assets	(8,476)	7
Net increase in other assets, before impairment	(20,457)	(18,298)
Net (decrease)/increase in deposits from banks and companies	(215,645)	501,897
Net decrease in other liabilities, before provisions	(83,830)	(85,261)
<b>Net cash from operating activities</b>	<b>(97,626)</b>	<b>644,779</b>
<b>Investment activities</b>		
Net purchase of assets available for sale	n/a	(2,134,989)
Sale of assets available for sale	n/a	2,217,157
Sale of financial assets at fair value through profit or loss	473,600	n/pa
Purchase of financial assets fair value through other comprehensive income	(1,857,535)	n/a
Sale of financial assets fair value through other comprehensive income	1,517,138	n/a
Net purchase of property, plant and equipment and intangible assets	(3,470)	(3,716)
<b>Net cash provided from investment activities</b>	<b>129,733</b>	<b>78,452</b>
<b>Financing activities</b>		
Increase in founder's capital	50,000	50,000
Increase in borrowings – withdrawn funds	2,284,763	3,849,787
Decrease in borrowings – repayments of principle	(2,658,936)	(1,729,575)
Decrease in debt securities issued – repayment	-	(1,852,051)
Other	1,063	-
<b>Net cash (used in)/provided from financing activities</b>	<b>(323,110)</b>	<b>318,161</b>
<b>Effect of foreign currency to cash and cash equivalents</b>		
Net foreign exchange	(168,279)	(133,162)
<b>Net effect</b>	<b>(168,279)</b>	<b>(133,162)</b>
Net (decrease)/increase in cash and cash equivalents	(459,282)	908,230
Balance as of 1 January, before impairment	1,402,004	493,774
Net (decrease)/increase in cash and cash equivalents	(459,282)	908,230
<b>Balance as at 31 December, before impairment</b>	<b>942,722</b>	<b>1,402,004</b>
<b>Additional note – operating activities</b>		
Interest paid	336,550	462,104
Interest received	649,694	689,666

\*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Separate Financial Statements of the Bank  
Statement of Changes in Equity  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit for the year HRK '000	Guarantee fund HRK '000	Total HRK '000
<b>Balance as at 1 January 2017</b>	<b>6,959,632</b>	<b>2,682,131</b>	<b>70,317</b>	<b>313,525</b>	<b>12,375</b>	<b>10,037,980</b>
Profit for the year	-	-	-	160,783	-	<b>160,783</b>
Other comprehensive income	-	-	20,140	-	-	<b>20,140</b>
Total comprehensive income	-	-	20,140	160,783	-	<b>180,923</b>
Net foreign exchange - Guarantee fund	-	-	-	-	(72)	<b>(72)</b>
Capital paid-in from the State Budget	50,000	-	-	-	-	<b>50,000</b>
Transfer of profit 2016 to retained earnings	-	313,525	-	(313,525)	-	-
<b>Balance as at 31 December 2017</b>	<b>7,009,632</b>	<b>2,995,656</b>	<b>90,457</b>	<b>160,783</b>	<b>12,303</b>	<b>10,268,831</b>
The effect of first time adoption of IFRS 9 as at 1 January 2018	-	(469,658)	-	-	-	<b>(469,658)</b>
The effect of reclassification of financial assets under IFRS 9 <sup>2</sup>	-	28,247	(24,250)	-	-	<b>3,997</b>
<b>Balance as at 1 January 2018</b>	<b>7,009,632</b>	<b>2,554,245</b>	<b>66,207</b>	<b>160,783</b>	<b>12,303</b>	<b>9,803,170</b>
Profit for the year	-	-	-	204,328	-	<b>204,328</b>
Other comprehensive income	-	-	(3,329)	-	-	<b>(3,329)</b>
Total comprehensive income	-	-	(3,329)	204,328	-	<b>200,999</b>
Net foreign exchange - Guarantee fund	-	-	-	-	(157)	<b>(157)</b>
Capital paid-in from the State Budget	50,000	-	-	-	-	<b>50,000</b>
Transfer of profit 2017 to retained earnings	-	160,783	-	(160,783)	-	-
<b>Balance as at 31 December 2018</b>	<b>7,059,632</b>	<b>2,715,028</b>	<b>62,878</b>	<b>204,328</b>	<b>12,146</b>	<b>10,054,012</b>

The accompanying accounting policies and notes are an integral part of these financial statements.

<sup>2</sup> The effect of reclassification of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through profit or loss, due to which the effect was transferred from Other reserves (fair value reserve) to Retained Earnings.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018

(All amounts are expressed in HRK thousand)

**1. General information**

**1.1. Group:**

The Croatian Bank for Reconstruction and Development („HBOR“ or „the Bank“) is the parent company of the Croatian Bank for Reconstruction and Development Group („Group“) that operates in the Republic of Croatia. The Group primarily performs banking activities and, to the lesser extent, insurance activities and credit risk assessment activities. These Financial Statements include separate and consolidated financial statements of the Bank and the Group (“Financial Statements”).

The headquarters of the Bank is located at Strossmayerov trg 9, Zagreb, Croatia.

The Group was formed in 2010, the Bank’s subsidiary companies are Hrvatsko kreditno osiguranje d.d. and Poslovni info servis d.o.o. that constitute the Hrvatsko kreditno osiguranje Group (“HKO Group”).

The Croatian Bank for Reconstruction and Development is the 100% owner of HKO, which is 100% owner of Poslovni info servis d.o.o.

The legal address of the HKO Group is Zagreb, Bednjanska 12.

As of 31 December 2018, the Group had 390 employees (31 December 2017: 386 employees), of which 4 employees are in substitution for maternity leave, long-term sick leave and return from unpaid leave.

**1.2. Bank:**

The Croatian Bank for Reconstruction and Development (“HBOR” or “the Bank”) was established on 12 June 1992 under the Act on the Croatian Credit Bank for Reconstruction (“HKBO”). In December 1995, the Bank changed its name to Croatian Bank for Reconstruction and Development. The founder and 100% owner of HBOR is the Republic of Croatia.

The Republic of Croatia guarantees HBOR’s liabilities unconditionally, irrevocably and on first call, without issuing any particular guarantee. The responsibility of the Republic of Croatia as guarantor for HBOR’s liabilities is joint and unlimited.

With the Act on the Croatian Bank for Reconstruction and Development passed in December 2006, HBOR’s founding capital was HRK 7 billion, the payment schedule of which is determined by the State budget.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**1. General information (continued)**

**1.2. Bank (continued):**

*Supervisory Board*

On the date of preparing these statements, members of the Supervisory Board were as follows:

- Zdravko Marić, DSc, Minister of Finance - ex officio President of the Supervisory Board,
- Darko Horvat, Minister of the Economy, Entrepreneurship and Trade – ex officio Vice President of the Supervisory Board,
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning,
- Tomislav Tolušić, Deputy Prime Minister of the Republic of Croatia and Minister of Agriculture,
- Gabrijela Žalac, Minister of Regional Development and EU Funds,
- Gari Cappelli, Minister of Tourism,
- Luka Burilović, President of the Croatian Chamber of Economy – ex officio Member of the Supervisory Board,
- Boris Lalovac, MSc, Member of the Croatian Parliament,
- Božica Makar, Member of the Croatian Parliament,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament.

*Management Board*

On the date of preparing these statements, members of the Management Board of HBOR were as follows:

- Tamara Perko, MSc, President of the Management Board and
- Hrvoje Čuvalo, MSc, Member of the Management Board.

As of 31 December 2018, HBOR had 370 employees (31 December 2017: 366 employees), of which 4 employees are in substitution for maternity leave, long-term sick leave and return from unpaid leave.

*Audit Committee*

On the date of preparing these statements, members of the Audit Committee were as follows:

- Prof. DSc. Lajoš Žager, Professor, Department of Accounting, Faculty of Economics and Business of the University of Zagreb, the Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, the Vice Chairman of the Audit Committee,
- Aurora Volarević, Director of Internal Controls, Audit and Risk in Hrvatski telekom d.d., Member of the Audit Committee.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**1. General information (continued)**

**1.2. Bank (continued):**

**1.2.1. Activities of the Bank:**

The principal activities of the Bank comprise the following:

- financing of reconstruction and development of the Croatian economy,
- financing of infrastructure,
- promoting exports,
- providing support to the development of SMEs,
- promoting environmental protection, and
- providing domestic goods and services export insurance against non-market risks for and on behalf of the Republic of Croatia.

HBOR may perform other financial activities according to the decisions of the Government of the Republic of Croatia if, in their opinion, it is in the best interest of the Republic of Croatia.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**2. Basis of Preparation of the Financial Statements**

**2.1. Statement of compliance**

These consolidated and separate financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. They were authorised for issue by the Bank's Management Board on 25 March 2019.

This is the first set of the Banks and Groups annual financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Changes to significant accounting policies are described in Note 4.1.

**2.2 Measurement**

The financial statements are prepared on the fair value basis for financial assets and liabilities at fair value through profit or loss, financial assets at fair value through other comprehensive income and assets available for sale. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

The financial statements are prepared on an accrual and a going concern basis.

**2.3. Functional and presentation currency**

These financial statements of the Bank and the Group are presented in Croatian Kuna (HRK), which is the Bank's functional currency. All amounts have been rounded to the nearest thousand, except when otherwise indicated.

**3. Use of judgements and estimates**

In preparing these consolidated financial statements, management has made judgements, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

*Judgements*

Applicable to 2018 only:

- classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding (Note 4.2.G.ii.),
- establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

Applicable to 2018 and 2017:

- determination of control over investees (Note 4.2.A).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 3. Use of judgements and estimates (continued)

#### *Assumptions and estimation uncertainties*

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2018 is included in the following notes.

Applicable to 2018 only:

- impairment of financial instruments: determining inputs into the ECL measurement model, including incorporation of forward-looking information (Note 4.2.G.ix.).

Applicable to 2018 and 2017:

- impairment of financial instruments: key assumptions used in estimating recoverable cash flows (Note 4.2.G.ix.).

Significant accounting estimates and judgements related to the application of IFRS 9 are described in Note (Note 4.2.G.).

### 4. Summary of significant accounting policies

#### 4.1. Changes in the accounting policies

Group has initially adopted IFRS 9 (see 4.1.1.) and IFRS 15 (see 4.1.2.) from 1 January 2018. As permitted by the standard, the Bank elected not to restate comparative figures for the year 2017. Any adjustments on the application of IFRS 9 are recognized in the opening retained earnings and other reserves of the current period.

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.

Although subsidiary companies, the HKO Group, due to immateriality, uses the temporary exemption from 1 January 2018 until 1 January 2021, pursuant to the amendment of IFRS 4 – application of IFRS 9 Financial instruments with IFRS 4 Insurance Contracts, and the financial statements of the Group are prepared with the full application of IFRS 9.

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 (see Note 5.);
- additional disclosures related to IFRS 9 (see Note 36.3.);
- additional disclosures related to IFRS 15 (see Note 8.).

Consequently, the Bank has applied the International Financial Reporting Standard 7 (revised due to the adoption of IFRS 9). Except for the changes below, the Group has consistently applied the accounting policies as set out in Note 4.2. to all periods presented in these consolidated financial statements.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 4. Summary of significant accounting policies (continued)

#### 4.1. Changes in the accounting policies (continued)

##### 4.1.1. IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognition and measurement, impairment, de-recognition and hedge accounting in general. 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.

Additionally, 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 5.

##### **Classification of financial assets**

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

For an explanation of how the Group classifies financial assets under IFRS 9, see Note 4.2.G.ii.

##### **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 4.2.

##### **Transition**

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.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.1. Changes in the accounting policies (continued)**

**4.1.1. IFRS 9 Financial instruments (continued)**

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 fair value through profit or loss,
- The designation of certain investments in equity instruments not held for trading as at fair value through other comprehensive income.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 5.

**4.1.2. 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 timing or amount of the Group's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15. The impact of IFRS 15 was limited to the new disclosure requirements (see Note 8).

**4.2. Significant accounting policies**

Principal accounting policies applied when preparing these financial statements are summarized below.

Except for the changes explained in Note 4.1., the Group has consistently applied the following accounting policies to all periods presented in these consolidated financial statements.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**A. Basis of consolidation**

*Subsidiaries*

Subsidiaries are entities controlled by 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. The Group reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Group having power over an investee.

The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

*Non-controlling interests*

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the date of acquisition.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

*Loss of control*

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interests and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

*Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealised income and expenses 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.

*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 has made payments on behalf of the associate.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**A. Basis of consolidation (continued)**

*Associates (continued)*

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 separate 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.

**B. Foreign currency transactions and foreign currency clause**

Assets and liabilities expressed in foreign currencies are converted into HRK at the exchange rates quoted by the Croatian National Bank at the reporting date or at the contract exchange rates. Income and expense arising from foreign currencies are converted at the exchange rate on the transaction date. The resulting foreign exchange gains and losses are recorded in profit or loss.

The Bank has assets originated in HRK and linked to a foreign currency with a one-way currency clause. Due to this clause, the Bank has the option to revalue the asset using a foreign exchange rate, if beneficial for the Bank valid as of the date of maturity, compared to the foreign exchange rate valid as of the date of origination of asset.

Foreign currency differences, arising from the translation of the equity investments in respect of which an election has been made to present subsequent changes in fair value in other comprehensive income, are recognised in other comprehensive income. Amounts recognised in other comprehensive income are not transferred to the profit or loss, they are retained in other comprehensive income at the moment of derecognition.

The principal exchange rate set forth by the Croatian National Bank and used in the preparation of the financial statements at the reporting dates were as follows:

31 December 2018	1 EUR = HRK 7.417575	1 USD = HRK 6.469192
31 December 2017	1 EUR = HRK 7.513648	1 USD = HRK 6.269733

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**C. Interest income and expense**

*Policy applicable from 1 January 2018*

*Effective interest rate*

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 instruments 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 ("POCI"), the Group estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit loss. For purchased or originated credit impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit loss.

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.

*Amortised cost and gross carrying amount*

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.

*Calculation of interest income and expense*

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.

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.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**C. Interest income and expense (continued)**

*Policy applicable from 1 January 2018*

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 the purpose of calculation of interest income for exposures allocated to stage 3 or for assets classified as purchased or originated credit-impaired financial assets, the concept of time value of money is used (unwinding). Unwinding, i.e. interest income for the mentioned exposures is calculated after the date of transfer of exposure to stage 3 or after the date of classification of assets as POCI and is recorded as provisions for the financial instrument with simultaneous decrease of interest income.

Fees constituting interest income, which are related to the generation of a placement and are accrued and collected at approval and placement of loan funds or during loan contract period, are deferred and recognised in the profit or loss using the effective interest rate method over the period to which they relate.

Interest income and expense are recognized in the profit or loss when earned or incurred. Interest income and expense are recognized in the profit or loss for all interest-bearing instruments on an accrual basis using the effective interest rate, which is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or on a shorter period, where appropriate. Interest income includes coupons earned on fixed income investments.

Loan origination fees, together with estimated related costs, are deferred and proportionally recognized as an adjustment to the effective yield on the loan over the term of loan.

Notional interest is recognized on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value and are recognized in the profit or loss.

**D. Fee and commission income**

Fee and commission income and expense that are integral to the effective interest rate on a financial asset or financial liability are included in the effective interest rate (see (C)). Other fee and commission income – fees income from companies for guarantees granted and other services rendered by the Group, together with commissions for managing funds for and on behalf of legal entities and fees for foreign and domestic payment transactions – is recognised as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

Fee and commission income of non-interest income character (loan management fees for and on behalf of other parties, payment transaction fees, other fees of non-interest type) are recognized in the profit or loss as they incur.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**E. Leases**

*Group acting as a lessee - Finance leases*

Assets held by the Group under leases that transfer to the Group substantially all of the risks and rewards of ownership are classified as finance leases. The leased asset is initially measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

*Group acting as a lessee - Operating leases*

Assets held under other leases are classified as operating leases and are not recognised in the Group's statement of financial position.

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

**F. Income tax**

Based on Article 9 of the Act on the HBOR, the parent company is exempt from income tax. Income tax liabilities arise exclusively from the activities of the other members of the Group.

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at date of reporting, and any adjustments to tax payable in respect of previous years.

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at date of reporting.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Group expects, at date of reporting, to recover or settle the carrying amount of its assets and liabilities.

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

Deferred tax assets and liabilities are offset only if certain criteria are met.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

#### G. Financial assets and financial liabilities

##### I. Recognition and initial measurement

The Group initially recognises loans to financial institutions, loans to other customers, deposits and debt securities issued on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at Fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

##### II. Classification

###### *Financial assets - Policy applicable from 1 January 2018*

On initial recognition, a financial asset is classified as measured at: amortised cost, Fair value through other comprehensive income or Fair value through profit or loss.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at fair value through profit or loss:

- 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 fair value through other comprehensive income only if it meets both of the following conditions and is not designated as at Fair value through profit or loss:

- 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 other comprehensive income. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at fair value through profit or loss.

In addition, at initial recognition, the Group may irrevocably designate that a financial asset is measured at fair value through profit or loss (financial assets that otherwise meet amortized cost requirements or at fair value through other comprehensive income) if this eliminates or significantly reduces the accounting mismatch that would otherwise have occurred.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

#### G. Financial assets and financial liabilities (continued)

##### II. Classification (continued)

###### **Business models**

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.

All financial assets, except for investments in equity securities classified in the category of investments in associates and subsidiary with more than 20% of voting power or control, are grouped in business models which reflects how the Group manages the group of financial assets to realise certain business objective and to generate cash flows.

Business models of the Group are:

- Business model, whose objective is to hold assets for the collection of contractual cash flows – it includes all financial assets held for the purpose of collection of contractual cash flows over the lifetime of the financial instrument.

For the purpose of classification in this business model, financial assets goes through the SPPI (Solely payment of principal and interest) test, and the following financial assets are allocated to this model:

- Cash on hand and current accounts with banks,
- Deposits with banks,
- Loans and reversed repo placements,
- Other receivables,

Credit risk is a basic risk managed under this business model.

- Business model aimed to collect the contractual cash flows and sale of financial assets – it includes financial assets held for the purpose of collecting the agreed cash flows and sale of financial assets. The following financial assets are allocated to the business model for the purpose of collection and sale:

- Debt securities (pass SPPI test),
- Equity securities (fail SPPI test),
- Shares in investment funds (fail SPPI test),

Liquidity risk is a basic risk managed under this business model.

- Business model under which financial assets are measured at fair value through profit and loss account (fail SPPI test) – combines all financial assets that are not held under the previously mentioned two business models.

Financial assets under this business model are managed for the purpose of generating cash flows from the sale of assets and generating short-term profit.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

##### G. Financial assets and financial liabilities (continued)

##### III. SPPI test

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.

Test of features of contractual cash flows from the point of view of solely payment of principal and interest (hereinafter: SPPI test) is one of the criteria for the classification of financial assets in an individual category of measurement. SPPI test is implemented for the purpose of establishing whether the interest rate on unsettled principle reflects the fee for time value of money, credit risk and other basic risks of borrowing, lending costs and 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:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse loans); and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

SPPI test is performed:

- For each financial asset, allocated to a business model whose purpose is to hold financial assets for the payment of contractual cash flows and a business model for the purpose of collecting contractual cash flows and selling financial asset on the date of its initial recognition,
- For each financial asset in cases where the original asset has been significantly modified and therefore re-recognised as new assets,
- When introducing new models and/or loan programs to determine in advance the eligibility of the considered loan term and conditions in relation to the need to subsequently monitor the value of any financial assets that would arise from them.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

##### G. Financial assets and financial liabilities (continued)

##### IV. Reclassification of financial assets

In case of change in the business model of financial assets management, all financial assets affected by the reclassification will be reclassified. Reclassification will be made prospectively, from the date of the reclassification, or from the first day of the next accounting period, respectively, without restating the previously recognised profit, loss or interest.

##### V. Derecognition

*Policy applicable from 1 January 2018*

Financial assets

The Group derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

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 derecognised) and the sum of (i) the consideration received for the part derecognised (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in other comprehensive income in respect of equity investment securities designated as at fair value through other comprehensive income is not recognised in profit or loss on derecognition of such securities. 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.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**VI. Modification of financial assets**

*Policy applicable from 1 January 2018*

Modification of financial assets means any change in contractual terms that results in the change in contractual cash-flows. In the case of a modification that is not substantial, the change in contractual terms does not result in the derecognition of the respective financial assets and the new gross carrying amount is established as present value of modified contractual cash-flows discounted by applying the original effective interest rate (EIR).

The difference between the original gross carrying amount before modification and the gross carrying amount established on the basis of modified cash-flows after modification is recognised in Profit or loss.

In the case of a substantial modification of financial assets, the financial assets are derecognised before modification and the modified financial assets are newly recognised as “new” financial assets and the new effective interest rate is established. The date of modification of contractual provisions is considered to be the date of initial recognition. Impairment of newly recognised financial assets is recognised in the amount of the expected credit losses in a twelve-month period (Stage 1) until the conditions for the reclassification to Stage 2 have been met. If it is established that the modified financial assets at initial recognition have been credit impaired, the financial assets are recognised as purchased or originated credit-impaired financial assets (POCI assets) and the credit risk adjusted effective interest rate is determined.

For the purpose of deciding whether the quantitative modification is material or immaterial, quantitative test is implemented to establish whether the materiality threshold has been exceeded. Gross carrying amounts before and after the modification are compared, and new cash flows are discounted by the original effective interest rate. As materiality threshold of quantitative modifications affecting the cash flows modification, difference in the amount of initial cash flow compared to the modified cash flow in the amount of 10% change of the initial cash flow is established.

**VII. Purchased or originated credit-impaired financial assets (POCI assets)**

*Policy applicable from 1 January 2018*

POCI assets are financial assets for which, at initial recognition, there is objective evidence of credit impairment as the credit risk of originated or issued assets is very high or, in the case of purchase, the assets have been purchased at a high discount.

At initial recognition, the expected credit losses are included in the fair value of POCI assets and the loss allowance equal zero.

On the reporting date, only cumulative changes in the lifetime expected credit losses that occur after the initial recognition of POCI assets are recognised as loss allowance for the impairment of POCI assets.

For the purposes of impairment calculation, the lifetime expected credit losses are always recognised for these assets. POCI assets remain allocated to Stage 3 until derecognition.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**VIII. Fair value measurement**

Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction at the measurement date in the principal or the most advantageous market under current market conditions.

Basic price is an exit price, regardless of whether that price is directly observable or estimated using another valuation technique.

At initial recognition, when an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price).

The fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price).

If another IFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the Group shall recognize the resulting gain or loss in profit or loss unless that IFRS specifies otherwise.

For measuring fair value the Group is maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The Group selects inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability.

If an asset or a liability measured at fair value has a bid price and an ask price (e.g. an input from a dealer market), the Group uses the price within the bid-ask spread as the most representative of fair value.

Pursuant to aforesaid, the carrying amounts of cash and balances with the Croatian National Bank approximately present their fair values.

The estimated fair value of deposits approximates their carrying amounts since all deposits mature up to 90 days.

Loans and advances to banks and other customers are presented net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. The interests subsidies that are recognized as deferred income in discounted amounts are presented within other liabilities are taken into account in estimating fair value. The fair value of HRK loans with one-way currency clause is assessed as described under the “Foreign currency transactions and foreign currency clause” paragraph.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**VIII. Fair value measurement (continued)**

The Bank's long-term borrowings have no quoted market price, and their fair value is estimated as the present value of future cash flows, discounted at interest rates in effect at the reporting date for new borrowings of a similar nature and with a similar remaining maturity.

The fair value of bonds issued by HBOR on 31 December 2018 is stated in Note 37.1.2. and is presented by using level 2 inputs that are observable at Bloomberg service on the basis of mid-rate of Bloomberg Generic (BGN) prices.

BGN or Bloomberg Generic price is the simple average price that includes indicative prices and executable prices. The mid-rate is the average between the quoted "ask" price and the "bid" price.

The Group takes care of the fair value hierarchy presentation that comprises of three levels of inputs to valuation techniques used to measure fair value as follows:

	Level 1	Level 2	Level 3
Inputs:	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.	Unobservable inputs for the asset or liability or adjusted market inputs.

The Group discloses transfers between levels of the fair value hierarchy at the end of the reporting period during which the transfer occurred.

Comparison between the fair value and the carrying value of financial instruments that are not measured at fair value is given in Note 37.1.2.

**IX. Impairment**

*Policy applicable from 1 January 2018*

Impairment of financial assets is recognised under the model of expected credit losses for assets that are subsequently measured at amortised cost and assets that are subsequently measured at fair value through other comprehensive income.

Impairment is performed during the accounting periods and at the year end at the balance sheet date, and the effects of impairment are stated for each asset individually in the statement on financial position, other comprehensive income and statement on profit and loss.

Impairment is performed by applying the general and simplified approach.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**IX. Impairment (continued)**

According to the **general approach** of impairment, financial assets are allocated at initial recognition to:

- Stage 1 – financial assets with no significant credit risk or
- POCI assets as financial assets that are purchased or originally credit impaired that are allocated to stage 3.

At the future reporting dates, all financial assets that have not been recognised as POCI assets are allocated in risk categories depending on the assessment whether significant increase in credit risk occurred and in accordance with other credit impairment criteria to three stages:

Stage 1 – financial instruments with low credit risk are allocated to this stage, such as:

- Financial instruments of issuers with investment rating given by external credit rating agencies
- Exposures to the Republic of Croatia and units of local and regional government, the Croatian National Bank, the European Investment Bank or other development banks.

Financial instruments which are not deemed instruments of low credit risk only due to the value of collaterals, because without such collaterals they are not deemed low credit risk instruments.

For financial instruments allocated to this stage, impairments are calculated on a collective basis for twelve-month expected credit losses.

Stage 2 – financial instruments of clients where significant increase in credit risk is identified since initial recognition to this stage. Also individually significant clients included in the watch list, are also in this category.

For detailed explanation of the triggers for classification in Stage 2 please see Note 36. Risk management.

For the financial instruments of clients classified into Stage 2, loss allowances are calculated on a collective basis for lifetime expected credit losses.

Stage 3 – financial instruments of clients in default – where objective evidence of the impairment has been identified as well as purchased or originated credit-impaired (POCI) financial assets.

Financial assets recognised as POCI assets remain allocated to Stage 3 until derecognition.

Expected credit losses are measured on a collective basis for clients allocated to Stage 1 and Stage 2 as well as for clients allocated to Stage 3, which are in the portfolio of small loans (gross exposure amount equal or lower than HRK 1,500 thousand), whereas individual assessment is carried out for the financial instruments of clients who are in a default status and for POCI assets.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**IX. Impairment (continued)**

When measuring the expected credit losses on a collective basis, HBOR has, on the basis of common credit risk characteristics, defined the following homogeneous groups:

- financial institutions,
- central government and local and regional government,
- direct large,
- direct SME,
- direct MICRO,
- direct citizens, and
- other receivables.

The calculation of the expected credit losses, i.e. probability of default (PD), for the category of central government and local and regional government was based on the ratings of external rating agencies for the Republic of Croatia: Standard & Poor's and on the publicly available reports of rating agencies on historical default rates.

The assessment of credit losses for financial institutions is based on the mapping of HBOR's ratings with the PDs of S&P rating agency, where the rating of Zagrebačka banka and the PD of Zagrebačka banka is used as the benchmark because this bank has an established rating.

The approach based on migration matrices was used for the modelling of PDs in the categories of direct loans (large, small and medium, micro, citizens) and others – development of exposure among the following risk categories:

- from 0 to 30 days overdue – Stage 1,
- from 31 to 90 days overdue – Stage 2,
- more than 90 days overdue and restructuring – default.

Credit loss is the difference between all contractual cash-flows and all cash-flows expected from debtors, discounted to the present value by using the original effective interest rate, or, in the case of POCI assets, by using the credit risk adjusted effective interest rate.

For the financial assets subsequently measured at amortised cost, the impairment is recognised in Profit or Loss, and the loss allowances reduce the carrying value of financial assets in the Statement of Financial Position. In the case of a reduction of the expected credit losses or due to the collection of receivables, loss allowances are reduced or cancelled in the Statement of Financial Position and are simultaneously recognised as income from the reversed loss allowance or income upon the collection in the profit or loss.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**IX. Impairment (continued)**

Impairment of financial assets classified at fair value through other comprehensive income is calculated by applying the model of expected credit losses in the manner that the loss allowances are recognised in other comprehensive income and do not reduce the carrying value of these financial assets in the Statement of Financial Position, with all gains or losses resulting from the impairment recognised in the profit or loss.

Gains or losses resulting from the change in the fair value of these financial assets are recognised as other comprehensive income, whereas foreign exchange gains or losses are recognised in the profit or loss.

The accumulated gains/losses recognised as other comprehensive income are reclassified from equity to the Profit or Loss after derecognition of assets and represent the reclassification adjustment, except for equity securities classified as financial assets at fair value through other comprehensive income, where reserves recognized within other comprehensive income will never be transferred to profit and loss.

Financial assets classified as assets at fair value through the Profit or Loss are initially and subsequently measured at the established fair value and are not subject to impairment; the fair value of assets is, however, established in accordance with the internal documents that regulate the methods of determining the value of financial instruments until derecognition of financial instruments.

Decrease or increase in the fair value of these financial assets is recorded through the increase or decrease in their carrying amount in the Statement of Financial Position, whereas gains or losses resulting from the change in the fair value are recognised in the Statement on Profit or Loss.

**Simplified approach** of impairment can be applied only from receivables from customers or receivables for leases as well as on other non-interest fees, and this impairment always equals the amount of the expected credit losses during the lifetime of the instrument.

At the initial recognition, the financial assets are allocated to Stage 2 (all financial assets that have not been credit impaired at initial recognition) or Stage 3 (all purchased or originated credit-impaired assets – POCI assets).

At the future reporting dates, all financial assets that have not been recognised as POCI assets are allocated exclusively in accordance with the credit impairment criteria to Stage 2 and Stage 3.

Financial assets that have been recognised as POCI assets remain allocated to Stage 3 until derecognition.

Details regarding the methodology are stated in Note 36. Risk Management.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories**

*Policy applicable from 1 January 2018*

Financial assets of the Group are comprised of:

- Cash in hand and funds on the transaction accounts,
- Deposits with banks,
- Loans,
- Debt securities,
- Equity securities,
- Shares in investment funds,
- Derivative financial assets and
- Other receivables.

*Cash on hand and current accounts with banks*

Cash on hand and current accounts with banks are allocated to a business model whose purpose is to hold assets for the payment of contracted cash flows and they meet the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments.

Pursuant to the above, cash on hand and current accounts with banks are classified to the assets subsequently measured at amortised cost.

In the case of identified expected credit losses on funds on transaction accounts with domestic banks and abroad, impairment is performed but the expected credit losses are not discounted to present value in accordance with the short-term character of these financial assets.

*Deposits with banks*

Deposits with banks are allocated to a business model whose purpose is to hold assets for the collection of contractual cash flows and they pass the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments.

Pursuant to the above, deposits with banks are classified to the assets subsequently measured at amortised cost.

Impairment is determined in the amount of the expected credit losses, however, in the case of short-term deposits, they are not discounted to present value in accordance with their short-term character.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories (continued)**

*Loans*

Loans are allocated to a business model whose purpose is to hold assets for the collection of contractual cash flows. Loans that pass the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments are classified to the assets subsequently measured at amortised cost. Loans that fail the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments are classified to the assets subsequently measured at fair value through profit or loss.

Impairment of loans subsequently measured at amortised cost is determined in the amount of the expected credit losses by applying the general impairment approach (see G.ix. Impairment).

Loan receivables are based on contracts. Any amendments to contract provisions that change the agreed loan cash flows are considered to be a modification of a loan (see G.vi.) Modification of financial assets).

Loans purchased or originated, for which the existence of expected credit losses was determined at initial recognition, are considered to be POCI assets (see G.vii.) Purchased or originated credit-impaired financial assets (POCI assets).

Interest income from fees is recognised in the profit or loss using the effective interest rate method wherever applicable. If a fee, which represents an incremental loan cost, arises before the first loan disbursement, the fee income is recognised in profit or loss on a time-proportionate basis (the so-called linear method) until the effective interest rate has been set. From the moment when the effective interest rate is set until the end of the loan lifetime, interest income is recognised in the profit or loss by applying the effective interest rate method on the unamortised fee amount.

Loans classified to assets subsequently measured at fair value through profit or loss are not subject to impairment, and the provisions described in Note G.x. "Shares in investment funds" apply to both initial and subsequent measurements.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories (continued)**

*Debt securities*

HBOR invests a portion of liquidity reserve funds in debt securities in accordance with the terms and conditions prescribed by the bank's internal documents regulating HBOR's investment policy. Owing to the development role of HBOR that has been determined by the Act on HBOR, and owing to the preservation of capital and the reduction of risks arising from the performance of activities determined by the Act on HBOR to the lowest level possible, the Bank does not acquire securities and investments for the purpose of recording short-term profit or loss from trading activities, it does so for the purpose of maintaining short-term liquidity reserves and managing short-term liquidity.

Debt securities are comprised of bonds and money market instruments: treasury bills and commercial papers.

Debt securities are allocated to a business model whose purpose is to collect the contractual cash flows and to sell the financial assets, they pass the SPPI test and are classified to the assets subsequently measured at fair value through other comprehensive income.

Debt securities are recorded off-balance sheet at nominal value as at the trading date, and they are recognised in the statement of financial position at fair value as at the settlement date including transaction costs directly attributable to the acquisition of financial assets.

The earned interest is recognised as interest receivables as at the settlement date and does not represent HBOR's revenue.

Interest accrued on the nominal value of debt securities is proportional to the interest rate and maturity date and is recognised as interest income in the profit or loss using the effective interest rate method.

Amortisation of initially recognised premium or discount and transaction costs for purchased debt securities is recognised in the profit or loss as an increase or a decrease in interest income using the effective interest rate method.

Debt securities are measured at balance sheet date at fair value that is determined in the manner prescribed by internal documents regulating the methods of measurement of financial instruments (Financial Instruments Measurement Methodology). Gains or losses arising from the change in the fair value of these financial assets are recognised in other comprehensive income, and foreign exchange gains or losses are recognised in the profit or loss.

If financial assets cease to be recognised, the cumulative gains or losses recognised in other comprehensive income are reclassified from equity to profit or loss as reclassification adjustment.

Impairment is determined in the amount of the expected credit losses (see G.ix.) Impairment - general approach).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories (continued)**

*Equity securities*

The accounting treatment of investment in ordinary or preference shares or business interests depends on the degree of control and influence HBOR has over the business and operating policies of company and on the type of investment.

Investments are broken down as follows:

1. investment without significant influence – equity stake below 20 %,
2. investment in associates – significant influence,
3. investment in subsidiaries – controlling influence.

When preparing separate financial statements, investments in associates and subsidiaries are stated either:

1. at acquisition cost, or
2. in accordance with IFRS 9, or
3. using the equity method.

The same accounting treatment is used for every investment category.

Where investments in subsidiaries and associates, stated at acquisition cost or using the equity method, are classified as investments held for sale or distribution, they are stated in accordance with the IFRS 5 "Foreclosed assets and Discontinued Operations".

In such circumstances, measurement of investments accounted for in accordance with the IFRS 9 is not changed.

*Investments without significant influence – equity stake below 20 %*

Equity securities are allocated to a business model whose purpose is to collect the contractual cash flows and to sell the financial assets and fail the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments. Therefore, equity securities are classified to the assets subsequently measured at fair value through profit or loss and are initially and subsequently measured at fair value.

The option of fair value through other comprehensive income is applied to the portion of equity securities: shares in the SWIFT company and in the European Investment Fund owing to the intention to permanently retain these shares in HBOR's portfolio. The option of fair value through other comprehensive income represents the manner of subsequent measurement where all changes in fair value are recognised in other comprehensive income and not in profit or loss. This is an irrevocable election and all equity instruments remain classified to this model of subsequent measurement until the moment of derecognition.

Gains or losses resulting from changes in exchange rates of foreign currencies are recognised in other comprehensive income. The amounts recognised in other comprehensive income are not transferred to the profit or loss and are retained within the other comprehensive income at the moment of derecognition.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories (continued)**

*Equity securities (continued)*

*Investments without significant influence – equity stake below 20 % (continued)*

Dividend income from equity securities is recognised on the basis of payment decision and in the period in which it is made, which is made by the assembly or another competent body, if it is reasonable that the dividend will be collected.

If the collection is uncertain, income shall be recognised at the moment of collection only.

Dividend is recognised in the profit or loss for all equity instruments irrespective of whether they have been classified as instruments subsequently measured at fair value through profit or loss or as instruments subsequently measured at fair value through other comprehensive income.

*Investments in associates – significant influence (exceeding 20%)*

Investments, in which HBOR holds more than 20% of voting power and which are under HBOR's significant influence, are considered to be investments in associates (see A. Associated companies).

*Investments in subsidiaries – controlling influence (see A. Subsidiary companies)*

*Shares in investment funds*

Shares in investment funds relate to the shares in cash or bond UCITS open-ended investment funds and to the shares in PE/VC venture capital alternative investment funds.

Shares in investment funds fail the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments. Therefore, they are classified to the assets subsequently measured at fair value through profit or loss.

The fair value of shares in investment funds is established in accordance with internal documents regulating the methods of measurement of financial instruments (Financial Instruments Measurement Methodology) until the moment of derecognition of financial instrument, whereas it is recognised in the business books at fair value through profit or loss.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**X. Financial assets – categories (continued)**

*Derivative financial assets*

Derivative financial assets relate to the FX Forward and FX Swap instruments contracted for the purpose of managing the currency and the liquidity risks.

Derivative financial assets are allocated to a business model within which financial assets are measured at fair value through profit or loss.

The contractual value of derivative financial instruments is initially recognised in off-balance sheet records as at the contract date with simultaneous recognition of changes in fair value in the statement of financial position and profit or loss from the change in fair value in profit or loss until the moment of derecognition.

The fair value of derivative financial assets is established as the present value of all future cash flows in accordance with the methodology prescribed by internal documents regulating the methods of measurement of financial instruments (Financial Instruments Measurement Methodology)

*Other receivables*

Other receivables include receivables due and not due from accrued non-interest income resulting from fees and commissions as well as other receivables not included in other items: advances to suppliers for short-term assets, receivables from buyers, individual prepayments and funds in accruals.

Receivables based on fees that have the character of non-interest income are fees for guarantees issued, fees for managing loans for and on behalf of others, fees for rendering payment transfer services, other fees of non-interest character.

Other receivables mature within the period of one year and sooner and are considered short-term receivables recognised in the statement of financial position as receivables not due or at the maturity date in accordance with the invoiced realisation principle

Other receivables are allocated to a business model whose purpose is to hold assets for the collection of contractual cash flows and pass the SPPI test in accordance with the Methodology for the Classification and Measurement of Financial Instruments. Therefore, other receivables are classified to the assets subsequently measured at amortised cost.

Impairment of other receivables is determined in the amount of the expected credit losses, and it is not discounted to present value in accordance with the short-term character of these financial assets.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

##### G. Financial assets and financial liabilities (continued)

##### X. Financial assets – categories (continued)

###### *Other receivables (continued)*

Impairment is performed by applying the impairment simplified approach (see G.ix. Impairment – simplified approach).

Contractual penalty interest is charged on overdue receivables under other receivables, and, if it is not contracted, legal penalty interest is charged.

##### XI. Financial assets – Policy applicable before 1 January 2018

The Group classified its financial assets into one of the following categories:

- loans and receivables,
- held-to-maturity,
- available-for-sale, and
- at fair value through profit or loss.

Financial instruments are classified into the above categories pursuant to the intention at acquisition. Classification of financial instruments at initial recognition and accounting principles of their measurement are prescribed by accounting policies brought by the Management Board.

The principal difference among the categories relates to the measurement approach of financial assets and the recognition of their fair values in the financial statements that is described in the text below.

All securities held by the Group are recognized using settlement date accounting and are initially measured at cost and directly attributable transaction costs when investments are not recognised at fair value through the profit or loss.

The Bank does not make acquisitions of financial instruments and investments to attain gain from short term trading activities.

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

Assets available for sale are financial assets designated as available for sale or not classified as either held to maturity or carried at fair value through profit or loss or loans and receivables.

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Significant accounting policies (continued)

##### G. Financial assets and financial liabilities (continued)

##### XI. Financial assets – Policy applicable before 1 January 2018 (continued)

###### *Available-for-sale financial assets (continued)*

Financial assets classified as assets available for sale are provided for the purposes of maintaining liquidity reserves or for the purpose of placement of available funds until their further placement in long-term loans. In the available-for-sale assets portfolio, investments in long-term securities and in other financial instruments are recorded, as well as equity instruments with the intention to hold over 90 days that are held for an unlimited period and shares in investment funds that the Bank intends to hold for a period of over 30 days.

Subsequent to initial recognition, available-for-sale financial assets are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt instruments is estimated using various valuation techniques including the use of present value of future cash flows and mathematical models, while the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer.

For available for sale assets, unrealized gains and losses arising from changes in fair value are recognized directly in other comprehensive income, until their disposal or impairment, at which time the realized gain or loss is included in the profit or loss.

Impairment losses on assets available for sale are presented in profit or loss. If the fair value of an equity instrument subsequently increases, the increase will be recognized in other comprehensive income, and will not be subsequently reversed in the profit or loss. Impairment losses recognized in profit or loss for debt instruments are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition.

When a decline in the fair value of available-for-sale financial assets has been recognized in other comprehensive income and there is an objective evidence that the asset is impaired according to IAS 39 provisions, the cumulative loss that has been recognized in other comprehensive income shall be reclassified from other comprehensive income to profit or loss as a reclassification adjustment, even though the financial asset has not been derecognized.

The objective evidence on impairment loss on certain investment in an equity instrument includes information on significant adverse changes with impact on the technological, market, economic or legal conditions of operation of the issuer and indicates that the cost of investment in debt instruments cannot be recovered.

Significant or prolonged decline in the fair value of investments into debt instruments below their cost is also an objective evidence of impairment.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**XI. Financial assets – Policy applicable before 1 January 2018 (continued)**

*Available-for-sale financial assets (continued)*

Interest earned whilst holding available for sale instruments is accrued on a daily basis and is reported as 'Interest income' in profit or loss.

Foreign exchange gains/(losses) related to available for sale equity instruments held in foreign currency are recognized together with fair value gains and losses in other comprehensive income until the financial asset is sold. Foreign exchange gains/(losses) related to available-for-sale debt instruments in foreign currency are reported in profit or loss.

*Held-to-maturity financial assets*

Investments held-to-maturity are financial assets with fixed or identifiable payments and fixed maturities for which the Group has the intent and ability to hold to maturity. This portfolio generally comprises instruments issued for a period exceeding one year, such as bonds, bills of exchange etc.

Financial assets held to maturity are initially recognised at fair value, increased by transaction costs. After initial recognition, assets held to maturity are measured and stated at amortized investment cost, i.e. acquisition cost (nominal value of purchased securities increased/decreased by a discount/premium and transaction costs) adjusted by amortized discount/premium.

Interest earned is recognized as interest receivable on the date of settlement and is not HBOR's income.

The Group assesses on a regular basis whether there is any objective evidence that an investment held-to-maturity may be impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount, which is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. The amount of the impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. When an impairment of assets is identified, the Group recognizes provisions through profit or loss under 'Impairment loss and provisions'.

*Loans to financial institutions and other customers*

Amounts paid-out by HBOR in providing funds directly to the borrower at drawdown are categorized as loans to customers and are carried at amortized cost derived from using the effective interest method and adjusted for possible impairment.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**G. Financial assets and financial liabilities (continued)**

**XI. Financial assets – Policy applicable before 1 January 2018 (continued)**

*Loans to financial institutions and other customers (continued)*

The amount of the subsidized interest provided for the final user under the Programme of Preferential Financing through HBOR's Loan Programmes is presented as deferred interest income in other liabilities and released over the term of the loan and is shown in profit or loss on a time basis during the repayment of the loan applying effective interest rate method.

All loans and advances are recognized when cash is paid-out to borrowers.

Provision for impairment is performed if there is objective evidence that HBOR will not be able to collect all amounts due. The Management Board of HBOR determines the adequacy of the provision based upon analysis of various factors, the structure of the loan portfolio and past experience.

The amount of the provision is the difference between the carrying and recoverable amounts of the balance outstanding, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted based on the effective interest rate.

The loan loss provision is also assessed on portfolio basis covering losses where there is objective evidence that possible losses are present, specifically identified in components of the loan portfolio at the Statement of Financial Position date. These have been estimated based upon historical patterns of losses (in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate).

If there is no objective evidence that an impairment loss has been incurred, whether it is significant or not, the financial asset is classified into the group of assets with similar credit risk characteristics and all assets from this group are subject to joint estimation for the purpose of a collective evaluation of impairment. Contracted cash flows and historical loss experience for assets with similar credit risk characteristics are subject to collective evaluation of expected cash flows.

When a loan is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries of these loans are recognized in the profit or loss.

Securities purchased under agreements to purchase and resell ('reverse repos') are not recognized in the Statement of Financial Position of the Bank and expenses based on such contracts are recognized in the statement on financial position as loans to financial institutions collateralized by securities that are the subject matter of contracts. Interest earned in the period from the purchase until the resale of the security is accrued on a daily basis and reported as 'Interest income' in profit or loss.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**H. Property, plant and equipment and intangible assets**

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

If significant parts of an item of property or equipment have different useful lives, then they are accounted for as separate items (major components) of property and equipment.

Any gain or loss on disposal of an item of property and equipment is recognised within other income in profit or loss. Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

Depreciation is calculated to write off the cost of items of property and equipment less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss.

Land is not depreciated.

Estimated useful lives are as follows:

	<b>2018</b>	<b>2017</b>
	years	years
Buildings	33	33
Computers	3	3
Furniture and Equipment	5 - 8	5 - 8
Vehicles	3	3
Other assets and investments not mentioned	5	5
Intangible Assets	3 - 5	3 - 5

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

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**I. Investment property**

Investment property held by the Group to earn rentals or for capital appreciation is initially measured at cost, and subsequently reduced by accumulated depreciation and any impairment losses.

Subsequent cost of replacing part of an existing asset is recognized in the carrying amount of an investment property at the time that cost is incurred, 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 expensed during the period in which they are incurred.

Land is not depreciated. Depreciation is provided on other investment property 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 life of the assets is as follows:	<b>2018</b>	<b>2017</b>
	years	years
Leased property	33	33

Remaining value, depreciation methods and the estimated useful life are reviewed periodically and reconciled, if necessary, at every financial position reporting date. If the carrying amount of the assets is found to be higher than the assessed recoverable amount, it is immediately written-off to the recoverable amount. Gains and losses from alienation are assessed by comparing sale revenues against the book amount and recorded in the comprehensive income.

Investment property is stated in Note 26 Other assets due to immaterial amount.

**J. Foreclosed assets**

Foreclosed assets consist of property, plant and equipment that the Group acquired in settlement of uncollected receivables. The Group expects that the carrying amount of these assets will be recovered principally through a sale transaction rather than through continuing use.

The Group measures these assets at the lower of its carrying amount and fair value (determined by an independent assessor) less estimated expected costs to sell.

Depreciation on these assets is not charged.

The Group recognises an impairment provision for any initial or subsequent partial write-off of these assets up to the fair value less costs to sell. It recognises a gain for any subsequent increase in fair value of assets less costs to sell up to the amount of cumulative impairment provision that has been recognised.

Impairment provisions are recognized in profit or loss, as well as gains/losses upon subsequent measurement and on sale of the Foreclosed assets.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**J. Foreclosed assets (continued)**

The cases in which due to more difficult circumstances of sale because of objective circumstances and events beyond the Group's control, the sale will not be completed in the planned period, or the period necessary for the conclusion of sale should be prolonged even after the period of one year, and a decision of an authorised body on giving up the sale or the plan of sale has not been made, and the activities are further undertaken to find a buyer and there is enough evidence that the Group has remained consistent with the plan of sale of such type of assets, do not exclude that the assets are still classified as Foreclosed assets.

**K. Deposits, borrowings and debt securities issued**

Debt securities issued and borrowings are the Group's sources of debt funding.

Deposits, debt securities issued and borrowings are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Group designates liabilities at Fair value through profit or loss.

Financial liabilities are stated in the contracted currency translated to Kuna at the middle exchange rate of the Croatian National Bank, contract exchange rate or determined rate arising from business and financial transactions based on documentation.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date (sale-and-repurchase agreement), the arrangement is accounted for as collateralized loans taken from financial institutions, and the underlying asset continues to be recognised in the Group's financial statements.

**L. Government grants**

Interest for the borrowers qualifying for subsidized interest under the Programme of Preferential Financing through HBOR's Loan Programmes, is subsidized by the Republic of Croatia – the Ministry of Finance during the entire loan repayment period.

The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income in other liabilities and is recognized in the profit or loss on a time basis during the repayment of the loan. Consequently, loans are measured at amortized cost by using interest rate without taking into account the effects of subsidies contributed by the State.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**M. Loan commitments**

The Group has issued no loan commitments that are measured at Fair value through profit or loss.

For other loan commitments:

- from 1 January 2018: the Group recognises a loss allowance;
- before 1 January 2018: the Group recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

Liabilities arising from loan commitments are included within provisions.

**N. Employee benefits**

The Group pays contributions to mandatory pension plans on a mandatory, contractual basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

The Group recognizes provisions for other liabilities towards employees when there is a contractual obligation or practice in the past based on which the obligation has arisen. Further, the Group recognizes the liabilities for accumulated vacation allowances based on unutilised vacation days as of the date of the financial statements.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.2. Significant accounting policies (continued)**

**O. Segment reporting**

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which are subject to risks and rewards that are different from those of other segments. Limited segment information is presented in respect of the Group's business segments. The primary format of business segments is based on the Bank's management and internal reporting structure.

The Group has identified three main segments: banking activities, insurance activities and other activities.

Since the Group predominantly operates in the Republic of Croatia, there are no secondary (geographical) segments.

**P. Managed funds for and on behalf of third parties**

The Bank manages significant assets for and on behalf of the Ministry of Finance, Ministry of the Economy, Entrepreneurship and Trade, Ministry of the Sea, Transport and Infrastructure, Ministry of Agriculture, Ministry of Regional Development and EU Funds, Ministry of Environment Protection and Energy, Vodovod i kanalizacija d.o.o., Split, the Croatian Agency for SMEs, Innovation and Investments ("HAMAG-BICRO") and commercial banks, that are used for the financing of reconstruction and development programmes.

These amounts do not represent assets of HBOR and are excluded from the Bank's Statement of financial position but are recorded separately from the Bank's operations.

Revenues and expense relating to this business activity are charged to third parties, and the Bank does not have other liabilities nor bears any risks. For services provided within the framework of some of the programmes, the Bank charges a fee, whereas other programmes are performed by the Bank free of charge (see Note 34.).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**4. Summary of significant accounting policies (continued)**

**4.3. Standards, supplements and interpretations of existing standards that are not yet in force and that have not been applied in the 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 consolidated financial statements.

Of those standards that are not yet effective, the Group plans to apply IFRS 16 Leases from 1 January 2019.

**4.3.1. IFRS 16 Leases**

The Group is required to adopt IFRS 16 Leases from 1 January 2019. The Group has assessed the impact that the initial application of IFRS 16 will have on its consolidated and separate financial statements.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

*a) Leases in which the Group is a lessee*

The Group has completed an initial assessment of the potential impact on its consolidated and separate financial statements but has not yet completed its detailed assessment. The actual impact of applying IFRS 16 on the financial statements in the period of initial application will depend on future economic conditions, the development of the Group's lease portfolio, the Group's assessment of whether it will exercise any lease renewal options and the extent to which the Group chooses to use practical expedients and recognition exemptions.

The Group applied modified retrospective approach as at 1 January 2019, future minimum lease payments under non-cancellable operating leases amounted to HRK 2,104 thousand, on a discounted basis, which the Group estimates it will recognise as additional lease liabilities.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

#### 4. Summary of significant accounting policies (continued)

##### 4.2. Standards, supplements and interpretations of existing standards that are not yet in force and that have not been applied in the preparation of these financial statements

##### 4.3.2. Other standards

The following amended standards are not expected to have a significant impact on the Group's consolidated financial statements.

- Annual Improvements to IFRS Standards 2015–2017 Cycle – various standards,
- Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28),
- Plan Amendment, Curtailment or Settlement (Amendments to IAS 19),
- Amended IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures (application deferred for an indefinite period),
- IFRIC 23 Uncertainty over Income Tax Treatments,
- Amendments to IFRS 9 Prepayment Features with Negative Compensation,
- Amendments to References to Conceptual Framework in IFRS Standards,
- IFRS 17 Insurance Contracts,
- Amendment to IFRS 3 Business Combinations,
- Amendment to IAS 1 Presentation of Financial Statements and
- Amendment to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

#### 5. Transition to IFRS 9

The effects of the application of IFRS 9 recognised directly in retained earnings and reserves as at 1 January 2018 for the Group amount to HRK 469,974 thousand.

Below, the impact of adoption of IFRS 9 on the Statement of Financial Position and the Retained Earnings and Reserves of the Group and the Bank is presented, including the effect of replacement of accounting losses under IAS 39 with expected credit losses under IFRS 9:

Group	IAS 39		Reclassification HRK '000	Expected credit loss HRK '000	Remeasurement Impairment recognized in other comprehensive income	Other <sup>2</sup> HRK '000	The effect of adjusting to fair value HRK '000	IFRS 9	
	Category	Amount HRK '000						Amount HRK '000	Category
<b>Financial assets</b>									
Cash on hand and current accounts with banks	L & R <sup>4</sup>	1,403,664	-	817	-	-	-	1,404,481	AC <sup>5</sup>
Deposits with other banks	L & R	29,138	-	202	-	-	-	29,340	AC
Loans to financial institutions	L & R	10,836,141	-	106,906	-	943	-	10,943,990	AC
Loans to other customers	L & R	12,383,623	(3,840)	(717,902)	-	135,001	(176)	11,796,706	AC
<i>To: Financial assets at FVPL<sup>6</sup></i>	<b>A</b>	-	(3,840)	-	-	-	(176)	-	
Other assets	L & R	19,297	-	(6,664)	-	-	-	12,633	AC
Assets held to maturity	L & R	1,399	(1,399)	-	-	-	-	-	
<i>To: Debt instruments at AC</i>	<b>B</b>	-	(1,399)	-	-	-	-	-	
Debt instruments at AC		-	1,399	(2)	-	-	-	1,397	AC
	<b>L &amp; R</b>	<b>24,673,262</b>	<b>(3,840)</b>	<b>(616,643)</b>	<b>-</b>	<b>135,944</b>	<b>(176)</b>	<b>24,188,547</b>	<b>AC</b>
Assets available for sale	AFS	3,321,564	(3,321,564)	-	-	-	-	-	n/a
<i>To: Financial assets at FVOCI<sup>7</sup></i>	<b>C</b>	-	(2,508,833)	-	-	-	-	-	
<i>To: Financial assets at FVPL</i>	<b>D</b>	-	(812,731)	-	-	-	-	-	
	<b>AFS</b>	<b>3,321,564</b>	<b>(3,321,564)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>n/a</b>
Financial assets at FVOCI	n/a	-	-	-	-	-	-	2,508,833	FVOCI
<i>From: AFS<sup>8</sup></i>	<b>E</b>	-	2,508,833	-	-	-	-	-	
	<b>n/a</b>	<b>-</b>	<b>2,508,833</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,508,833</b>	<b>FVOCI</b>
Financial assets at FVPL	FVPL/n/a	291	-	-	-	-	-	291	FVPL
<i>From: AFS</i>	<b>F</b>	-	812,731	-	-	-	-	812,731	
<i>From: Loans to other customers</i>	<b>G</b>	-	3,840	-	-	-	176	4,016	
	<b>FVPL/n/a</b>	<b>291</b>	<b>816,571</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>176</b>	<b>817,038</b>	<b>FVPL</b>
<b>Total financial assets</b>		<b>27,995,117</b>	<b>-</b>	<b>(616,643)</b>	<b>-</b>	<b>135,944</b>	<b>-</b>	<b>27,514,418</b>	
Provision for guarantees and commitments	<b>H</b>	(64,360)	-	15,013	-	-	-	(49,347)	
Other reserves		(94,683)	28,254	-	(4,288) <sup>9</sup>	-	-	(70,717)	
<i>To: Retained earnings and Reserves</i>	<b>I</b>	-	28,254 <sup>10</sup>	-	-	-	-	-	
Recognition of expected credit losses in retained earnings	<b>J</b>	-	-	(4,288)	-	-	-	-	
<b>The effect of IFRS 9 on Retained Earnings and Reserves</b>	<b>K</b>	<b>-</b>	<b>-</b>	<b>(605,918)</b>	<b>(4,288)</b>	<b>135,944</b>	<b>-</b>	<b>-</b>	

<sup>3</sup> Others relates to interest and fees transferred from the off-balance sheet records net of the transfer of loan principal to financial assets at fair value through profit or loss.

<sup>4</sup> L & R: Loans and receivables; <sup>5</sup> AC: Amortised cost; <sup>6</sup> FVPL: Financial assets at fair value through profit or loss; <sup>7</sup> FVOCI: Financial assets at fair value through other comprehensive income; <sup>8</sup> AFS: Assets available for sale

<sup>9</sup> The allowance for financial assets classified at fair value through other comprehensive income does not impact the carrying amount of financial assets in the Statement on Financial Position, but is recognised in the accounts of other comprehensive income.

<sup>10</sup> The effect of adjusting to fair value of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through the Statement on Profit or Loss, due to which the effect from Other reserves is stated on Retained Earnings and Reserves.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 5. Transition to IFRS 9 (continued)

The effects of the application of IFRS 9 recognised directly in retained earnings and reserves as at 1 January 2018 for the Bank amount to HRK 469,658 thousand.

Bank	IAS 39		Remeasurement Impairment recognized in other comprehensive income				IFRS 9		
	Category	Amount HRK '000	Reclassification HRK '000	Expected credit loss HRK '000	Other <sup>11</sup> HRK '000	The effect of adjusting to fair value HRK '000	Amount HRK '000	Category	
<b>Financial assets</b>									
Cash on hand and current accounts with banks	L & R <sup>12</sup>	1,401,130	-	817	-	-	1,401,947	AC <sup>13</sup>	
Deposits with other banks	L & R	29,138	-	202	-	-	29,340	AC	
Loans to financial institutions	L & R	10,836,141	-	106,906	-	943	10,943,990	AC	
Loans to other customers	L & R	12,383,623	(3,840)	(717,902)	-	135,001	11,796,706	AC	
<i>To: Financial assets at FVPL<sup>14</sup></i>	<b>A</b>	-	(3,840)	-	-	(176)	-		
Ostala imovina	L & R	12,282	-	(6,641)	-	-	5,641	AC	
	<b>L &amp; R</b>	<b>24,662,314</b>	<b>(3,840)</b>	<b>(616,618)</b>	<b>-</b>	<b>135,944</b>	<b>(176)</b>	<b>24,177,624</b>	<b>AC</b>
Assets available for sale	AFS	3,277,194	(3,277,194)	-	-	-	-	n/a	
<i>To: Financial assets at FVOCI<sup>15</sup></i>	<b>C</b>	-	(2,469,160)	-	-	-	-		
<i>To: Financial assets at FVPL</i>	<b>D</b>	-	(808,034)	-	-	-	-		
	<b>AFS</b>	<b>3,277,194</b>	<b>(3,277,194)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>n/a</b>	
Financial assets at FVOCI	n/a	-	-	-	-	-	2,469,160	FVOCI	
<i>From: AFS<sup>16</sup></i>	<b>E</b>	-	2,469,160	-	-	-	-		
	<b>n/a</b>	<b>-</b>	<b>2,469,160</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,469,160</b>	<b>Fvoci</b>	
Financial assets at FVPL	n/a	-	-	-	-	-	812,050	FVPL	
<i>From: AFS</i>	<b>F</b>	-	808,034	-	-	-	808,034		
<i>From: Loans to other customers</i>	<b>G</b>	-	3,840	-	-	176	4,016		
	<b>n/a</b>	<b>-</b>	<b>811,874</b>	<b>-</b>	<b>-</b>	<b>176</b>	<b>812,050</b>	<b>FVPL</b>	
<b>Total financial assets</b>		<b>27,939,508</b>	<b>-</b>	<b>(616,618)</b>	<b>-</b>	<b>135,944</b>	<b>-</b>	<b>27,458,834</b>	
Provision for guarantees and commitments	<b>H</b>	(64,360)	-	15,013	-	-	(49,347)		
Other reserves		(90,457)	28,247	-	(3,997) <sup>17</sup>	-	(66,207)		
<i>To Retained earnings and reserves</i>	<b>I</b>	-	28,247 <sup>18</sup>	-	-	-	-		
Recognition of expected credit losses in retained earnings	<b>J</b>	-	-	(3,997)	-	-	-		
<b>The effect of IFRS 9 on Retained Earnings and Reserves</b>	<b>K</b>	<b>-</b>	<b>-</b>	<b>(605,602)</b>	<b>(3,997)</b>	<b>135,944</b>	<b>-</b>		

<sup>11</sup> Others relates to interest and fees transferred from the off-balance sheet records net of the transfer of loan principal to financial assets at fair value through profit or loss.

<sup>12</sup> L & R: Loans and receivables; <sup>13</sup> AC: Amortised cost; <sup>14</sup> FVPL: Financial assets at fair value through profit or loss; <sup>15</sup> FVOCI: Financial assets at fair value through other comprehensive income; <sup>16</sup> AFS: Assets available for sale;

<sup>17</sup> The allowance for financial assets classified at fair value through other comprehensive income does not impact the carrying amount of financial assets in the Statement on Financial Position, but is recognised in the accounts of other comprehensive income.

<sup>18</sup> The effect of adjusting to fair value of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through the Statement on Profit or Loss, due to which the effect from Other reserves is stated on Retained Earnings and reserves.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 5. Transition to IFRS 9 (continued)

**A** Since 1 January 2018, the Group has concluded that mezzanine loans, that are complex structured products, do not meet the criteria of the SPPI test. Therefore, these loans, which previously were measured at amortised cost in accordance with IAS 39, have been reclassified to financial assets measured at fair value through profit or loss. As at 31 December 2017, net value of these loans for the Group and the Bank amounted to HRK 3,840 thousand, whereas, as at 1 January 2018, estimated fair value equaled HRK 4,016 thousand and the estimation effect of HRK 176 thousand was recorded in the retained earnings and reserves.

**B** As of 1 January 2018, the Group has concluded that the assets previously classified as held to maturity are managed within the business model for collecting contractual cash flows and are measured at amortised cost as well as in accordance with IAS 39. Consequently, the Group has classified these instruments as Debt Securities at Amortised Cost and, as at 1 January 2018, the value of these instruments for the Group amounts to HRK 1,397 thousand and for the Bank HRK 0 thousand.

**C** Since 1 January 2018, the Group has concluded that, except for a small part, as described under D, the financial instruments, which were previously classified as liquidity reserve to the portfolio of assets available for sale, have been managed under the business model of collecting contractual cash flows and selling financial assets. Therefore, the Group has classified these instruments as debt securities, i.e. as financial assets at fair value through other comprehensive income. As at 1 January 2018, the value of these instruments for the Group amounted to HRK 2,508,833 thousand and for the Bank amounted to HRK 2,469,161 thousand. This category includes equity securities (shares of companies) that the Group has no intention to sell and which are subject to irrevocable option of subsequent measurement at fair value through other comprehensive income without recycling. As at 1 January 2018, the value of these instruments for the Group and the Bank amounted to HRK 25,462 thousand.

**D** Since 1 January 2018, the Group has classified part of its equity instruments in the amount of HRK 19,112 thousand as financial assets measured at fair value through profit or loss because they are measured neither at amortised cost nor at fair value through other comprehensive income. In addition, investments in investment funds (obligatorily under IFRS 9) for the Group in the amount of HRK 793,619 thousand and for the Bank HRK 788,921 thousand have been classified to these assets. These financial assets were previously classified to assets available for sale and gains/losses from measurement at fair value of investments in investment funds were previously recognised in other comprehensive income. At the reclassification of these assets, the cumulative gains/losses of HRK 28,254 thousand for the Group and HRK 28,247 thousand for the Bank, that were previously recognised in other comprehensive income have been reclassified from other reserves to retained earnings and reserves.

**E** As described under C

**F** As described under D

**G** As described under A

**H** Since 1 January 2018, the effect of calculating provisions pursuant to IFRS 9 for loan commitments amounts to HRK 15,013 thousand.

**I** As described under D

**J** Impairment of debt securities classified to Financial assets at fair value through other comprehensive income is calculated by recognising impairment losses in other comprehensive income without reducing the carrying amount of these financial assets in the Statement of Financial Position. As at 1 January 2018, for the Group they amounted to HRK 4,288 thousand and for the Bank HRK 3,997 thousand.

**K** The total effect of expected credit losses under IFRS 9 as a result of remeasurement amounts to HRK 469,974 thousand for the Group and HRK 469,658 thousand for the Bank, whereas the effect of reclassification of financial instruments, due to which cumulative gains/losses previously recognized in other comprehensive income were reclassified to retained earnings and reserves, amounts to HRK 28,254 thousand for the Group and HRK 28,247 thousand for the Bank.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 6. Interest income calculated using the effective interest method

Interest income by borrowers:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Public sector	98,383	113,744	97,008	112,117
State-owned companies	32,585	51,300	32,585	51,300
Foreign companies	29,077	13,566	29,077	13,566
Domestic companies	332,255	359,964	332,255	359,964
Domestic financial institutions	203,566	246,331	203,566	246,331
Foreign financial institutions	476	845	476	845
Penalty interest	9,526	14,461	9,526	14,461
Other	27,215	67,614	27,215	67,614
	<b>733,083</b>	<b>867,825</b>	<b>731,708</b>	<b>866,198</b>

Interest income by type of facility:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Interest on loans				
- financial institutions	204,190	248,613	204,190	248,613
- other customers	495,078	577,814	495,078	577,814
	<b>699,268</b>	<b>826,427</b>	<b>699,268</b>	<b>826,427</b>
Investments in securities	33,325	40,540	31,951	38,913
- Bonds of the Republic of Croatia	29,996	31,359	28,667	29,836
- Corporate bonds	113	172	68	68
- Treasury bills of the Ministry of Finance	3,216	9,009	3,216	9,009
Deposits	490	858	489	858
	<b>733,083</b>	<b>867,825</b>	<b>731,708</b>	<b>866,198</b>

The difference between interest income and interest received or collected (see Statement of Cash Flows) mostly relates to the income in respect to interest subsidies inflows that are recorded upon payment. The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income (see Note 30 Other liabilities) and is recognized in profit or loss on a time basis during the repayment of the loan. Interest income earned on this basis in 2018 amounts to HRK 70,011 thousand (31 December 2017: HRK 99,635 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 7. Interest expense

Interest expense by type of payee:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Domestic financial institutions	5,003	2,246	5,003	2,246
Foreign financial institutions	351,063	388,214	351,063	388,214
	<b>356,066</b>	<b>390,460</b>	<b>356,066</b>	<b>390,460</b>

Interest expense by type of facility:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Borrowings	285,204	276,128	285,204	276,128
Debt securities	70,449	113,340	70,449	113,340
Debt securities	413	992	413	992
	<b>356,066</b>	<b>390,460</b>	<b>356,066</b>	<b>390,460</b>

The difference between interest expense and interest paid (see the Statement of Cash Flows) mostly relates to the changes in the amount of the interest accrued in relation to the prior year and the amortization of discount for issued debt securities.

## 8. Net fee and commission income

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Fee and commission income from contracts with customers:</b>				
Asset management - from managed funds for and on behalf of third parties	13,423	14,201	13,423	14,201
From payment operations	271	526	271	526
Other	12	71	12	71
<b>Total fee and commission income from contracts with customers</b>	<b>13,706</b>	<b>14,798</b>	<b>13,706</b>	<b>14,798</b>
From issued guarantees <sup>19</sup>	28,722	30,741	28,722	30,741
Reinsurance commission income	2,555	2,586	-	-
<b>Total fee and commission income</b>	<b>44,983</b>	<b>48,125</b>	<b>42,428</b>	<b>45,539</b>
Fee and commission expense	(3,778)	(3,144)	(3,778)	(3,144)
<b>Net fee and commission income</b>	<b>41,205</b>	<b>44,981</b>	<b>38,650</b>	<b>42,395</b>

<sup>19</sup> Although income from performance guarantees is recognised in accordance with the principles of IFRS 15, the performance guarantees are in the scope of IAS 37 and the fee income from it is not revenue from contracts with customers. The Group presents the fee income from performance guarantees as part of total fee and commission income.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**9. Net gains/(losses) on financial operations**

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:				
Cash on hand, accounts at banks and due from banks	1,732	(9,680)	1,732	(9,680)
Loans given to financial institutions and other customers	(159,219)	(149,163)	(159,219)	(149,163)
Financial assets at fair value through profit or loss	(4)	(2)	-	-
Debt instruments at amortised cost	(15)	n/a	-	-
Financial assets at fair value through other comprehensive income	(8,695)	n/a	(8,570)	n/a
Assets available for sale	n/a	(9,855)	n/a	(9,764)
Other	1,170	(72)	1,170	(72)
	(165,031)	(168,768)	(164,887)	(168,679)
Net foreign exchange gains/(losses) on foreign currency liabilities:				
Deposits	4,836	322	4,836	322
Borrowings and issued long-term securities	178,007	144,257	178,007	144,257
Other	(1,483)	667	(1,397)	671
	181,360	145,246	181,446	145,250
<b>Net foreign exchange gains/(losses) on foreign currency assets and liabilities</b>	<b>16,329</b>	<b>(23,522)</b>	<b>16,559</b>	<b>(23,429)</b>
currency assets and liabilities	(7,086)	7	(7,020)	-
Realized (losses)/gains on financial assets at fair value through other comprehensive income	(9)	n/a	(33)	n/a
Assets available for sale	n/a	2,799	n/a	2,804
<b>Net gains/(losses) on financial operations</b>	<b>9,234</b>	<b>(20,716)</b>	<b>9,506</b>	<b>(20,625)</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**10. Operating expenses**

Operating expenses can be shown as follows:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
10 a) Employee expenses	93,845	90,055	90,469	86,518
10 b) Depreciation	6,329	7,539	6,284	7,482
10 c) Other expenses	70,726	61,406	64,407	55,432
<i>From what:</i>				
<i>Administration expenses</i>	20,892	15,831	20,376	15,537
<i>Material and services</i>	30,165	34,074	28,541	32,041
<i>Other expenses</i>	19,669	11,501	15,490	7,854
	<b>170,900</b>	<b>159,000</b>	<b>161,160</b>	<b>149,432</b>

Material and services contain audit costs as follows:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Audit services	540	731	366	513
Non-audit services (subproject audit)	33	30	33	30
	<b>573</b>	<b>761</b>	<b>399</b>	<b>543</b>

Other expenses of the Group presented contain changes in technical reserves:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Change in the claims provision	(5,112)	3,685	-	-
Change in the claims provision, reinsurer's share	4,454	(2,204)	-	-
<b>Expenses of insurance operations</b>	<b>(658)</b>	<b>1,481</b>	<b>-</b>	<b>-</b>

Provisions for losses as at 31 December 2018 consisted of reported and unreported losses in the framework proportion 30:70. During 2018, total gross provisions for losses were significantly decreased compared to the end of 2017, because the losses stated in the provisions at the end of 2017 were liquidated and paid during 2018. In 2018, a record amount of losses (HRK 9.8 million) was paid. The Bornhuetter-Ferguson method was used for the gross amount of provisions. The reinsurance share is determined in accordance with the valid terms and conditions of the reinsurance contract.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 11. Impairment loss and provisions

The provision for impairment losses/(gains) on placements may be summarized as follows:

#### a. Impairment loss and provisions on financial instruments in accordance with IFRS 9

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Impairment losses on cash on hand and due from financial institutions	1,625	(2,221)	1,608	(2,221)
Impairment losses on deposits with other banks	1,216	106	1,216	106
Impairment losses on loans to financial institutions	(13,149)	(123,846)	(13,149)	(123,846)
Impairment losses on loans to other customers and interest	(211,161)	337,888	(211,161)	337,888
Modification loss – financial institutions	3,021	n/a	3,021	n/a
Modification loss – other customers	5,543	n/a	5,543	n/a
POCI assets – fair value adjustment at initial recognition	62,368	n/a	62,368	n/a
Impairment of financial assets at fair value through other comprehensive income	2,477	n/a	2,481	n/a
Impairment losses on other assets	20,915	2,195	20,814	1,908
Provisions for commitments	68,931	(11,125)	68,931	(11,125)
<b>Total</b>	<b>(58,214)</b>	<b>202,997</b>	<b>(58,328)</b>	<b>202,710</b>

#### b. Other impairment losses and provisions

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Provision for guarantees	141,180	770	141,180	770
Impairment losses on foreclosed assets	(157)	526	(157)	526
Provision for other liabilities	(16,918)	(9,106)	(16,789)	(9,086)
<b>Total</b>	<b>124,105</b>	<b>(7,810)</b>	<b>124,234</b>	<b>(7,790)</b>
<b>Total</b>	<b>65,891</b>	<b>195,187</b>	<b>65,906</b>	<b>194,920</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 12. Income tax

Based on Article 9 of the Act on the HBOR, the parent company is exempt from income tax. Income tax liabilities arise exclusively from the activities of the other members of the Group.

	Group	
	2018	2017
	HRK '000	HRK '000
<b>Recognised in Income Statement</b>		
Current tax - recognised in Income Statement	(26)	(102)
<b>Income tax</b>	<b>(26)</b>	<b>(102)</b>
<b>Income tax reconciliation</b>		
<b>Profit before tax</b>	<b>204,763</b>	<b>162,303</b>
Profit of the Bank not subject to income tax	(204,328)	(160,783)
<b>Profit before tax subject to income tax</b>	<b>435</b>	<b>1,520</b>
Income tax at 18% rate	-	(54)
Income tax at 12% rate	(24)	(43)
Non-deductible expense	(2)	(5)
<b>Total income tax expense</b>	<b>(26)</b>	<b>(102)</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**13. Cash on hand current accounts with banks**

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK 000	HRK 000	HRK 000	HRK 000
Account with the Croatian National Bank	921,278	1,316,520	921,278	1,316,520
Cash on hand	2	16	2	16
Foreign currency account - domestic banks	6,232	1,544	6,231	1,544
Foreign currency account - foreign banks	18,129	83,924	15,211	83,924
Domestic currency account - domestic banks	444	2,534	-	-
	<b>946,085</b>	<b>1,404,538</b>	<b>942,722</b>	<b>1,402,004</b>
Loss allowances	(1,668)	(858)	(1,651)	(858)
	<b>944,417</b>	<b>1,403,680</b>	<b>941,071</b>	<b>1,401,146</b>

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group				Bank			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	946,083	-	-	<b>946,083</b>	942,720	-	-	<b>942,720</b>
Loss allowances	(1,668)	-	-	<b>(1,668)</b>	(1,651)	-	-	<b>(1,651)</b>
<b>Balance as of 31 December 2018</b>	<b>944,415</b>	-	-	<b>944,415</b>	<b>941,069</b>	-	-	<b>941,069</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**13. Cash on hand current accounts with banks (continued)**

The movements in the loss allowances on amounts due from banks may be summarized as follows:

	Group	Bank
	HRK '000	HRK '000
Balance as of 1 January 2017	3,079	3,079
Increase of loss allowances on amounts due from banks	-	-
Release of loss allowances on amounts due from banks	(2,221)	(2,221)
<b>Balance as of 31 December 2017</b>	<b>858</b>	<b>858</b>
The effect of IFRS 9 (Note 5)	(817)	(817)
<b>Balance as of 1 January 2018</b>	<b>41</b>	<b>41</b>
Increase of loss allowances on amounts due from banks	2,217	2,200
Release of loss allowances on amounts due from banks	(592)	(592)
<i>Total recognised through Income Statement (Note 11)</i>	<i>1,625</i>	<i>1,608</i>
Net foreign exchange gains on loss allowances	2	2
<b>Balance as of 31 December 2018</b>	<b>1,668</b>	<b>1,651</b>

Net foreign exchange gains on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**14. Deposits with other banks**

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Deposits with domestic banks	263,283	29,468	263,283	29,468
Accrued interest	3	24	3	24
	263,286	29,492	263,286	29,492
Loss allowances	(1,361)	(354)	(1,361)	(354)
	261,925	29,138	261,925	29,138

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group				Bank			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	263,286	-	-	263,286	263,286	-	-	263,286
Loss allowances	(1,361)	-	-	(1,361)	(1,361)	-	-	(1,361)
<b>Balance as of 31 December 2018</b>	<b>261,925</b>	<b>-</b>	<b>-</b>	<b>261,925</b>	<b>261,925</b>	<b>-</b>	<b>-</b>	<b>261,925</b>

The movements in the loss allowances on amounts due from banks may be summarized as follows:

	Group	Bank
	HRK '000	HRK '000
Balance as of 1 January 2017	248	248
Increase of loss allowances on deposits with other banks	106	106
Release of loss allowances on deposits with other banks	-	-
<b>Balance as of 31 December 2017</b>	<b>354</b>	<b>354</b>
The effect of IFRS 9 (Note 5)	(202)	(202)
<b>Balance as of 1 January 2018</b>	<b>152</b>	<b>152</b>
Increase of loss allowances on deposits with other banks	1,465	1,465
Release of loss allowances on deposits with other banks	(249)	(249)
<i>Total recognised through Income Statement (Note 11)</i>	1,216	1,216
Net foreign exchange losses on loss allowances	(7)	(7)
<b>Balance as of 31 December 2018</b>	<b>1,361</b>	<b>1,361</b>

Net foreign exchange gains on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**15. Loans to financial institutions**

	Group and Bank	
	31 December 2018	31 December 2017
	HRK '000	HRK '000
Long-term loans under loan programmes	9,695,037	10,868,288
Short-term loans and reverse repo transactions	691,269	236,400
Accrued interest	7,350	27,672
Deferred recognition of loan origination fees	(41,514)	(58,293)
	10,352,142	11,074,067
Loss allowances	(117,154)	(237,926)
	<b>10,234,988</b>	<b>10,836,141</b>

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group and Bank			
	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	10,142,966	158,678	50,498	10,352,142
Loss allowances	(78,126)	(20,941)	(18,087)	(117,154)
<b>Balance as of 31 December 2018</b>	<b>10,064,840</b>	<b>137,737</b>	<b>32,411</b>	<b>10,234,988</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**15. Loans to financial institutions (continued)**

The movements in the loss allowances on loans to financial institutions may be summarized as follows:

	<b>Group and Bank</b>
	<b>HRK '000</b>
Balance as of 1 January 2017	363,317
Increase of loss allowances on loans to financial institutions	7,949
Release of loss allowances on loans to financial institutions	(131,795)
<i>Total recognised through Income Statement (Note 11)</i>	<u>(123,846)</u>
Net foreign exchange losses on loss allowances	(1,438)
Acquisition of immovable property	(1,105)
Loss allowances transferred from loans to other customers	998
<b>Balance as of 31 December 2017</b>	<b><u>237,926</u></b>
The effect of IFRS 9 (Note 5)	(106,906)
<b>Balance as of 1 January 2018</b>	<b><u>131,020</u></b>
Increase of loss allowances on loans to financial institutions	45,560
Release of loss allowances on loans to financial institutions	(58,709)
<i>Total recognised through Income Statement (Note 11)</i>	<u>(13,149)</u>
Net foreign exchange losses on loss allowances	(964)
Loss allowances transferred to loans to other customers	(28)
Unwinding – changes due to the lapse of time	275
<b>Balance as of 31 December 2018</b>	<b><u>117,154</u></b>

Net foreign exchange losses on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**15. Loans to financial institutions (continued)**

Loans to financial institutions, impaired for loss allowances, by purpose of the loan programs:

	<b>Group and Bank</b>	
	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK '000</b>	<b>HRK '000</b>
Loan programme for reconstruction and development of the economy	1,915,895	2,218,744
Export financing	2,448,494	2,935,166
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	1,130,702	1,584,242
Loan programme for small and medium-sized enterprises	4,192,912	4,121,412
Loan programme for war-torn and demolished housing and business facilities	7,034	8,724
Other	691,269	236,400
Accrued interest	7,350	27,672
Deferred recognition of loan fees	(41,514)	(58,293)
	<u>10,352,142</u>	<u>11,074,067</u>
Loss allowances	(117,154)	(237,926)
	<b><u>10,234,988</u></b>	<b><u>10,836,141</u></b>

Average interest rates for total loans to financial institutions are stated at 0.74% (31 December 2017: 0.90%) and are equal to average interests rates for loans under HBOR loan programmes excluding the liquidity reserve.

Average interest rates reflect the ratio of interest income generated from the mentioned placements and average assets.

Item "Other" refers to reverse repo agreements in the total amount of HRK 691,269 thousand (31 December 2017: HRK 236,400 thousand). The above placements are collateralized by securities in the amount of HRK 737,701 thousand (31 December 2017: HRK 249,727 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**16. Loans to other costumers**

Loans to other customers, impaired for loss allowances, may be summarized by sectors as follows:

	Group and Bank	
	31 December 2018	31 December 2017
	HRK '000	HRK '000
Domestic companies	10,252,669	11,294,141
State-owned companies	1,103,711	1,260,227
Public sector	2,995,506	1,744,426
Foreign companies	787,639	316,005
Non-profit institutions	5,902	3,407
Other	588,164	653,179
Accrued interest	251,405	101,042
Deferred recognition of loan origination fees	(94,014)	(113,501)
	<u>15,890,982</u>	<u>15,258,926</u>
Loss allowances	(3,380,296)	(2,875,303)
	<u><b>12,510,686</b></u>	<u><b>12,383,623</b></u>

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group and Bank				
	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	9,760,653	1,636,528	4,198,058	295,743	<b>15,890,982</b>
Loss allowances	(351,878)	(494,557)	(2,469,639)	(64,222)	<b>(3,380,296)</b>
<b>Balance as of 31 December 2018</b>	<u><b>9,408,775</b></u>	<u><b>1,141,971</b></u>	<u><b>1,728,419</b></u>	<u><b>231,521</b></u>	<u><b>12,510,686</b></u>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**16. Loans to other costumers (continued)**

The movements in the loss allowances on loans to other customers may be summarized as follows:

	Group and Bank
	HRK '000
Balance as of 1 January 2017	2,579,501
Increase of loss allowances on loans to other customers and interest	553,952
Release of loss allowances on loans to other customers and interest	(216,064)
<i>Total recognised through Income Statement (Note 11)</i>	<u>337,888</u>
Net foreign exchange losses on loss allowances	(3,643)
Acquisition of immovable property	(284)
Write-offs	(7,610)
Sale of receivables	(31,636)
Loss allowances transferred to loans to financial institutions	(998)
Other	2,085
<b>Balance as of 31 December 2017</b>	<u><b>2,875,303</b></u>
The effect of IFRS 9 (Note 5)	717,902
<b>Balance as of 1 January 2018</b>	<u><b>3,593,205</b></u>
Increase of loss allowances on loans to other customers and interest	1,137,393
Release of loss allowances on loans to other customers and interest	(1,348,554)
<i>Total recognised through Income Statement (Note 11)</i>	<u>(211,161)</u>
Net foreign exchange losses on loss allowances	(15,114)
Write-offs	(43,258)
Loss allowances transferred from loans to financial institutions	28
Unwinding – changes due to the lapse of time	57,089
Acquisition of immovable property	(989)
Interest transferred from the off-balance sheet records	496
<b>Balance as of 31 December 2018</b>	<u><b>3,380,296</b></u>

Net foreign exchange losses on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**16. Loans to other costumers (continued)**

Loans to other customers, net of loss allowances, may be summarized by loan programme as follows:

	Group and Bank	
	31 December 2018	31 December 2017
	HRK '000	HRK '000
Loan programme for reconstruction and development of the economy	3,588,290	4,546,833
Export financing	5,428,712	5,274,935
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	3,771,861	3,392,439
Loan programme for small and medium-sized enterprises	1,818,620	2,010,315
Other	1,126,108	46,863
Accrued interest	251,405	101,042
Deferred recognition of loan origination fees	(94,014)	(113,501)
	<u>15,890,982</u>	<u>15,258,926</u>
Loss allowances	(3,380,296)	(2,875,303)
	<u><b>12,510,686</b></u>	<u><b>12,383,623</b></u>

Average interest rates on loans to other customers are stated at 1.79% (31 December 2017: 2.08%).  
Average interest rates reflect the ratio of interest income from generated the mentioned placements and average assets.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**17. Financial assets at fair value through profit or loss**

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Loans at FVPL:</b>				
Mezzanine loans	2,045	n/a	2,045	n/a
	<u>2,045</u>	<u>n/a</u>	<u>2,045</u>	<u>n/a</u>
<b>Ulaganja u investicijske fondove:</b>				
Investments in investment funds at FVTPL	334,060	291	328,597	-
	<u>334,060</u>	<u>291</u>	<u>328,597</u>	<u>-</u>
<b>Listed equity instruments:</b>				
Investments in corporate shares	-	n/a	-	n/a
	<u>-</u>	<u>n/ap</u>	<u>-</u>	<u>n/a</u>
<b>Unlisted equity instruments:</b>				
Investments in corporate shares	-	n/a	-	n/a
Investments in financial institutions' shares	161	n/a	161	n/a
	<u>161</u>	<u>n/a</u>	<u>161</u>	<u>n/a</u>
	<u><b>336,266</b></u>	<u><b>291</b></u>	<u><b>330,803</b></u>	<u><b>n/a</b></u>

On 7 September 2018, the Management Board accepted the Bid for takeover of the company Brodogradilište Viktor Lenac d.d., Rijeka and offered price from the Bid was accepted in the amount of HRK 9.26 per share for the package of 1,367,268 shares of the Company owned by HBOR, in the nominal amount of HRK 10.00 per share. The shares were acquired under the restructuring measures of this company in exchange for a part of placement (31 December 2017: HRK 18.951 thousand; classified as Assets Available for Sale). On 24 September 2018, payment was received in respect of the sales of the mentioned shares in the amount of HRK 12,661 thousand.

Shares of companies that are not listed relate to the shares of the company Vinka d.d. for the production of agricultural products acquired through company restructuring measures in replacement of a portion of placements. The percentage of HBOR's share in the equity of the company Vinka d.d., Vinkovci representing a 0.9365%. The shares of the company Vinka d.d., Vinkovci (LPVC-R-B) are not listed and the fair value is estimated to be HRK 0 thousand (31 December 2017: HRK 0 thousand; shares classified as assets available for sale).

The shares of financial institutions that are not listed relate to the shares of Tržište novca i kratkoročnih vrijednosnica d.d. (Money Market and Short-Term Securities) and are stated in the amount of HRK 161 thousand (31 December 2017: HRK 161 thousand; classified as Assets Available for Sale).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**18. Financial assets at fair value through other comprehensive income**

	Group			Bank
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Republic of Croatia	1,124,611	n/a	1,088,457	n/a
Corporate bonds	770	n/a	-	n/a
Treasury bills of the Ministry of Finance	1,666,299	n/a	1,666,299	n/a
Accrued interest	11,313	n/a	10,839	n/a
	<b>2,802,993</b>	<b>n/a</b>	<b>2,765,595</b>	<b>n/a</b>
<b>Unlisted debt instruments:</b>				
Corporate bonds	535	n/a	535	n/a
Accrued interest	233	n/a	233	n/a
	<b>768</b>	<b>n/a</b>	<b>768</b>	<b>n/a</b>
<b>Equity instruments:</b>				
<b>Unlisted equity instruments:</b>				
Investments in shares of foreign legal entities - SWIFT	38	n/a	38	n/a
Shares of foreign financial institutions – EIF	25,671	n/a	25,671	n/a
	<b>25,709</b>	<b>n/a</b>	<b>25,709</b>	<b>n/a</b>
	<b>2,829,470</b>	<b>n/a</b>	<b>2,792,072</b>	<b>n/a</b>

The following table sets out information about the credit quality of financial assets measured at FVOCI. The amounts in the table represent gross carrying amounts:

	Group				Bank			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	2,802,223	770	768	2,803,761	2,765,595	-	768	2,766,363
<b>Balance as of 31 December 2018</b>	<b>2,802,223</b>	<b>770</b>	<b>768</b>	<b>2,803,761</b>	<b>2,765,595</b>	<b>-</b>	<b>768</b>	<b>2,766,363</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**18. Financial assets at fair value through other comprehensive income (continued)**

Changes in the loss allowances of financial assets at fair value through other comprehensive income, do not impair the carrying value of financial assets, may be summarized as follows:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January 2018 – The effect of IFRS 9 (Note 5)	4,288	n/a	3,997	n/a
Increase of loss allowances	5,325	n/a	5,325	n/a
Release of loss allowances	(2,848)	n/a	(2,844)	n/a
<i>Total recognised through Income Statement (Note 11)</i>	<i>2,477</i>	<i>n/a</i>	<i>2,481</i>	<i>n/a</i>
Net foreign exchange losses on loss allowances	(19)	n/a	(19)	n/a
<b>Balance as of 31 December 2018</b>	<b>6,746</b>	<b>n/a</b>	<b>6,459</b>	<b>n/a</b>

Net foreign exchange losses on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**18. Financial assets at fair value through other comprehensive income (continued)**

The following text contains investment breakdown:

	Date of issue	Date of maturity	Interest rate (%)	Group		Bank	
				31 December 2018	31 December 2017	31 December 2018	31 December 2017
				HRK '000	HRK '000	HRK '000	HRK '000
<b>Listed debt instruments:</b>							
<b>Debt instruments:</b>							
<i>Bonds of the Republic of Croatia with a currency clause:</i>							
RHMF-O-19BA	29.11.2004.	29.11.2019.	5.375	44,711	n/a	43,777	n/a
RHMF-O-227E	22.7.2011.	22.7.2022.	6.5	169,815	n/a	169,815	n/a
RHMF-O-247E	10.7.2013.	10.7.2024.	5.75	18,083	n/a	12,728	n/a
RHMF-O-203E	5.3.2010.	5.3.2020.	6.5	797	n/a	-	-
<i>Bonds of the Republic of Croatia in foreign currency:</i>							
XS1117298916	11.3.2015.	11.3.2025.	3.0	55,867	n/a	55,867	n/a
<i>Bonds of the Republic of Croatia in foreign currency:</i>							
RHMF-O-203A	5.3.2010.	5.3.2020.	6.75	35,074	-	32,270	-
RHMF-O-257A	9.7.2015.	9.7.2025.	4.5	9,861	-	-	-
RHMF-O-26CA	14.12.2015.	14.12.2026.	4.25	44,544	n/a	35,261	n/a
RHMF-O-217A	8.7.2016.	8.7.2021.	2.75	229,636	n/a	227,522	n/a
RHMF-O-222A	7.2.2017.	7.2.2022.	2.25	73,106	n/a	73,106	n/a
RHMF-O-282A	7.2.2017.	7.2.2028.	2.875	12,653	n/a	10,641	n/a
RHMF-O-023BA	27.11.2017.	27.11.2023.	1.75	427,470	n/a	427,470	n/a
RHMF-O-297A	9.7.2018.	9.7.2029.	2.38	2,994	n/a	-	n/a
<i>Corporate bonds in HRK:</i>							
JDGL-O-20CA	21.12.2015.	21.12.2020.	5.81	770	n/a	-	-
Treasury bills in HRK up to 364 days			0.214 - 0.387	1,369,700	n/a	1,369,700	n/a
Treasury bills in foreign currency up to 455 days			0.093	296,599	n/a	296,599	n/a
Accrued interest				11,313	n/a	10,839	n/a
				<b>2,802,993</b>	<b>n/a</b>	<b>2,765,595</b>	<b>n/a</b>
<b>Unlisted debt instruments:</b>							
<i>Corporate bonds with a currency clause:</i>							
LNGU-O-31AE	24.7.2015.	15.10.2031.	4.5	535	n/a	535	n/a
Accrued interest				233	n/a	233	n/a
				768	n/a	768	n/a
<b>Equity instruments:</b>							
<i>Unlisted equity instruments:</i>							
Investments in shares of foreign legal entities - SWIFT				38	n/a	38	n/a
Investments in shares of foreign financial institutions - EIF				25,671	n/a	25,671	n/a
				<b>25,709</b>	<b>n/a</b>	<b>25,709</b>	<b>n/a</b>
				<b>2,829,470</b>	<b>n/a</b>	<b>2,792,072</b>	<b>n/a</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**19. Debt instruments at amortised cost**

	Group			Bank
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Republic of Croatia	1,352	n/a	-	n/a
Accrued interest	13	n/a	-	n/a
	<b>1,365</b>	<b>n/a</b>	<b>-</b>	<b>n/a</b>
Loss allowances	(2)	n/a	-	n/a
	<b>1,363</b>	<b>n/a</b>	<b>-</b>	<b>n/a</b>

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group				Bank			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	1,365	-	-	<b>1,365</b>	-	-	-	-
Loss allowances	(2)	-	-	<b>(2)</b>	-	-	-	-
<b>Balance as of 31 December 2018</b>	<b>1,363</b>	<b>-</b>	<b>-</b>	<b>1,363</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

The movements in the loss allowances on debt instruments at amortised cost may be summarized as follows:

	Group			Bank
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January 2018 – The effect of IFRS 9 (Note 5)	2	n/a	-	n/a
<b>Balance as of 31 December 2018</b>	<b>2</b>	<b>n/a</b>	<b>-</b>	<b>n/a</b>

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203E) issued with foreign currency clause on 5 March 2010 are repayable over 10 years with an interest rate of 6.5%. As of 31 December 2018, the value of these outstanding bonds amounted to HRK 454 thousand (31 December 2017: HRK 467 thousand; classified as Assets held to maturity).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-19BA) issued with foreign currency clause on 29 November 2004 are repayable over 15 years with an interest rate of 5.375%. As of 31 December 2018, the value of these outstanding bonds amounted to HRK 898 thousand (31 December 2017: HRK 918 thousand; classified as Assets held to maturity).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 20. Assets available for sale

Below we give an overview of investments in financial instruments as at 31 December 2017, pursuant to IAS 39 that have been reclassified to Financial assets at fair value through other comprehensive income and Financial assets at fair value through profit and loss according to IFRS 9:

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Republic of Croatia	n/a	884,763	n/a	846,428
Corporate bonds	n/a	770	n/a	-
Treasury bills of the Ministry of Finance	n/a	1,583,313	n/a	1,583,313
Accrued interest	n/a	13,836	n/a	13,269
	<b>n/a</b>	<b>2,482,682</b>	<b>n/a</b>	<b>2,443,010</b>
<b>Unlisted debt instruments:</b>				
Corporate bonds	n/a	522	n/a	522
Accrued interest	n/a	167	n/a	167
	<b>n/a</b>	<b>689</b>	<b>n/a</b>	<b>689</b>
<b>Equity instruments:</b>				
<b>Listed equity instruments:</b>				
Investments in companies' shares	n/a	18,951	n/a	18,951
	<b>n/a</b>	<b>18,951</b>	<b>n/a</b>	<b>18,951</b>
<b>Unlisted equity instruments:</b>				
Investments in shares of foreign legal entities	n/a	35	n/a	35
Investments in financial institutions' shares	n/a	161	n/a	161
Shares of foreign financial institutions -EIF	n/a	25,427	n/a	25,427
Investments in companies' shares	n/a	16,725	n/a	16,725
Impairment losses	n/a	(16,725)	n/a	(16,725)
	<b>n/a</b>	<b>25,623</b>	<b>n/a</b>	<b>25,623</b>
<b>Investments in investment funds:</b>				
Shares classified as assets available for sale	n/a	793,619	n/a	788,921
	<b>n/a</b>	<b>793,619</b>	<b>n/a</b>	<b>788,921</b>
<b>Total</b>	<b>n/a</b>	<b>3,321,564</b>	<b>n/a</b>	<b>3,277,194</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 21. Assets held to maturity

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Republic of Croatia	n/a	1,385	n/a	-
Accrued interest	n/a	14	n/a	-
<b>Total</b>	<b>n/a</b>	<b>1,399</b>	<b>n/a</b>	<b>-</b>

## 22. Investments in subsidiaries

As at 31 December 2018, the Bank's subsidiaries are as follows:

Consolidated company	Activity	Ownership 31 December 2018	Ownership 31 December 2017	Investment 31 December 2018	Investment 31 December 2017
<b>Direct share</b>					
Hrvatsko kreditno osiguranje d.d. Zagreb, Republic of Croatia	Providing insurance for company's foreign and domestic short-term receivables regarding shipments of goods and services	100%	100%	36,124	36,124
<b>Total</b>				<b>36,124</b>	<b>36,124</b>

Result of the subsidiary has been disclosed in Appendix – Financial performance of the HKO Group.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**23. Investments in associates**

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Investments in associates	17,500	21,873	17,500	21,873
Value adjustments	(17,500)	(21,873)	(17,500)	(21,873)
	-	-	-	-

Investments in associates were carried out within a Program of investments in the equity of companies – small and medium sized entrepreneurs or pursuant to single decisions of authorized bodies of HBOR. The investments were made for a period ranging from 4 to 6 years with the right of HBOR to sell the shares after the contracted term of holding an equity stake.

	Line of business	% ownership in 2018	% ownership in 2017
THC d.o.o., Obrovac	Production of metal products	38.45%	38.45%
Tri D Drvo d.o.o., Vrhovine, in bankruptcy	Wood processing, production of wood products	-	26.00%
Pounje d.d., Hrvatska Kostajnica	Textile industry – clothes production	13.55%	13.55%
Metal-Sint Oklaj d.d., Oklaj	Metal industry sintered products and composed material production	40.84%	40.84%

The value of investment was 100% adjusted in prior years due to assessed non-recoverability of the investment.

By the Decision of the Management Board of 11 May 2018, the share in the company Tri D Drvo d.o.o., Vrhovine in bankruptcy was derecognised in the amount of HRK 4,373 thousand burdening the impairment, the bankruptcy proceedings completed and the company deleted from the court register.

Changes in provisions for possible losses from investments in associates can be presented as follows:

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	21,873	23,687	21,873	23,687
Decrease of provisions for possible losses from investments in associates due to derecognition	-	(1,814)	-	(1,814)
Write-offs due to the conclusion of the bankruptcy proceedings	(4,373)	-	(4,373)	-
<b>Balance as at 31 December</b>	<b>17,500</b>	<b>21,873</b>	<b>17,500</b>	<b>21,873</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**24. Property, plant and equipment and intangible assets**

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
<b>2018</b>							
Cost							
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,977</b>	<b>15,381</b>	<b>708</b>	<b>103,168</b>	<b>28,652</b>	<b>131,820</b>
Additions	-	47	-	3,470	3,517	24	3,541
Transfer from assets not yet ready for use	-	780	821	(3,282)	(1,681)	1,681	-
Disposals and write-offs	-	(1,091)	(1,099)	-	(2,190)	-	(2,190)
<b>At 31 December 2018</b>	<b>77,102</b>	<b>9,713</b>	<b>15,103</b>	<b>896</b>	<b>102,814</b>	<b>30,357</b>	<b>133,171</b>
Accumulated depreciation and write-off							
<b>At 31 December 2017</b>	<b>30,481</b>	<b>9,206</b>	<b>13,941</b>	<b>-</b>	<b>53,628</b>	<b>24,635</b>	<b>78,263</b>
Depreciation for 2018	2,336	431	627	-	3,394	2,871	6,265
Disposals and write-offs	-	(1,091)	(1,098)	-	(2,189)	-	(2,189)
<b>At 31 December 2018</b>	<b>32,817</b>	<b>8,546</b>	<b>13,470</b>	<b>-</b>	<b>54,833</b>	<b>27,506</b>	<b>82,339</b>
<b>Net book value at 31 December 2018</b>	<b>44,285</b>	<b>1,167</b>	<b>1,633</b>	<b>896</b>	<b>47,981</b>	<b>2,851</b>	<b>50,832</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>771</b>	<b>1,440</b>	<b>708</b>	<b>49,540</b>	<b>4,017</b>	<b>53,557</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**24. Property, plant and equipment and intangible assets (continued)**

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>							
Cost							
<b>At 31 December 2016</b>	<b>77,102</b>	<b>9,977</b>	<b>15,381</b>	<b>708</b>	<b>103,168</b>	<b>28,652</b>	<b>131,820</b>
Additions	-	-	-	3,736	3,736	-	3,736
Transfer from assets not yet ready for use	-	624	370	(4,064)	(3,070)	3,070	-
Disposals and write-offs	-	(1,865)	(225)	-	(2,090)	-	(2,090)
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,977</b>	<b>15,381</b>	<b>708</b>	<b>103,168</b>	<b>28,652</b>	<b>131,820</b>
Accumulated depreciation and write-off							
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,682</b>	<b>13,173</b>	-	<b>51,000</b>	<b>21,869</b>	<b>72,869</b>
Depreciation for 2017	2,336	1,381	992	-	4,709	2,766	7,475
Disposals and write-offs	-	(1,857)	(224)	-	(2,081)	-	(2,081)
<b>At 31 December 2017</b>	<b>30,481</b>	<b>9,206</b>	<b>13,941</b>	-	<b>53,628</b>	<b>24,635</b>	<b>78,263</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>771</b>	<b>1,440</b>	<b>708</b>	<b>49,540</b>	<b>4,017</b>	<b>53,557</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,536</b>	<b>2,063</b>	<b>1,036</b>	<b>53,592</b>	<b>3,713</b>	<b>57,305</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**24. Property, plant and equipment and intangible assets (continued)**

Bank	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2018</b>							
Cost							
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,589</b>	<b>15,177</b>	<b>707</b>	<b>102,575</b>	<b>28,013</b>	<b>130,588</b>
Additions	-	-	-	3,470	3,470	-	3,470
Transfer from assets not ready for use	-	780	821	(3,282)	(1,681)	1,681	-
Disposals and write-offs	-	(1,091)	(1,086)	-	(2,177)	-	(2,177)
<b>At 31 December 2018</b>	<b>77,102</b>	<b>9,278</b>	<b>14,912</b>	<b>895</b>	<b>102,187</b>	<b>29,694</b>	<b>131,881</b>
Accumulated depreciation and write-off							
<b>At 31 December 2017</b>	<b>30,481</b>	<b>8,823</b>	<b>13,769</b>	-	<b>53,073</b>	<b>24,001</b>	<b>77,074</b>
Depreciation for 2018	2,336	407	614	-	3,357	2,863	6,220
Disposals and write-offs	-	(1,091)	(1,086)	-	(2,177)	-	(2,177)
<b>At 31 December 2018</b>	<b>32,817</b>	<b>8,139</b>	<b>13,297</b>	-	<b>54,253</b>	<b>26,864</b>	<b>81,117</b>
<b>Net book value at 31 December 2018</b>	<b>44,285</b>	<b>1,139</b>	<b>1,615</b>	<b>895</b>	<b>47,934</b>	<b>2,830</b>	<b>50,764</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>766</b>	<b>1,408</b>	<b>707</b>	<b>49,502</b>	<b>4,012</b>	<b>53,514</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**24. Property, plant and equipment and intangible assets (continued)**

Bank	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>							
Cost							
<b>At 31 December 2016</b>	<b>77,102</b>	<b>10,830</b>	<b>15,034</b>	<b>1,036</b>	<b>104,002</b>	<b>24,951</b>	<b>128,953</b>
Additions	-	-	-	3,725	3,725	-	3,725
Transfer from assets not ready for use	-	624	368	(4,054)	(3,062)	3,062	-
Disposals and write-offs	-	(1,865)	(225)	-	(2,090)	-	(2,090)
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,589</b>	<b>15,177</b>	<b>707</b>	<b>102,575</b>	<b>28,013</b>	<b>130,588</b>
Accumulated depreciation and write-off							
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,329</b>	<b>13,016</b>	<b>-</b>	<b>50,490</b>	<b>21,247</b>	<b>71,737</b>
Depreciation for 2017	2,336	1,351	977	-	4,664	2,754	7,418
Disposals and write-off	-	(1,857)	(224)	-	(2,081)	-	(2,081)
<b>At 31 December 2017</b>	<b>30,481</b>	<b>8,823</b>	<b>13,769</b>	<b>-</b>	<b>53,073</b>	<b>24,001</b>	<b>77,074</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>766</b>	<b>1,408</b>	<b>707</b>	<b>49,502</b>	<b>4,012</b>	<b>53,514</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,501</b>	<b>2,018</b>	<b>1,036</b>	<b>53,512</b>	<b>3,704</b>	<b>57,216</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**25. Foreclosed assets**

	Group			Bank
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Foreclosed assets	25,330	16,697	25,330	16,697
	<b>25,330</b>	<b>16,697</b>	<b>25,330</b>	<b>16,697</b>

In 2018, acquisition of property took place with present value in the amount of HRK 8,538 thousand, acquisition value of HRK 10,195 thousand and provisions of HRK 1,657 thousand, and relates to land plot in the amount of HRK 2,286 thousand, acquisition value of HRK 2,584 thousand and provisions of HRK 298 thousand and buildings in the amount of HRK 6,252 thousand, acquisition value of HRK 7,611 thousand and provisions of HRK 1,359 thousand (in 2017, acquisition of property took place with present value of HRK 154 thousand, acquisition value of HRK 1,827 thousand and provisions of HRK 1,673 thousand and relates to land plot). Fair value of acquired property at the end of 2018 amounted to HRK 10,579 thousand.

In 2018, sale of foreclosed assets took place with present value in the amount of HRK 0 thousand, acquisition value and provisions of HRK 19 thousand, and relates to movable property (in 2017, sale of foreclosed assets took place in the amount of HRK 317 thousand, which relates to land plot in the amount of HRK 27 thousand and buildings in the amount of HRK 290 thousand).

In 2018, foreclosed assets was transferred to lease on the item Investments in property in the amount of HRK 1,743 thousand (2017: HRK 1,807 thousand), which is presented under Other assets due to immaterial significance. In 2018, this property was depreciated in the amount of HRK 64 thousand.

The fair value of foreclosed assets at the beginning of the reporting period stood at HRK 27,773 thousand and the end of the reporting period at HRK 38,261 thousand.

Adjustment decrease amount for the Group and the Bank that has an effect on the Statement of Profit or Loss stood at HRK 157 thousand in 2018 (in 2017: increase of HRK 526 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**26. Other assets**

	Group			Bank
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Fees receivable	27,161	9,363	27,161	9,363
Other receivables	11,070	9,511	10,904	9,365
Prepaid expenses	3,002	2,146	3,002	2,146
Accrued income	6,437	6,113	6,437	6,113
Premium receivables	7,371	6,318	-	-
Receivables for reinsurance commissions	867	583	-	-
Receivables for risk assessment fees	371	259	-	-
Deferred tax assets	-	231	-	-
Other assets	1,543	1,684	1,543	1,685
	<b>57,822</b>	<b>36,208</b>	<b>49,047</b>	<b>28,672</b>
Loss allowances	(34,118)	(6,737)	(33,883)	(6,446)
	<b>23,704</b>	<b>29,471</b>	<b>15,164</b>	<b>22,226</b>

The following table sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

	Group				Bank			
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000	HRK 000
Gross amount	11,596	12	35,232	<b>46,840</b>	2,821	12	35,232	<b>38,065</b>
Loss allowances	(281)	-	(33,837)	<b>(34,118)</b>	(46)	-	(33,837)	<b>(33,883)</b>
<b>Balance as of 31 December 2018</b>	<b>11,315</b>	<b>12</b>	<b>1,395</b>	<b>12,722</b>	<b>2,775</b>	<b>12</b>	<b>1,395</b>	<b>4,182</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**26. Other assets (continued)**

The following text contains the breakdown of positions stated as credit risk:

	Group			Bank
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Fees receivable	27,161	9,363	27,161	9,363
Other receivables	11,070	9,511	10,904	9,365
Premium receivables	7,371	6,318	-	-
Receivables for reinsurance commissions	867	583	-	-
Receivables for risk assessment fees	371	259	-	-
Loss allowance	(34,118)	(6,737)	(33,883)	(6,446)
<b>Subtotal – credit risk</b>	<b>12,722</b>	<b>19,297</b>	<b>4,182</b>	<b>12,282</b>

The movements in the loss allowances on other assets may be summarized as follows:

	Group	Bank
	HRK 000	HRK 000
Balance as at 1 January 2017	4,541	4,537
Increase of loss allowances on other assets	2,756	2,399
Release of loss allowances on other assets	(561)	(491)
<i>Total recognised through Income Statement (Note 11)</i>	<b>2,195</b>	<b>1,908</b>
Write-offs	(1)	(1)
Other adjustments	2	2
<b>Balance as of 31 December 2017</b>	<b>6,737</b>	<b>6,446</b>
The effect of IFRS 9 (Note 5)	6,664	6,641
Other	(178)	-
<b>Balance as of 1 January 2018</b>	<b>13,223</b>	<b>13,087</b>
Increase of loss allowances on other assets	27,356	27,157
Release of loss allowances on other assets	(6,441)	(6,343)
<i>Total recognised through Income statement (Note 11)</i>	<b>20,915</b>	<b>20,814</b>
Write-offs	(10)	(10)
Acquisition of immovable property	(14)	(14)
Net foreign exchange gains on loss allowances	6	6
Other	(2)	-
<b>Balance as of 31 December 2018</b>	<b>34,118</b>	<b>33,883</b>

Net foreign exchange gains on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 27. Deposits from customers

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Bank deposits	149,140	489,364	149,140	489,364
Foreign currency regular accounts of companies	6	6	6	6
Foreign currency account of the Ministry of Finance of the Republic of Croatia	22,593	31,250	22,593	31,250
Foreign currency special purpose accounts of the companies	10,725	27,237	10,725	27,237
State institutions' deposits	237,972	88,179	237,972	88,179
Other deposits	8,660	8,705	8,660	8,705
	<b>429,096</b>	<b>644,741</b>	<b>429,096</b>	<b>644,741</b>

Bank deposits in 2018 relate to loro deposit of UniCredit Bank Austria AG, and in 2017 mostly to loro deposit of the European Investment Bank (EIB).

The foreign currency account of the Ministry of Finance of the Republic of Croatia relates to the Export Insurance Guarantee Fund comprising of reinsurance premiums paid for export insurance operations of HRK 9,693 thousand (31 December 2017: HRK 18,747 thousand), grant funds provided by the Global Environment Facility (GEF) aimed at the Renewable Energy Resources Project of HRK 7,078 thousand (31 December 2017: HRK 6,860 thousand), the grant funds provided by the GEF aimed at the Programme of issuing bank guarantees for energy efficiency projects within the Energy Efficiency Project of HRK 5,822 thousand (31 December 2017: HRK 5,643 thousand), all managed by HBOR for and on behalf of the Republic of Croatia.

State institutions' demand deposits relate to the Bank's operations carried out for and on behalf of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development, EU Funds, the company Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs, Innovations and Investments ("HAMAG-BICRO").

Foreign currency special purpose accounts of the companies relate to the inflow of funds and disposition of the advance payment funds paid to the company's account in relation to the issued guarantees of HBOR for the repayment of advance for export transactions. The funds of the advance are used exclusively for the specified purpose of implementation of an export contract, with the consent of HBOR.

HBOR does not pay interest on the above deposits.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

## 28. Borrowings

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	15,399,788	13,378,057	15,399,788	13,378,057
New borrowings	2,284,763	3,849,787	2,284,763	3,849,787
Repayments	(2,658,936)	(1,729,575)	(2,658,936)	(1,729,575)
Net foreign exchange gains	(162,189)	(98,481)	(162,189)	(98,481)
	<b>14,863,426</b>	<b>15,399,788</b>	<b>14,863,426</b>	<b>15,399,788</b>
Accrued interest	55,014	63,737	55,014	63,737
Deferred fees	(40,453)	(75,644)	(40,453)	(75,644)
	<b>14,877,987</b>	<b>15,387,881</b>	<b>14,877,987</b>	<b>15,387,881</b>

The bank is subject to various financial clauses from the Contract. During 2018 and as of 31 December 2018 the Bank was in compliance with all required financial clauses from the Contract.

## 29. Debt securities issued

The book value of bonds includes interest.

Group and Bank	Effective interest rate	Fair value	Net book value	Fair value	Net book value
		31 December 2018	31 December 2018	31 December 2017	31 December 2017
		HRK '000	HRK '000	HRK '000	HRK '000
Bonds EUR 150 million	6.37	1,190,721	1,107,413	1,255,316	1,118,122
Accrued interest		-	43,347	-	43,909
Deferred fees		-	(203)	-	(332)
		<b>1,190,721</b>	<b>1,150,557</b>	<b>1,255,316</b>	<b>1,161,699</b>

The fair value of bonds issued by HBOR is presented by using level 2 inputs corroborated by the market and observable at Bloomberg service on the basis of the mid-rate of Bloomberg Generic prices (BGN).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**30. Other liabilities**

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Deferred recognition of interest income	226,064	314,271	226,064	314,271
Liabilities in respect of subsidized interest	120,726	107,262	120,726	107,262
Provisions for guarantees and commitments	261,283	64,360	261,283	64,360
Provisions for other liabilities	60,208	76,980	60,078	76,723
Accrued salaries	7,405	6,997	7,218	6,660
Liabilities to suppliers	2,766	1,393	2,662	1,261
Liabilities for prepaid receivables	2,378	2,759	2,378	2,759
Deferrable premium	2,880	2,925	-	-
Provisions for claims	4,527	5,235	-	-
Provisions for return premiums	791	642	-	-
Liabilities to re-insurers	2,407	1,165	-	-
Deferred tax liabilities	669	889	-	-
Other liabilities	8,130	20,575	6,866	19,355
	<b>700,234</b>	<b>605,453</b>	<b>687,275</b>	<b>592,651</b>

Liabilities in respect of subsidized interest represent advances taken in respect of interest subsidies on loans, which are provided for final customers at a lower interest rate in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia. These liabilities include:

- HRK 120,433 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (31 December 2017: HRK 107,262 thousand) and
- HRK 293 thousand in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet – Ministry of Agriculture – interest subsidy (31 December 2017: HRK 0 thousand),

Deferred recognition of interest income of HRK 226,064 thousand (31 December 2017: HRK 314,271 thousand) consists of state subsidies for interest in respect of loans which are provided and drawn down by final borrowers at lower interest rates but are not yet in repayment stage, amounting to HRK 7,694 thousand (31 December 2017: HRK 11,305 thousand), and in respect of those already in repayment stage amounting to HRK 218,370 thousand (31 December 2017: HRK 302,966 thousand) (see Note 4).

Provisions for guarantees and commitments represent the best estimation of the outflow for settlement of the outstanding liabilities at the Statement of Financial Position date and are determined in accordance with IAS 37 – Provisions, contingent liabilities and contingent assets.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**30. Other liabilities (continued)**

Out of the total provisions for guarantees and commitments, HRK 2,444 thousand relates to financial institutions (31 December 2017: HRK 20,653 thousand), HRK 258,622 thousand relates to domestic companies (31 December 2017: HRK 36,604 thousand), HRK 0 thousand relates to state-owned companies (31 December 2017: HRK 1,153 thousand), HRK 147 thousand relates to the public sector (31 December 2017: HRK 4,291 thousand), HRK 70 thousand relates to other liabilities (31 December 2017: HRK 195 thousand), HRK 0 thousand to foreign legal entities (31 December 2017: HRK 1,439 thousand) and HRK 0 thousand to non-profit institutions (31 December 2017: HRK 25 thousand).

Movements in the provision for guarantees, commitments and other liabilities may be summarized as follows:

	Group	Bank
	HRK '000	HRK '000
<b>Balance as at 1 January 2017</b>	75,103	75,103
Increase in provision for guarantees and commitments	11,523	11,523
Release in provision for guarantees and commitments	(21,878)	(21,878)
Net foreign exchange differences on loss allowances	(388)	(388)
<b>Balance as of 31 December 2017 - Provision for guarantees and commitments</b>	<b>64,360</b>	<b>64,360</b>
The effect of IFRS 9 (Note 5)	(15,013)	(15,013)
<b>Balance as at 1 January 2018</b>	<b>49,347</b>	<b>49,347</b>
Increase in provision for guarantees and commitments	343,304	343,304
Release in provision for guarantees and commitments	(133,193)	(133,193)
<i>Total recognised through Income Statement (Note 11)</i>	<i>210,111</i>	<i>210,111</i>
Net foreign exchange differences on loss allowances	1,825	1,825
<b>Balance as at 31 December 2018 – Provision for guarantees and commitments</b>	<b>261,283</b>	<b>261,283</b>
<b>Balance as at 1 January 2018</b>	<b>76,980</b>	<b>76,723</b>
Increase in provision for other liabilities	19,192	19,082
Release in provision for other liabilities	(36,110)	(35,871)
<i>Total reconised through Income Statement (Note 11)</i>	<i>(16,918)</i>	<i>(16,789)</i>
Unrealized actuarial gains	144	144
Other	2	-
<b>Balance as at 31 December 2018 – Provision for other liabilities</b>	<b>60,208</b>	<b>60,078</b>

Net foreign exchange gains/(losses) on loss allowances are shown within net gains/ (losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 30. Other liabilities (continued)

In 2018, provisions for other liabilities for the Group totalled HRK 60,208 thousand (31 December 2017: HRK 76,980 thousand) and for the Bank stood at HRK 60,078 thousand (31 December 2017: HRK 76,723 thousand). The total amount of provisions for other liabilities was comprised of HRK 6,787 thousand for court proceedings initiated against the Bank (31 December 2017: HRK 24,929 thousand), HRK 28,494 thousand for liabilities for the Group and for the Bank based on benefits defined in accordance with IAS 19 Employee Benefits (31 December 2017: HRK 27,459 thousand), and in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets HRK 24,927 thousand for provisions for other liabilities for the Group (31 December 2017: HRK 24,592 thousand) and HRK 24,797 thousand for the Bank (31 December 2017: HRK 24,335 thousand).

The latest actuarial assessment of present value of liabilities based on defined benefits as at 31 December 2018 was performed by a certified actuary. The model took into account mortality and discount rate, and the calculations for every employee considered age, gender, years of service, expected mortality and discount rate, i.e. the long-run sustainable yield rate on bonds.

The applied discount rate that represents the yield rate on bonds sustainable in the long run is 4.25%, the same as in 2017.

Unrealised actuarial gains/(losses) arising from the calculation of provisions are stated within the framework of other comprehensive income so that net assets or liability may reflect the entire value of deficit or surplus planned.

### 31. Founder's capital

Under the HBOR Act, the prescribed founder's capital should amount to HRK 7,000,000 thousand, paid from the State Budget and from other sources as specified by separate laws.

The schedule of annual amounts of payment and the time schedule of payments out of the State Budget into the capital are not set in advance, but are determined by the Croatian Parliament as part of the process of adoption of the State Budget of the Republic of Croatia.

Within its Accounting policies, the Group has set out its objectives of capital management, category of capital managed by the Bank as well as measuring and assessing the policies for capital management. Capital management is described and presented in Note 39.

Founder's capital of the subsidiary Hrvatsko kreditno osiguranje d.d. amounts to HRK 37,500 thousand and is 100% owned by the Bank, and the founder's capital of the company Poslovni info servis d.o.o. amounts to HRK 300 thousand and is 100% owned by Hrvatsko kreditno osiguranje d.d.. The capital of both companies is subscribed and paid in full.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 32. Guarantee fund

Group and Bank	HRK '000
<b>Balance as of 1 January 2017</b>	<b>12,375</b>
Net foreign exchange	(72)
<b>Balance as of 31 December 2017</b>	<b>12,303</b>
Net foreign exchange	(157)
<b>Balance as of 31 December 2018</b>	<b>12,146</b>

The Guarantee fund of HRK 12,146 thousand and HRK 12,303 thousand as of 31 December 2018 and 2017 respectively, relates to funds of the guarantee fund from Deutsche Investitions- und Entwicklungsgesellschaft (DEG) in respect of a financial contribution (granted funds) for the account of the German Government, which are used for covering contingent losses on guarantees issued for loans granted under the Programme for financing business start-ups in Croatia. The funds of the Guarantee fund are unconditionally contributed and have no maturity. The funds of the Guarantee fund give the Government of the Federal Republic of Germany neither controlling rights nor a right to a share of the operating results of the Group.

### 33. Guarantees and commitments

In its regular activities, the Group contracts various commitments and contingent liabilities. The purpose of these instruments is to ensure that the funds are available to a customer when required.

These obligations contain credit risk and are therefore part of the overall risk of the Group although they are not recognised in the Statement of financial position.

Group and Bank	31 December 2018 HRK '000	31 December 2017 HRK '000
Guarantees issued in HRK	33,917	34,338
Guarantees issued in foreign currency	1,994,851	2,475,971
Undrawn loans	3,379,519	3,021,163
EIF – subscribed, not called up capital	47,472	48,087
Other irrevocable contingent liabilities	93	339
	<b>5,455,852</b>	<b>5,579,898</b>
Provisions for guarantees and commitments	(261,283)	(64,360)
	<b>5,194,569</b>	<b>5,515,538</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**33. Guarantees and commitments (continued)**

The following table sets out information about the credit quality of guarantees and commitments. For loan commitments and financial guarantee contracts, the amounts in the table represent the amount committed or guaranteed:

	Group and Bank				
	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Gross amount	2,708,846	669,160	2,009,169	21,205	<b>5,408,380</b>
Loss allowances	(9,170)	(65,094)	(175,996)	(11,023)	<b>(261,283)</b>
<b>Balance as of 31 December 2018</b>	<b>2,699,676</b>	<b>604,066</b>	<b>1,833,173</b>	<b>10,182</b>	<b>5,147,097</b>

*Guarantees*

Issued guarantees and open letters of credit represent the liability to the Bank to make payments on behalf of customers if the customer is unable to honour its commitments towards third parties or in the event of a specific act, generally related to the export or import of goods and other purposes specified in the contracts with the customers. Guarantees and letters of credit bear the same credit risk as loans. However, since all the stated guarantees issued are non-financial guarantees, i.e. they are performance related guarantees, they are not measured in accordance with IFRS 9 but in accordance with the IAS 37 provisions, Contingent Liabilities and Contingent Assets.

Bank guarantees are, to the extent of 81%, collateralized by the guarantees, deposits and bank guarantees.

*Commitments upon undrawn loans*

The Bank has an obligation to disburse funds for loans and revolving loans upon committed undrawn loans. The expiry date of disbursement or other termination clause is determined by the contract. Disbursements are exercised in several withdrawals, depending on the purpose of the loan, phase of the project or documentation needed for disbursement. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash outflows. Committed undrawn loans include less potential credit risk than loans, since most commitments depend upon meeting specific terms and conditions by the customers in order to use the funds. The Bank monitors the terms to maturity of loan commitments.

*Other irrevocable contingent liabilities*

Other irrevocable contingent liabilities relate to HBOR's obligation based on the Agreement concluded on 24 January 2014 with HBOR – Export Credit Insurance performing transactions for and on behalf of the Republic of Croatia. Pursuant to this Agreement, HBOR shall, in case of disposal of the real estate taken over and the recovery from debtors in a pre-bankruptcy settlement, provided that certain conditions have been fulfilled, pay the recovered funds to the Guarantee fund of the Export Credit Insurance.

In the reporting period, the contingent liability was reduced due to the completion of bankruptcy proceedings during which recourse payment was not collected.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**34. Managed funds for and on behalf of third parties**

The Group manages funds on behalf of and for the account of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the Ministry of Environment and Energy, the company Vodovod i kanalizacija d.o.o., Split, the Croatian Agency for SMEs, Innovations and Investments ("HAMAG-BICRO") and commercial banks, that are mainly used for various reconstruction and development programmes. These assets are separated from the Group's assets. The income and expense relating to these transactions are charged to the principal, and the Group does not have any other liabilities. The Group charges a fee for part of the services and part of the services are performed free of charge depending on the contract with the customer and taking into account that the stated amounts are insignificant for the Group.

Agency business funds per individual programmes amount to:

Group and Bank	31 December 2018	31 December 2017
	HRK '000	HRK '000
Development and Reconstruction of Rural Housing	27,220	29,092
Employment of Former Soldiers	345,318	340,344
Municipal Environmental Infrastructure Investment Program – MEIP	868,298	863,297
Collection of receivables under HAMAG-BICRO guarantees	155	193
Insurance of export transactions	396,366	331,431
Programme of Preferential Financing through HBOR's Loan Programmes - Ministry of Finance	120,433	107,262
Programme for Regional Development of the Republic of Croatia - loans	7,090	9,131
Renewable Energy Resources Project	24,676	24,142
VIK – EKO account A – dedicated water charge	659,036	630,090
VIK – EKO account B – VAT	156,050	154,732
Financing the Establishment of Fishing Infrastructure – Ministry of the Sea, Transport and Infrastructure	5,822	5,643
Model for the Reconstruction and Modernisation of the Fishing Fleet – Ministry of Agriculture – interest subsidy	46,665	46,665
Model for the Reconstruction and Modernisation of the Fishing Fleet – Ministry of Agriculture – interest subsidy	293	-
Micro-Loans with EU Support – commercial banks	428	303
Transactions related to investments in the Economic Co-operation Funds*	486,353	492,950
ESIF – Growth and Expansion Loans	420,846	414,277
ESIF - Energy Efficiency in Public Sector Buildings	47,682	-
ESIF - Loans for Public Lighting	38,061	-
Investment loans for rural development	134,196	-
	<b>3,784,988</b>	<b>3,449,552</b>

\*The fair value of net assets value of the Economic Co-operation Funds in 2018 is recognised on the basis of the latest available data and does not represent the final fair value, whereas, in 2017, the amount was recognised in accordance with the audited financial statements.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 35. Related party transactions

Related parties are companies that directly or indirectly, through one or more intermediaries, control, or are controlled by, the reporting company.

The majority of related-party transactions relate to the transactions with the Republic of Croatia, the 100% owner of the Bank and state-owned companies over which the Republic of Croatia has the controlling influence.

All transactions stated were carried out under usual/regular conditions of the Bank.

As of 31 December 2018 and 31 December 2017 balances arising from transactions with related parties, including the Bank's key management personnel, include the following:

#### a. Related-party transactions

Group	Assets		Liabilities	
	31 December 2018	31 December 2018	31 December 2017	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	4,335,942	189,014	3,059,698	185,536
Government funds, executive authorities and agencies	1,044,262	189,877	1,076,606	30,358
State-owned companies	1,118,540	19	1,354,828	1
Associates	40	10	1	-
Key management personnel	4,498	2,117	5,073	1,991
<b>Total</b>	<b>6,503,282</b>	<b>381,037</b>	<b>5,496,206</b>	<b>217,886</b>

Group	Income		Expense	
	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2017	Jan 1 – Dec 31 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	56,380	6,519	82,760	581
Government funds, executive authorities and agencies	146,400	710	31,099	1,327
State-owned companies	53,209	15,469	60,539	20,066
Associates	10	3	4,001	-
Key management personnel	153	9,749	147	7,731
<b>Total</b>	<b>256,152</b>	<b>32,450</b>	<b>178,546</b>	<b>29,705</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 35. Related-party transactions (continued)

#### a. Related-party transactions (continued)

Bank	Assets		Liabilities	
	31 December 2018	31 December 2018	31 December 2017	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	4,335,942	189,014	3,059,698	185,536
Government funds, executive authorities and agencies	1,006,177	189,666	1,032,525	30,199
State-owned companies	1,117,758	17	1,354,442	-
Subsidiary companies	36,124	-	36,124	-
Associates	40	10	1	-
Key management personnel	4,412	2,014	4,844	1,956
<b>Total</b>	<b>6,500,453</b>	<b>380,721</b>	<b>5,487,634</b>	<b>217,691</b>

Bank	Income		Expense	
	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2017	Jan 1 – Dec 31 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	56,380	6,519	82,760	581
Government funds, executive authorities and agencies	144,853	194	29,783	751
State-owned companies	53,164	15,403	60,521	19,997
Subsidiary companies	-	-	-	-
Associates	10	3	4,001	-
Key management personnel	147	8,318	139	7,185
<b>Total</b>	<b>254,554</b>	<b>30,437</b>	<b>177,204</b>	<b>28,514</b>

Assets include loans to other customers, debt instruments at amortised cost, financial assets at fair value through other comprehensive income, other assets and off-balance sheet exposure relating to commitments.

Liabilities include liabilities for deposits, salaries, provisions on behalf of retirement and jubilee awards of key management and other liabilities.

Income includes interest income, fee income and reversal of impairment losses and provisions.

Expenses include expenses for key management salaries, impairment loss and provisions.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**35. Related-party transactions (continued)**

b. Collateral received

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
The Republic of Croatia	4,192,023	4,235,919	4,096,373	4,138,695
State agencies	471,641	573,727	471,641	573,727
<b>Total</b>	<b>4,663,664</b>	<b>4,809,646</b>	<b>4,568,014</b>	<b>4,712,422</b>

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising the Republic of Croatia guarantees, HAMAG-BICRO guarantees, insurance policies of export transactions against political and/or commercial risks and statutory guarantees in cases when the Republic of Croatia or other state executive body guarantees the liabilities of certain borrowers pursuant to provisions of certain laws.

HBOR issues reinsurance policies for and on behalf of the Republic of Croatia, i.e. covers a proportional part (quota reinsurance) of political and commercial risks of export loans and receivables arising from export of goods and services. The reinsurer covers all non-marketable (non-market) risks underwritten by the Insurer or Hrvatsko kreditno osiguranje d.d. in the percentage ranging from 15% to 90% of an insured amount.

c. Salaries of key management personnel

Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, benefits payable for past service and payments under contractual agreements. In 2018, salaries for the Group amounted to HRK 9,495 thousand (31 December 2017: HRK 7,435 thousand), and for the Bank HRK 8,198 thousand (31 December 2017: HRK 7,033 thousand).

Remuneration for the work of the members of the Supervisory Board in 2018 amounted to HRK 254 thousand for the Group (31 December 2017: HRK 287 thousand) and for the Bank HRK 119 thousand (31 December 2017: HRK 143 thousand) and it relates to the members of supervisory boards at associates and subsidiaries who were appointed by HBOR.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management**

Based on the Act on the Croatian Bank for Reconstruction and Development, the Group is obliged to mitigate business risks directed by the principles of banking operations.

In the process of risk management, the Group identifies, estimates, measures, monitors, contains and controls the risks to which it is or might be exposed in the course of business and reports about them to the relevant authorities. By the mentioned procedures, appropriate internal documents and adequate organisational structure, a comprehensive and complete risk management system is provided.

The most significant risks the Group is exposed are credit risk, liquidity risk, interest rate risk in the Bank's book, foreign exchange risk, operational risk and outsourcing risk. These risks are managed daily in accordance with the policies, ordinances, procedures, methodologies and limit systems as well as decisions/conclusions of the Supervisory Board, the Management Board and the risk management committees.

The Group implements the sensitivity analyses and scenario analyses, provided that one or several risk factors are changed in regular or stressful circumstances, and the systems of pro-active risk management are continuously developed for the purpose of reducing possible future risks.

**36.1. Overview of the most important risks**

**Credit risk**

The Group controls credit risk through credit policies, ordinances and prescribed procedures that determine the internal control systems with an objective to act preventively.

The credit risk management system is the most important part of the HBOR business policy and is an important factor of its operation strategy.

**Liquidity risk, currency risk and interest rate risk in the Bank's book**

The Group ensures quality management of liquidity, currency and interest rate risks in the banking book through the Asset and Liability Management Committee. The management of these risks implies a reduction of interest rate risk, currency risk and liquidity risk to the lowest possible level. The majority of the Group's organisational units are included, directly and indirectly, in the operations of the Asset and Liability Management Committee in order to ensure a high-quality, integrated and comprehensive system for the management of these risks.

**Liquidity risk**

The basic principles for managing HBOR's liquidity risk are determined in the internal documents as well as in the decisions and conclusions made by the Supervisory Board, the Management Board and the Asset and Liability Management Committee.

In order to manage liquidity risk, the Group has established a system of limits, it monitors and controls limit utilisation, maintains the adequate level of liquidity reserve, continuously monitors current and planned liquidity, ensures HRK and foreign currency funds necessary for timely settlement of liabilities and for disbursements of approved loans and planned loan approvals. In terms of liquidity risk management, the Group monitors and strives to achieve compatibility of contracted and planned placements with the respective sources according to maturity. The Group does not hold deposits of citizens and is therefore not exposed to wide daily fluctuations in liquidity.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.1. Overview of the most important risks (continued)

#### Liquidity risk (continued)

The Group monitors liquidity risk by implementing the sensitivity analyses and scenario analyses in regular or stressful business conditions. Early warning signals and procedures for liquidity crisis indication or occurrence are determined by the Ordinance on Liquidity Risk Management.

#### Interest rate risk in the Bank's book

The basic principles for managing the Group's interest rate risk are determined in the internal documents as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. For the purpose of measurement and monitoring of interest rate risk, the Group carries out interest rate gap analysis. Interest rate gap is calculated for certain periods according to the possibilities of interest rate changes and presents the sensitivity of the Group to the changes in interest rates. Interest rates are structured per currency, type and value and projections of average weighted interest rates for Group's funds and placements are made. Furthermore, in addition to harmonising interest rates on sources and placements, current market conditions and movements in forecasted market indicators are also monitored.

#### Currency risk

The basic principles for managing HBOR's currency risk are determined in the internal acts as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. Methods for the measurement, i.e. assessment, monitoring and management of currency risk have been established, limits and proceedings both for cases of crisis indication and occurrence have been determined, and reports necessary for comprehensive perception of this risk have been defined.

The Group measures exposure to currency risk by monitoring open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the projections of its developments, the Group uses, for the measurement/assessment of currency risk, the VaR model as an auxiliary model and regularly reports to the bodies in charge on maximum possible losses on significant currencies. Scenario analyses and sensitivity analyses in regular or stressful business conditions are also performed.

#### Operational risk

The Group has established a framework for operational risk management that is, to a considerable extent, aligned with regulations prescribed by the Croatian National Bank applicable to the Bank's business and good banking practices in the area of risk management that was introduced in 2012.

The basic principles of operational risk management were identified in the umbrella act, Operational Risk Management Policies, the structure of management and accountability in the system was set up, the approach for the calculation of capital requirements for operational risk was determined, the recording and reporting system was established.

The Committee for IT management was established in order to monitor IT system performance with the purpose of IT resources management by setting the appropriate level of efficiency and security of IT for providing, among other things, appropriate management of risks arising from IT technology utilisation. The IT system security control function is in charge of monitoring the security of the IT system. Within this function, a system for the management of business continuity was established.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.1. Overview of the most important risks (continued)

#### Outsourcing risk

The Group manages the outsourcing risk on the basis of internal documents that are in compliance with the regulations prescribed by the Croatian National Bank applicable to the Group as a special financial institution. The internal documents that determine the management of this risk determine also the procedures for the outsourcing of activities, the rules for the management of relations with the service providers and the obligation to reduce the risk to the lowest level.

The central records of outsourced activities have been established and reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on annual basis.

### 36.2. Strategy and risk management systems

**The Supervisory Board** is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Group. The Supervisory Board adopts HBOR's Risk Management Strategy that lays out the main principles and standards of risk management and defines the tendency towards risk-taking.

**The Management Board** of the Bank is responsible for implementing the risk management strategy and establishing an effective and reliable risk management system. In order to accomplish its task, the Management Board delegated their risk management authority to four committees.

#### Risk management committees

- **Assets and Liabilities Management Committee (ALCO)** – manages liquidity risk, interest rate risk in the Bank's book and currency risk within the framework of the Liquidity Risk Management Ordinance, the Currency Risk Management Procedures and the Interest Rate Risk Management Procedures, the Assets and Liabilities Management Policies as well as other documents of the Bank that regulate this area,
- **Credit Risk Evaluation and Measurement Committee** – manages credit risk within the framework set through accepted Loan Policies, Credit Risk Management Ordinance, methodologies, ordinances and other internal acts that cover issues related to credit risk,
- **HBOR Information System Management Committee** – manages the resources of the information system and adequately manages the risks that result from the use of information technology,
- **Business Change Management Committee** – manages business changes (co-ordination of procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce risks associated with the implementation of business changes.

#### Organizational unit for Risk Management

The Risk Management unit is organised as a functionally and organizationally separate and independent organizational unit for the control of business risks, which is directly responsible to the Management Board. This organisational unit is responsible for defining, evaluating or measuring, monitoring and controlling the risks to which the Group is exposed in the course of its business.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.2. Strategy and risk management systems (continued)

##### Organizational unit for Risk Management (continued)

The Risk Management unit carries out its role by performing risk analyses and evaluations or measurements, developing risk management ordinances, procedures and methodologies, supervising and monitoring their application, recommending and controlling the accepted exposure limits, giving suggestions and recommendations for adequate risk management as well as reporting to the relevant authorities.

The risk management strategy is directed towards achieving and maintaining the system that would provide quality and efficiency in risk management complied with domestic and international banking practices and Croatian National Bank, European regulations and Basel Committee recommendations applicable to the Bank as a special financial institution.

##### Risk measurement and reporting systems

When assessing or measuring risk, the Group takes into account historical data, business plans, current and expected market conditions and the specific characteristics of the Group as a special financial institution. The results of risk assessments or measurements, analyses carried out and stress test are presented at the meetings of the Risk Management Committee, the Management Board and the Supervisory Board. For the purpose of risk monitoring and control, systems of limits are introduced for the management of credit risk, liquidity risk, interest rate risk in the Bank's book and currency risk.

Bodies in charge are systematically reported on the quality of the loan portfolio, high exposure and the highest permissible exposure, regulatory capital adequacy, collection of receivables and risk placements, changes in internal ratings of commercial banks and measures taken in case of rating deterioration, a number of liquidity status indicators and projections of open foreign currency positions, possible losses by significant currencies, interest rate gap, projections of average weighted rates for sources and placements of financial institutions, etc. The reporting dynamics and the risk measurement and assessment methodologies are prescribed by the Group's internal acts.

#### 36.3. Credit risk

The Group controls credit risk by way of credit policies and ordinances for the management of this risk that determine internal control systems aiming to act preventively.

The credit risk management system is a crucial part of the Group's business policy and it is an important strategic factor of business conduct, and therefore this area is regulated by a separate act - Credit risk management ordinance, that are applied on all phases of the credit process (from the development of new bank products or from the credit application, monitoring of the client's business operations until the final loan repayment).

Credit risk management ordinance is a comprehensive document that includes the methodologies intended for the assessment of operations of different client target groups.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

In the case of direct financing, the Group uses the Credit risk evaluation methodology (for loans over HRK 1,500 thousand) or the Credit scoring methodology (for loans below HRK 1,500 thousand) to determine creditworthiness. The Credit scoring methodology is used to determine creditworthiness of clients that belong to the "small portfolio" and contains five scoring models: placements up to HRK 300 thousand to companies, crafts businesses and farmers, placements to start-ups up to HRK 300 thousand, placements from HRK 300 thousand to HRK 1,500 thousand to companies, placements to start-ups from HRK 300 thousand to HRK 1,500 thousand and placements from HRK 300 thousand to HRK 1,500 thousand for all other entrepreneurs.

The Credit Rating Assessment Methodology is used for the assessment of the risk of the clients that have been classified to the portfolio of individually significant clients, i.e. the loans exceeding HRK 1,500 thousand. The risk assessment can be contained in the assessment of client creditworthiness, assessment of investment project success and assessment of client creditworthiness containing analysis of future operations.

Pursuant to the HBOR Act, the Group on-lends part of its placements via commercial banks or leasing companies. The assessment of commercial banks is based on the Methodology for the Evaluation and Selection of Banks and the Methodology for the Evaluation and Selection of Foreign Banks, whereas the assessment of leasing companies is based on the Methodologies for the Evaluation and Selection of Leasing Companies. With an objective of facilitating the availability of HBOR's funds, the Group channels part of its placements through the risk sharing model, under which commercial banks and HBOR participate in the financing of clients in accordance with in advance agreed proportions.

The Group, as a developmental financial institution, supports growth and development of the Croatian economy through investment. For this reason, the clients mainly approach the Group with applications for credit financing of investment projects. In order to minimize risk and objectively estimate economic sustainability of the project as well as a return on investment, the Group is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

By continuous monitoring and evaluation of the clients' businesses, the Group makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Group tries to find appropriate ways to collect receivables by considering the possibilities of alternative repayment terms with a view to continue the production process and employment increase. Special emphasis is placed on identifying and monitoring reasons for bad debts, and procedures for prevention are built in operational procedures with a view to decreasing the share of high risk placements of the Group.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

For the purpose of risk monitoring and control, the systems of limits have been established for the management of credit risk. High exposure limits and amounts of maximum permitted credit exposure to individual borrowers and persons related to borrowers have been established.

#### 36.3.1. Risk related to loan commitments

Bank clients can be issued guarantees and letters of credit with deferred payment terms (also from loan proceeds) in accordance with the same procedure as prescribed for loan commitments to direct clients.

All guarantees are monitored on the basis of validity periods, whereas letters of credit with deferred payment terms are monitored on the basis of maturities. In the case of calling for payment, the Group shall make a payment on behalf of client. For the Group, such obligations generate exposures to risks that are similar to credit risks and they are mitigated by the same procedures that are applied to loans.

#### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018)

Impairment is formed in accordance with the International Financial Reporting Standard 9, documents made by CNB applicable to HBOR and ordinances and methodologies regulating the Group's operations.

On the basis of the assessed level of credit risk and the manner of calculating expected credit losses, clients are allocated to the following categories:

- Stage 1 – includes all clients with low credit risk and clients with respect to which no significant increase in credit risk has been established,
- Stage 2 – includes all clients with respect to which a significant increase in credit risk since initial recognition has been established
- Stage 3 – includes clients in default, i.e. clients with respect to which there is objective evidence of value impairment as well as purchased or originated credit-impaired (POCI) financial assets.

During the contractual relationship with a client, the level of expected credit losses of client is estimated. The estimation is carried out on the basis of the following three criteria:

- Debtor's creditworthiness
- Due fulfilment of obligations, and
- Quality of collateral.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

#### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018)

For the entire duration of contractual relationship, debtor's creditworthiness is assessed in order to identify possible changes in the client's (debtor's) financial position, i.e. the probability of deterioration in its creditworthiness. When establishing client's creditworthiness, the group of related entities is also taken into account due to the effect of contamination, i.e. the possibility of the transfer of risk among related entities, and the creditworthiness of client is monitored through:

- Changes in financial rating of client and entities related to client,
- Criteria whose objective is to identify financial difficulties of client,
- Criteria contained in the client watch list, and
- Criteria for identification of increased credit risk.

A client is considered to duly meet its obligations if it settles all of its obligations fully (principal, interest, commissions, fees and other charges) in the amounts and within the deadlines determined in the respective contracts, where all placements and of-balance sheet liabilities of a client are considered as one.

Collateral assessment is based on the quality of collateral and the assessed amount as well as expected period of collection through collateral.

#### 36.3.2.1. Definition of default status and exit from default status

Default status of an individual client occurs when one or both of the following conditions are met:

- it is considered probable that client will not settle its obligations towards HBOR entirely without taking into account the possibility of collection through collateral activation,
- clients is more than 90 days overdue in settling its due obligation under any significant loan liability. The significance threshold equals HRK 1,750 and is calculated on the client level by adding due obligations under all client placements.

When assessing the probability of a debtor not settling its obligations entirely, the following elements are considered:

- recognised impairment for credit losses due to identified significant deterioration in credit quality of debtor,
- selling of credit exposure at a considerable economic loss,
- rescheduling or restructuring of credit exposure owing to financial difficulties of debtor,
- bankruptcy or similar proceedings (pre-bankruptcy settlement, liquidation) against debtor,
- appointment of extraordinary administration, revoke of operating license, application of early intervention measures,
- cancellation of contract.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

###### 36.3.2.1. Definition of default status and exit from default status (continued)

When determining a default status, in addition to the aforementioned, the relations within a group of related entities are also considered if the default status has been established with regard to one of the debtors within the respective group of related entities that results in the spreading of the default status on other entities within the same group.

All financial instruments of client in default status are classified to Stage 3.

Placements to clients in default status due to a material delay in the payment of obligations for more than 90 days can be classified to the rehabilitated category if 150 days have lapsed from the moment of non-existence of the default status trigger. During the 150-day trial period, client must not be more than 30 days overdue in the payment of obligations in a materially significant amount.

After the lapse of 150 days, only those clients are considered to have been cured who are found not to be in financial difficulties. If there are signs of default status recurrence, the status is not changed until a genuine and permanent improvement in the credit quality of client.

Restructured exposures caused by financial difficulties and repayment problems can be classified as cured after the lapse of two years from the last occurrence of the following events:

- restructuring day,
- default status establishment date,
- grace period expiry if approved under the restructuring process.

During the two-year trial period, the exposures that meet all of the following conditions can be classified to non-default status exposures:

- debtor has duly settled, upon maturity, at least the amount of restructured obligations in the amount of those due at the moment of the restructuring implementation,
- debtor has been regularly settling due obligations in accordance with the repayment schedule (or up to 30 days overdue),
- default status is not probable to occur,
- there are no overdue obligations after restructuring,
- there is no doubt that the debtor will continue to settle its obligations upon maturity.

All of the above conditions have to be satisfied also for the new placements to the same client. Only the placements to client that is not in financial difficulties can be reclassified to the cured category.

After all trial-period conditions have been satisfied, the financial instruments of cured clients can be reclassified to Stage 1.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

###### 36.3.2.2. Bank's procedure of internal rating and probability to default (PD) assessment

The approach used for the modelling of PD is based on TTC (Through-the-Cycle) migration matrices for exposures in homogenous groups of direct borrowers and others. Risk categories (bucket) have been identified, and the movements of exposures among the aforementioned categories are analysed.

Risk categories for the aforementioned exposures are defined on the basis of the days overdue and the restructured exposure status. Before the modelling of PD, the data for the preceding 5-year period are collected.

On the occasion of the modelling of PD, the movement of exposures among the following categories is analysed:

- from 0 to 30 days overdue – category 1,
- from 31 to 90 days overdue – category 2,
- more than 90 days overdue and restructuring – default status event.

On the basis of the matrices of exposure movements from category to category, a PD 12-month value is calculated. PD marginal values are calculated by further multiplication of matrices and they are used for vector creation. PD borderline value vector is the basis for the calculation of a lifelong PD. The value of a lifelong PD depends on the tenor, i.e. the remaining period until maturity of individual exposure.

Approach based on external rating published by external credit rating agencies has been used for the calculation of PD for exposures from homogenous categories of financial institutions and central government and local and regional government.

For exposures to domestic financial institutions, owing to the fact that there is no external rating for all financial institutions in the Group portfolio, the existing internal ratings for domestic financial institutions have been mapped against the external rating, where a financial institution that has an external rating has been used as the mapping starting point, due to which the Group's internal rating has been made equal to the rating of S&P: "BB". In this way, the upper limit has been established for domestic financial institutions at the level of the government rating. Distribution of PD value for the other internal ratings is determined on the basis of the method of linear interpolation.

Ratings of external credit rating agencies are used for exposures to foreign financial institutions and, therefore, the appropriate PD value from their matrices is used, and if non-existing, the internal rating is used, i.e. the rules are applied that are identical to those applied to domestic financial institutions.

The value of 12-month PD is assessed by multiplying TTC matrix with itself. The value of lifelong PD is the cumulative value of marginal PD values or the sum of borderline PD values depending on the exposure tenor.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

#### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

##### 36.3.2.3. Exposure at default

For the purpose of modelling exposures at the moment of the occurrence of default status (Exposure at Default, hereinafter: EAD), or for the purpose of calculating credit conversion parameter (Credit Conversion Factor, hereinafter: CCF) and prepayment ratio, the data for the preceding five-year period are taken into account.

Pursuant to the mentioned historical data, the established ratio of premature collection almost equals zero and the loan conversion factor equals 1.

EAD is calculated for each contract. There are two approaches to the calculation of EAD:

- if there is a repayment schedule for exposure – based on the cash flow from the repayment schedule,
- if there is no repayment schedule for exposure – based on exposure amount on the reporting date.

For exposures classified in risk stage 1 and for exposures due, EAD is equal to the current exposure.

For exposures not yet due, lifelong EAD is calculated based on the repayment schedule, taking into account the amounts and the maturity period, but not later than until the final date of exposure maturity (tenor).

##### 36.3.2.4. Loss given default

For groups of direct borrowers and others, loss at the moment of occurrence of the status of non-fulfilment of obligations (Loss Given Default, hereinafter: LGD) is estimated based on transactions after the date of occurrence of loss given default. Each transaction is discounted on the date of occurrence of loss given default by an appropriate discount rate, and the discount factor depends on the time elapsed. All increases after the date of occurrence of loss given default are cumulated with an individual exposure. The result of the mentioned calculation is the collection rate for each exposure in a homogenous group, and the total collection rate for a single homogenous group is comprised of the weighted average of collection rates of all individual exposures.

The probability of exit from the loss given default status is also taken into consideration in the calculation of LGD.

A report of external credit rating agencies is used as foundation for determining LGDs for the groups central government and local and regional government and financial institutions. In the annual reports on the occurrence of loss given default and collection status, credit rating agencies publish both historical and market rates of collection. The market rate of collection is the market price of a bond as compared to its value immediately before or at the moment of bond default. Based on market rates of collection for senior unsecured debt, issuer-weighted recovery rate is determined.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

#### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

##### 36.3.2.5. Significant increase in credit risk

For the purpose of identifying an increased credit risk, changes for all clients of the Group are monitored continuously, but at least once a year. All placements to the client, where an increased credit risk has been identified or in case of individually significant clients, whose exposure exceeds HRK 1,500 thousand and are on the client watch list, on the next reporting date, all financial instruments of the client with increased credit risk are classified to stage 2 based on the observed criteria such as:

- client's delay in the settlement of any significant obligation due towards HBOR more than 30 days (and less than 90 days),
- the client is in financial difficulties, but is not in LGD status,
- deterioration of rating, low credit rating of the client,
- non-compliance with contractual provisions
- loss of key buyers or suppliers etc.

Exit from the increased credit risk status is conditional on non-existence of all the criteria based on which the client has been grouped into the respective status upon the occurrence of the risk, and verification of all indicators is made at least once a year within the framework of the annual monitoring of the client. Deactivation of a portion of indicators can be carried out after six months. Indicators of an increased credit risk are active for a year, after which they have to be checked, and based on the monitoring results, either reactivated or deactivated. The result of any change is either the reclassification of financial instruments of the client to stage 1 or its stay in stage 2.

Financial instruments of the client with an investment rating of external credit rating agencies are deemed financial instruments of low credit risk. All exposures to the Republic of Croatia and units of local and regional government (ULRG), the Croatian National Bank, the European Investment Bank (EIB) and other development banks are also deemed financial instruments of clients with low credit risk. Financial instruments of clients with low credit risk are always grouped into stage 1.

##### 36.3.2.6. Grouping financial assets measured on a collective basis

Credit risk is evaluated on a collective basis for all clients classified into risk stages 1 and 2 as well as for clients in the risk stage 3 belonging to the small loan portfolio. The clients belonging to the small loan portfolio are clients to which HBOR is exposed in the gross amount that is equal or less than HRK 1,500 thousand.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

#### 36.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

##### 36.3.2.6. Grouping financial assets measured on a collective basis (continued)

For the purpose of identifying a significant increase in credit risk and recognition of loss allowances for impairment on a collective basis, financial instruments are grouped into the following groups, based on the common features of credit risk, for the purpose of easier evaluation of a significant increase in credit risk:

- financial institutions,
- central government and local and regional government,
- direct borrowers – large,
- direct borrowers – small and medium-sized,
- direct borrowers – micro,
- direct borrowers – citizens,
- others.

By grouping financial instruments into homogeneous groups, it is ensured that in case of a significant increase in credit risk, the goal of recognising expected credit losses during the entire lifetime of a financial instrument is attained, even if the evidence on such significant increase in credit risk is still not available on the level of an individual instrument.

#### 36.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD

When including any information about the future, available sources (Croatian National Bank, Croatian Bureau of Statistics) on macroeconomic conditions are used with a view to projecting their impact on the current value of risk parameters.

Based on a historical analysis of impact of macroeconomic conditions and the available macroeconomic forecasts, a potential impact of future movement of macroeconomic conditions on the value of risk parameters is established by using the scenarios with related probabilities of occurrence of an individual scenario.

When estimating expected credit losses through the application of a previous experience on credit losses, the data on earlier credit losses rates are applied to the formed homogenous groups, and through the application of a certain method, connecting of a single group of financial instruments with the data on earlier experience on credit losses in the groups of financial instruments with similar characteristics of credit risk is made possible, as well as with important relevant data reflecting the current status.

The expected credit losses reflect the Group's expectations in respect of credit losses. However, when the Group, during the estimation of such expected credit losses, considers all reasonable and reliable data that are available with no necessary costs and efforts, the Group also considers appropriate market data on the credit risk of a certain financial instrument or similar financial instruments.

For the calculation of expected credit losses, the Group uses a large number of macroeconomic conditions, of which for two of them, correlations on PDs have been established per individual homogenous groups: GDP and exchange rate.

(All amounts are expressed in HRK thousand)

## 36. Risk management (continued)

### 36.3. Credit risk (continued)

#### 36.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD (continued)

In order to determine the impact of future macroeconomic conditions on expected credit losses, by analysis based on historical data, the connection between macroeconomic conditions and PD is identified. After that, the impact of macroeconomic forecasts on PD values is estimated and the ratio is calculated, by means of which the estimated value of PD in two scenarios, an optimistic and a pessimistic one, is corrected.

#### 36.3.4. Quantitative analysis of the reliability of the information used to calculate the ECL allowance

For the application of macroeconomic factors, the Bank uses a methodology with the level of reliability of 90%.

#### 36.3.5. Overview of modified and restructured loans

Any amendment to the contractual provisions resulting in the conversion of contractual cash flows from financial assets is deemed to be modification.

A change of placement terms and conditions includes changes to certain contractual terms defined, mostly for the purpose of adaptation to changes during the implementation of an investment, and possibly also during repayments, and not caused by financial difficulties of the client. The amended terms would most frequently be accepted when approved if known or are the result of circumstances not controlled by the client.

Any changes in contractual obligations, by which a concession is made to the client that is considered to be in financial difficulties, are deemed to be rescheduling or restructuring. Concession may relate to any of the following measures:

- change of earlier contractual terms and conditions that are considered impossible to be met by the client and lead to the loss of its ability to settle liabilities and which would not be approved if the borrower had no financial difficulties (e.g. interest rate reduction, reduction or cancellation of interest income, change in principal amount, change or prolongation of repayment terms etc.)
- complete or partial refinancing of placements that would not be approved if the debtor had no financial difficulties.

Evidence on concession includes the following:

- the difference in favor of the client between the changed terms and conditions of the contract and former terms and conditions of the contract,
- inclusion of more favorable terms and conditions in the changed contract as compared to the terms and conditions that other debtors with a similar risk profile in the Bank portfolio could have obtained.

Rescheduling is considered any change of the originally agreed loan terms and conditions due to temporary financial difficulties of the client. Restructuring is considered any change of the originally agreed loan terms and conditions due to significant financial difficulties of the client that needs financial, business and operational restructuring, i.e. the client that is already in default.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### 36.3.6. Analysis of risk concentration

Through its development loan programmes, the Group encompasses the area of the entire Republic of Croatia with emphasis on supported areas. Credit risk is spread across geographic areas, industries, sectors and loan programmes. The Group seeks to avoid excessive concentration of credit risk and support the development of less developed areas of the Republic of Croatia through more favorable terms and conditions and new loan programmes (products) in accordance with the national strategy of development of certain activities.

Through financing of different sectors by stimulating production and development with the purpose of developing the Croatian economy, the Group is creating a better base for repayment of loans and minimization of risk.

As of 31 December 2018, the highest credit exposure of the Group and the Bank to one debtor equaled HRK 2,883,122 thousand (31 December 2017: HRK 2,536,756 thousand for the Group and for the Bank) without considering the effect of mitigation through collateral received.

As a special financial institution, the Bank performs its development role by granting loans to final borrowers via commercial banks with which it has entered into co-operation agreements. Since the exposure towards some of the banks has reached the maximum permitted level, the Bank, in order to be able to continue performing its development role and make the loans accessible to as many final borrowers as possible, has an approval from the Supervisory Board for an increase in the exposure towards the banks and their associated entities that have, in accordance with HBOR's internal methodology, been assigned a high rating. The exposure level is maintained by using all instruments and techniques available for mitigating HBOR's exposure towards the banks.

This exposure increase approved by the Supervisory Board was used by the Bank for further operating activities carried out with two banks.

##### 36.3.7. Risk-Sharing Model

The Risk-Sharing Model covers the manner of implementing HBOR's loan programmes in cooperation with commercial banks, where HBOR assumes a portion of direct lending risk (e.g. 50%), whereas the commercial bank assumes the risk associated with the other part of the loan (irrespective of whether it is financed from HBOR's funds or from commercial bank's funds).

The commercial bank takes the role of the administrative payment and collateral agent and reports to HBOR monthly and quarterly, on the basis of the business cooperation agreement executed between the commercial bank and HBOR, on any changes in creditworthiness of client, changes in provisions, changes in the value of collateral, on whether payments are made duly, on pre-bankruptcy and bankruptcy proceedings and on any other changes in the operations of clients and the repayments of placements.

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### 36.3.7. Risk-Sharing Model (continued)

There are several groups/types of risk-sharing model as follows:

- Initially, the sharing of risk with banks was launched through the programmes of the Government of the Republic of Croatia as a promotional measure aimed at strengthening the liquidity of the economy in the economic crisis period. During that time, three risk-sharing models were implemented: the Model A, the Model A+ and the Economy Development Programme.

Due to the scope of activities and the necessity of exceptionally fast action by HBOR, within the framework of the mentioned loan programmes, commercial banks as administrative, payment and collateral agents submitted to HBOR a shortened application form, and consequently, a shortened loan application procedure was adopted.

Further to the shortened procedure, in the mentioned loan programmes, HBOR had not initially entered collaterals in its business records, because it was the obligation of commercial banks to take charge of, and to activate, the collaterals. Subsequently, in some cases, HBOR entered collaterals in its business records if the agency business with commercial banks was terminated (e.g. because the banks sold their exposures etc.) or individual placements were restructured. Exposure under mentioned placements was entered in the business records of HBOR.

- Other loans under the risk-sharing models under the HBOR loan programmes (primarily investment and restructuring loans, and to a lesser extent loans for liquidity) are implemented in the manner that commercial banks included in the transactions still remain agents (administrative, payment and collateral agents), but HBOR implements a customary procedure as for any other direct loan and enters both exposures and collaterals into the business records at the moment of approving and contracting of placements.

##### 36.3.8. Collaterals and other credit quality (creditworthiness) improvement

Collateral for the Bank's placements are:

- obligatory (bills of exchange and promissory notes),
- ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local and regional authorities, guarantees from HAMAG-BICRO (Croatian Agency for SMSs, Innovation and Investment), insurance policy against political and/or commercial risks), and
- other collateral (movable property, bills of exchange or guarantees from other companies with solid creditworthiness, fiduciary or pledge of companies' equity instruments, repossession of cash receivables or assignment for collectible receivables, deposit repossession, restriction of transferability on insurance policy of assets and/or person, pledge on a trademark, etc.).

All Group placements have to be secured with obligatory collateral. Low-exposure placements must be secured with one obligatory instrument of collateral at least. The selection of eligible collaterals does not depend on the insurance ratio achieved only, but also on the risks identified, with marketable and more valuable collaterals being preferred.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**36.3.8. Collaterals and other credit quality (creditworthiness) improvement (continued)**

Acceptable ordinary and other collateral are classified according to quality in five groups. The evaluation of collateral is based on quality, estimated based on marketability, documentation and possibility of supervision by the Bank as well as the possibility of enforced collection.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the security instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLPS), guarantees from HAMAG-BICRO, loan insurance policy and when the Republic of Croatia, JLPS or other government authorities guarantee for clients implicitly.

For the purpose of mitigation of credit risk and reduction of business costs, and in compliance with the Act on the Croatian Bank for Reconstruction and Development, the Group approves part of its placements through financial institutions. As collateral for placements approved to final customers through financial institutions, the Group uses mandatory collateral from commercial banks/leasing companies. The financial institution is obliged to deliver them based on the Mutual business cooperation agreement, but not for each individual placement to the final customer based on that Agreement. In the individual contracts for placements to the final customers, the use of obligatory collateral delivered with the Agreement on mutual business cooperation is contracted. As the financial institutions take on the risk of default by the final customer, they are given the option to contract sufficient collateral with the final customer/leasing company.

Where the loan is approved through a commercial bank, depending on the financial institution's internal rating, the Bank contracts a sub-mortgage. In this case, either the commercial bank transfers the ownership over the collateral, while the Bank takes a mortgage over the same collateral, or the commercial bank forms a mortgage on the collateral, while the Bank takes a sub-mortgage on the same collateral.

By signing the Agreement on mutual business cooperation, a transfer of any claims the commercial bank may have towards the final customer is made to HBOR. Pursuant to the Agreement, the commercial bank authorises HBOR to unilaterally inform the bank in written form that, in the case of the commercial bank's insolvency or threat of liquidation, untimely repayments or default on the commitments agreed in the individual contract on interbank loan or actual (insolvent or regular) liquidation, the Bank assumes the receivable towards the final customer from the commercial bank, with the effect of assignment of receivables instead of contract fulfilment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR that HBOR may, without having to obtain any further consent or approval from the commercial bank, enter itself into all public registers, books or records as the creditor instead of the commercial bank under any security arrangements for assigned receivables as well as under any other proceedings.

From the moment of the assignment, the final customer is obliged to make all payments related to the assigned receivable directly to HBOR. Should the commercial bank receive any payments in the name of collection of receivables per particular placement, the bank is obliged to immediately transfer the funds to HBOR.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**36.3.8. Collaterals and other credit quality (creditworthiness) improvement (continued)**

All direct placements are mainly secured with a transfer of ownership or with a mortgage over real estate and, if is possible, the Group obtains as security against credit risk a guarantee from HAMAG-BICRO, a guarantee from the local and regional authority, a guarantee from the Republic of Croatia, etc.

The Group has the right to verify the appraisal of the collateral value and such a confirmed appraisal is considered as the final collateral value.

Depending on the type of collateral, the credit programme, the general terms of security or the decision of an authorised body, the Group has determined the necessary ratio of placements and collateral.

In case of the real estate, the necessary ratio of placement and estimated market value of the real estate should be 1:1.3, except in case of investments on the islands, supported areas where such ratio is 1:1.2. In case of moveable property, the necessary ratio of placement and estimated market value of moveable property should be 1:2. If a lower ratio of the collateral value than those prescribed is proposed, reasons and justifications of deviations from the prescribed ratio are explained.

The Bank continually monitors the value of collaterals by re-estimation or confirmation/verification of the value. Monitoring of the value of mortgaged real estate is performed once a year for business real estate, and every three years for residential buildings. The Bank has formed a special organizational unit for:

- evaluation and verification of already appraised and offered collateral (real estate and movables),
- technical and technological analysis of investment projects, and
- financial supervision over the withdrawal of loan funds for the purpose of the implementation of the investment project.

In the event that it is not possible for the Bank to collect from regular operations, the Bank starts collection from the collateral at its disposal. This encompasses initiating collection from the obligatory collateral, then from first-class, unconditional collateral payable on first demand and then from the mortgage or fiduciary ownership of the real estate or movable property, including their repossession with a view to decreasing or fully settling the Bank's receivables. The Bank does not use repossessed assets for business purposes.

In the case of risk-sharing models, collateral is created by commercial banks depending on the type of the model:

- in accordance with their own internal documents and good banking practices, and, consequently, HBOR's documents and collateral ratios prescribed in them do not apply,
- or collateral is created by commercial banks and HBOR for their respective shares in the loan in accordance with their own documents, decisions and/or procedures.

**Write-offs**

Write-off is performed in accordance with the Methodology for Write-Off of Receivables.

The criteria for considering the write-off of receivables can be classified into 3 main groups:

- A. exhaustion of all available forms of regular and compulsory collection;
- B. implementation of settlement, sale of receivables or restructuring of placements;
- C. difficult social and/or medical condition of the debtor (and/or the co-debtor, guarantor).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**36.3.9. Credit risk - Policy applicable before 1 January 2018**

**Credit risk assessment internal methodologies**

For the analysis and evaluation of various target groups of clients, the Bank has prescribed internal methodologies. They represent the guidelines for decisions on approval of loans, guarantees and letters of credit and one of criteria for determination of the placement risk category.

Methodology for evaluation of credit rating is applied when determining the creditworthiness of clients in the case of direct placements over HRK 1,500 thousand. It comprises three main evaluation areas: client evaluation, project/investment evaluation and evaluation of client by means of analysing future operations. All evaluation areas consist of three basic parts: financial, non-financial analysis and correction of evaluation based on currency-induced credit risk (VIKR) for placements in foreign currency or in kuna indexed to foreign currency.

Methodologies of credit scoring are used during credit risk evaluation for all direct placements below HRK 1,500 thousand where the Bank is exposed to credit risk. The quality and value of collateral for the placement are a part of the credit scoring procedure.

Methodologies for the analysis of clients who keep their business records in accordance with the Income Tax Act (commitments) are applied on the occasion of determining the creditworthiness of clients in the case of direct lending for placements above HRK 1,500 thousand together with the evaluation of the project based on the Methodology for the evaluation of credit rating (project evaluation).

The Methodology for evaluation and selection of banks and the Methodology for evaluation and selection of foreign banks are used for evaluation of domestic and foreign banks. The Methodology for the evaluation and selection of leasing companies is used for evaluation of leasing companies. The methodologies include the estimation of the financial risk (quantitative evaluation), the estimation of business risks for banks/leasing companies analysed (qualitative evaluation) and the estimation of reputation risk.

The result of application of the above methodologies is the rating of the client.

**Impairment loss and provisions**

The Bank forms provisions for identified losses in accordance with International Financial Reporting Standards and internal rules. Forming provisions is under the competence of the Credit risk evaluation and measurement committee.

**Provisioning on an individual basis**

Provisioning on an individual basis represents impairment of partly recoverable and irrecoverable investments (risk groups "B" and "C"). Allocation of placements on an individual basis into risk groups is performed by the following criteria:

- creditworthiness,
- debtors' regularity of repayment upon maturity, and
- quality of placement collateral.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**36.3.9. Credit risk - Policy applicable before 1 January 2018 (continued)**

**Provisioning on an individual basis (continued)**

Placements that represent the portfolio of small loans are classified by the criteria of regular repayment upon maturity. The Bank does not determine the present value of discounted cash flows for partially recoverable placements where the expected inflow is expected within one year of the financial statements date.

**Provisioning on a collective basis**

Provisions on a collective basis are formed for fully recoverable placements or placements and commitments allocated in risk group "A". Allocation of debtors within the risk group is performed according to industry risk factor, geographical affiliation, type and the debtor's foreign currency alignment.

Regardless of other classification criteria, investments which are at least 80% covered by first class collateral are allocated in risk group "A".

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure**

The table below shows the highest net credit risk exposures in the Statement of Financial Position and in guarantees and commitments as of the reporting date, before the effect of mitigation through collateral received:

	Highest exposure	Group Highest exposure	Highest exposure	Bank Highest exposure
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and current accounts with banks	944,415	1,403,664	941,069	1,401,130
Deposits with other banks	261,925	29,138	261,925	29,138
Loans to financial institutions	10,234,988	10,836,141	10,234,988	10,836,141
Loans to other customers	12,510,686	12,383,623	12,510,686	12,383,623
Financial assets at fair value through profit or loss*	2,045	-	2,045	-
Financial assets at fair value through other comprehensive income*	2,803,761	n/a	2,766,363	n/a
Debt instruments at amortised cost	1,363	n/a	-	n/a
Assets available for sale	n/a	2,483,371	n/a	2,443,699
Assets held to maturity	n/a	1,399	n/a	-
Other assets	12,722	19,297	4,182	12,282
<b>Total</b>	<b>26,771,905</b>	<b>27,156,633</b>	<b>26,721,258</b>	<b>27,106,013</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,576	33,993	33,576	33,993
Issued guarantees in foreign currency	1,822,396	2,446,324	1,822,396	2,446,324
Undrawn loans	3,291,032	2,986,798	3,291,032	2,986,798
Other irrevocable contingent liabilities	93	335	93	335
<b>Total</b>	<b>5,147,097</b>	<b>5,467,450</b>	<b>5,147,097</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>31,919,002</b>	<b>32,624,083</b>	<b>31,868,355</b>	<b>32,573,463</b>

\*The disclosed financial statements as at and for the year ended on 31 December 2017 under these positions included also investments in investment funds. This change relates to all parts of Note 36.3. Credit risk.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, net exposure, according to geographical segments, before the effect of mitigation through collateral received, is as follows:

Group	Republic of Croatia	EU countries	Other countries	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and current accounts with banks	929,211	14,740	464	944,415
Deposits with other banks	261,922	3	-	261,925
Loans to financial institutions	10,234,988	-	-	10,234,988
Loans to other customers	11,736,094	-	774,592	12,510,686
Financial assets at fair value through profit or loss	2,045	-	-	2,045
Financial assets at fair value through other comprehensive income	2,803,761	-	-	2,803,761
Debt instruments at amortised cost	1,363	-	-	1,363
Other assets	5,362	7,293	67	12,722
<b>Total</b>	<b>25,974,746</b>	<b>22,036</b>	<b>775,123</b>	<b>26,771,905</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,576	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	1,822,396
Undrawn loans	2,788,456	-	502,576	3,291,032
Other irrevocable contingent liabilities	93	-	-	93
<b>Total</b>	<b>4,644,521</b>	<b>-</b>	<b>502,576</b>	<b>5,147,097</b>
<b>Total credit risk exposure</b>	<b>30,619,267</b>	<b>22,036</b>	<b>1,277,699</b>	<b>31,919,002</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, net exposure, according to geographical segments, before the effect of mitigation through collateral received (continued):

Group	Republic of Croatia	EU countries	Other countries	Total
31 December 2017	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and current accounts with banks	1,320,579	82,884	201	1,403,664
Deposits with other banks	29,116	22	-	29,138
Loans to financial institutions	10,836,141	-	-	10,836,141
Loans to other customers	12,075,474	-	308,149	12,383,623
Assets available for sale	2,483,371	-	-	2,483,371
Assets held to maturity	1,399	-	-	1,399
Other assets	13,105	6,045	147	19,297
<b>Total</b>	<b>26,759,185</b>	<b>88,951</b>	<b>308,497</b>	<b>27,156,633</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,324,416</b>	<b>602</b>	<b>142,432</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>32,083,601</b>	<b>89,553</b>	<b>450,929</b>	<b>32,624,083</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, net exposure, according to geographical segments, before the effect of mitigation through collateral received (continued):

Bank	Republic of Croatia	EU countries	Other countries	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and current accounts with banks	925,865	14,740	464	941,069
Deposits with other banks	261,922	3	-	261,925
Loans to financial institutions	10,234,988	-	-	10,234,988
Loans to other customers	11,736,094	-	774,592	12,510,686
Financial assets at fair value through profit or loss	2,045	-	-	2,045
Financial assets at fair value through other comprehensive income	2,766,363	-	-	2,766,363
Other assets	4,106	9	67	4,182
<b>Total</b>	<b>25,931,383</b>	<b>14,752</b>	<b>775,123</b>	<b>26,721,258</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,576	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	1,822,396
Undrawn loans	2,788,456	-	502,576	3,291,032
Other irrevocable contingent liabilities	93	-	-	93
<b>Total</b>	<b>4,644,521</b>	<b>-</b>	<b>502,576</b>	<b>5,147,097</b>
<b>Total credit risk exposure</b>	<b>30,575,904</b>	<b>14,752</b>	<b>1,277,699</b>	<b>31,868,355</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to geographical segments, net exposure, before the effect of mitigation through collateral received (continued):

Bank	Republic of Croatia	EU countries	Other countries	Total
31 December 2017	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and current accounts with banks				
Deposits with other banks	1,318,045	82,884	201	1,401,130
Loans to financial institutions	29,116	22	-	29,138
Loans to other customers	10,836,141	-	-	10,836,141
Financial assets at fair value through profit or loss	12,075,474	-	308,149	12,383,623
Financial assets at fair value through other comprehensive income	2,443,699	-	-	2,443,699
Other assets	11,911	224	147	12,282
<b>Total</b>	<b>26,714,386</b>	<b>83,130</b>	<b>308,497</b>	<b>27,106,013</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,324,416</b>	<b>602</b>	<b>142,432</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>32,038,802</b>	<b>83,732</b>	<b>450,929</b>	<b>32,573,463</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to industry, net exposure, before and after the effect of mitigation through collateral received:

Group	Highest exposure 31 December 2018 HRK '000	Highest exposure after the effect of mitigation through collateral received 31 December 2018 HRK '000	Highest exposure 31 December 2017 HRK '000	Highest exposure after the effect of mitigation through collateral received 31 December 2017 HRK '000
Financial intermediation and insurance	13,037,974	-	13,991,248	-
Water and electric supply and other infrastructure	1,381,948	1,029,981	1,260,064	931,740
Tourism	3,113,457	77,346	3,550,174	268,536
Transport, warehousing and connections	1,955,578	695,034	1,979,350	857,758
Shipbuilding	2,995,154	382,101	2,994,248	416,604
Agriculture and fishery	517,983	129,394	455,716	68,992
Food industry	824,235	117,622	952,014	143,121
Construction industry	1,011,185	66,009	1,225,516	52,841
Other industry	460,568	131,022	493,034	149,251
Public administration	3,788,365	3,788,365	2,473,206	2,473,206
Education	43,562	39,163	47,201	42,085
Manufacture of basic metals and fabricated metal products, except machinery and equipment	219,087	19,227	321,123	55,470
Manufacture of chemicals and chemical products	74,185	54,370	403,043	89,662
Manufacture of other non-metallic mineral products	207,541	65,207	261,053	55,823
Pharmaceutical industry	461,803	911	544,777	891
Other	1,826,377	312,829	1,672,316	476,548
<b>Total credit risk exposure</b>	<b>31,919,002</b>	<b>6,908,581</b>	<b>32,624,083</b>	<b>6,082,528</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to industry, net exposure, before and after the effect of mitigation through collateral received:

Bank	Highest exposure	Highest exposure after the effect of mitigation through collateral received	Highest exposure	Highest exposure after the effect of mitigation through collateral received
	31 December 2018	31 December 2018	31 December 2017	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation and insurance	13,027,345	-	13,982,804	-
Water and electric supply and other infrastructure	1,381,948	1,029,981	1,260,064	931,740
Tourism	3,113,457	77,346	3,550,170	268,533
Transport, warehousing and connections	1,955,578	695,034	1,979,333	857,741
Shipbuilding	2,995,154	382,101	2,994,248	416,604
Agriculture and fishery	517,943	129,354	455,679	68,956
Food industry	824,134	117,521	951,920	143,027
Construction industry	1,011,110	65,933	1,225,514	52,839
Other industry	460,205	130,659	492,757	148,974
Public administration	3,750,268	3,750,268	2,432,805	2,432,805
Education	43,562	39,163	47,201	42,085
Manufacture of basic metals and fabricated metal products, except machinery and equipment	218,982	19,122	321,017	55,363
Manufacture of chemicals and chemical products	74,166	54,351	403,025	89,644
Manufacture of other non-metallic mineral products	207,522	65,189	261,037	55,807
Pharmaceutical industry	460,893	-	543,887	-
Other	1,826,088	312,540	1,672,002	476,249
<b>Total credit risk exposure</b>	<b>31,868,355</b>	<b>6,868,562</b>	<b>32,573,463</b>	<b>6,040,367</b>

Concentration of assets and guarantees and commitments according to industry for both years has been compiled in accordance with the National Classification of Activities 2007 ("NKD 2007"). In the preparation of the Note, a combined approach is applied, which takes into consideration business activities of a debtor, retains the names of activities different from those in the National Classification of Activities and unites similar business activities.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

The fair value of collateral for the Group in 2018 amounted to HRK 25,010,421 thousand (31 December 2017: HRK 26,541,555 thousand) and for the Bank HRK 24,999,793 thousand (31 December 2017: HRK 26,533,096 thousand).

In the total net highest exposure of the Bank after the effect of mitigation through collateral received in 2018, the credit risk of HRK 5,287,160 thousand (31 December 2017: HRK 3,966,003 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 1,572,804 thousand (31 December 2017: HRK 619,922 thousand), from local (regional) authorities of HRK 647,039 thousand (31 December 2017: HRK 510,573 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 228,404 thousand (31 December 2017: HRK 240,099 thousand), government funds of HRK 85 thousand (31 December 2017: HRK 43 thousand), government bonds and Treasury bills of the Ministry of Finance of HRK 2,765,595 thousand (31 December 2017: HRK 2,443,010 thousand). In addition, an amount of HRK 73,233 thousand (31 December 2017: HRK 152,356 thousand) relates to receivables from a majority state-owned company (controlling influence).

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and the further increase in exposure has been stopped pending the submission of the full collateral necessary for compliance with the requested collateral coverage ratio.

Financial intermediation includes mainly commercial bank.

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Credit risk quality according to type of financial assets**

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Group	Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Net exposure of portfolio after the effect of mitigation through collateral received Stage 1	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received POCI	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>31 December 2018</b>												
<b>Assets</b>												
Cash on hand and current accounts with banks	944,415	-	-	-	-	944,415	-	-	-	-	-	-
Deposits with other banks	261,925	-	-	-	-	261,925	-	-	-	-	-	-
Loans to financial institutions	10,064,840	137,737	32,411	-	-	10,234,988	-	-	-	-	-	-
Loans to other customers	9,408,775	1,141,971	1,728,419	231,521	-	12,510,686	2,930,911	127,418	278,948	1,372	-	3,338,649
Financial assets at fair value through profit or loss	-	-	-	-	2,045	2,045	-	-	-	-	2,045	2,045
Financial assets at fair value through other comprehensive income	2,802,223	770	768	-	-	2,803,761	2,802,223	770	768	-	-	2,803,761
Debt instruments at amortised cost	1,363	-	-	-	-	1,363	1,363	-	-	-	-	1,363
Other assets	11,315	12	1,395	-	-	12,722	3,067	1	1,281	-	-	4,349
<b>Total</b>	<b>23,494,856</b>	<b>1,280,490</b>	<b>1,762,993</b>	<b>231,521</b>	<b>2,045</b>	<b>26,771,905</b>	<b>5,737,564</b>	<b>128,189</b>	<b>280,997</b>	<b>1,372</b>	<b>2,045</b>	<b>6,150,167</b>
<b>Guarantees and commitments</b>												
Guarantees issued in HRK	13,236	-	20,340	-	-	33,576	12,371	-	-	-	-	12,371
Issued guarantees in foreign currency	31,756	-	1,790,640	-	-	1,822,396	1,469	-	293,997	-	-	295,466
Undrawn loans	2,654,591	604,066	22,193	10,182	-	3,291,032	318,481	110,058	21,945	-	-	450,484
Other irrevocable contingent liabilities	93	-	-	-	-	93	93	-	-	-	-	93
<b>Total</b>	<b>2,699,676</b>	<b>604,066</b>	<b>1,833,173</b>	<b>10,182</b>	<b>-</b>	<b>5,147,097</b>	<b>332,414</b>	<b>110,058</b>	<b>315,942</b>	<b>-</b>	<b>-</b>	<b>758,414</b>
<b>Total credit risk exposure</b>	<b>26,194,532</b>	<b>1,884,556</b>	<b>3,596,166</b>	<b>241,703</b>	<b>2,045</b>	<b>31,919,002</b>	<b>6,069,978</b>	<b>238,247</b>	<b>596,939</b>	<b>1,372</b>	<b>2,045</b>	<b>6,908,581</b>

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

*1. Allowances*

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument by risk category:

**Cash on hand and current accounts with banks**

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	41	-	-	-	41	3,079
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Increase of loss allowance	2,217	-	-	-	2,217	-
Release of loss allowance	(592)	-	-	-	(592)	(2,221)
Net foreign exchange gains on loss allowances	2	-	-	-	2	-
<b>Balance at 31 December</b>	<b>1,668</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,668</b>	<b>858</b>

**Deposits with other banks**

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	152	-	-	-	152	248
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Increase of loss allowance	1,465	-	-	-	1,465	106
Release of loss allowance	(249)	-	-	-	(249)	-
Net foreign exchange losses on loss allowances	(7)	-	-	-	(7)	-
<b>Balance at 31 December</b>	<b>1,361</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,361</b>	<b>354</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### I. Allowances (continued)

#### Loans to financial institutions

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	76,581	33,937	20,502	-	131,020	363,317
Transfer to Stage 1	89	(89)	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	(727)	727	-	-	-
Increase of loss allowance	39,481	3,594	2,485	-	45,560	7,949
Release of loss allowance	(41,651)	(11,810)	(5,248)	-	(58,709)	(131,795)
Unwind – changes due to the lapse of time	-	-	275	-	275	-
Loss allowances transferred from/to loans to other customers	(4)	(24)	-	-	(28)	998
Acquisition of immovable property	-	-	-	-	-	(1,105)
Net foreign exchange losses on loss allowances	(553)	(272)	(139)	-	(964)	(1,438)
<b>Balance at 31 December</b>	<b>73,943</b>	<b>24,609</b>	<b>18,602</b>	<b>-</b>	<b>117,154</b>	<b>237,926</b>

#### Loans to other customers

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	381,600	452,780	2,758,825	-	3,593,205	2,579,501
Transfer to Stage 1	22,243	(21,969)	(274)	-	-	-
Transfer to Stage 2	(379,180)	382,723	(3,543)	-	-	-
Transfer to Stage 3	(39,281)	(82,634)	121,915	-	-	-
Increase of loss allowance	211,756	416,830	415,807	93,000	1,137,393	553,952
Release of loss allowance	(445,286)	(104,673)	(714,670)	(83,925)	(1,348,554)	(216,064)
Write-offs	(2)	-	(42,028)	(1,228)	(43,258)	(7,610)
Unwind – changes due to the lapse of time	337	213	51,357	5,182	57,089	-
Loss allowances transferred to/from loans to financial institutions	4	24	-	-	28	(998)
Acquisition of immovable property	(5)	-	(984)	-	(989)	(284)
Interest transferred from the off-balance sheet records	-	-	496	-	496	-
Sale of receivables	-	-	-	-	-	(31,636)
Other	-	-	-	-	-	2,085
Net foreign exchange losses on loss allowances	(5,082)	(2,196)	(8,466)	630	(15,114)	(3,643)
<b>Balance at 31 December</b>	<b>(252,896)</b>	<b>1,041,098</b>	<b>2,578,435</b>	<b>13,659</b>	<b>3,380,296</b>	<b>2,875,303</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### I. Allowances (continued)

#### Financial assets at fair value through other comprehensive income

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	3,837	451	-	-	4,288	-
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	(1,739)	1,739	-	-	-
Increase of loss allowance	4,032	-	1,293	-	5,325	-
Release of loss allowance	(2,848)	-	-	-	(2,848)	-
Net foreign exchange losses on loss allowances	(14)	-	(5)	-	(19)	-
<b>Balance at 31 December</b>	<b>5,007</b>	<b>(1,288)</b>	<b>3,027</b>	<b>-</b>	<b>6,746</b>	<b>-</b>

#### Other assets

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	140	4	13,079	-	13,223	4,541
Transfer to Stage 1	8	-	(8)	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	(9)	(9)	18	-	-	-
Increase of loss allowance	395	2	26,958	1	27,356	2,756
Release of loss allowance	(272)	(5)	(6,163)	(1)	(6,441)	(559)
Write-offs	-	-	(10)	-	(10)	(1)
Acquisition of immovable property	-	-	(14)	-	(14)	-
Other	(2)	-	-	-	(2)	-
Net foreign exchange losses on loss allowances	-	-	6	-	6	-
<b>Balance at 31 December</b>	<b>260</b>	<b>(8)</b>	<b>33,866</b>	<b>-</b>	<b>34,118</b>	<b>6,737</b>

#### Guarantees and commitments

Group	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	20,203	749	28,395	-	49,347	75,103
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	(65,094)	65,094	-	-	-	-
Transfer to Stage 3	-	(1)	1	-	-	-
Increase of loss allowance	69,535	83,274	170,322	20,173	343,304	11,523
Release of loss allowance	(79,902)	(19,787)	(24,364)	(9,140)	(133,193)	(21,878)
Net foreign exchange losses on loss allowances	(193)	382	1,645	(9)	1,825	(388)
<b>Balance at 31 December</b>	<b>(55,451)</b>	<b>129,711</b>	<b>175,999</b>	<b>11,024</b>	<b>261,283</b>	<b>64,360</b>

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### Credit risk quality according to type of financial assets (continued)

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows (continued):

Group	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio	Net exposure of portfolio of risk group A after the effect of mitigation through collateral received	Net exposure of portfolio of risk group B after the effect of mitigation through collateral received	Net exposure of portfolio of risk group C after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
31 December 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	1,403,664	-	-	1,403,664	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Assets available for sale	2,483,371	-	-	2,483,371	2,483,371	-	-	2,483,371
Assets held to maturity	1,399	-	-	1,399	1,399	-	-	1,399
Other assets	18,871	426	-	19,297	10,608	426	-	11,034
<b>Total</b>	<b>25,551,778</b>	<b>1,604,855</b>	<b>-</b>	<b>27,156,633</b>	<b>5,256,601</b>	<b>51,132</b>	<b>-</b>	<b>5,307,733</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>22,176</b>	<b>-</b>	<b>5,467,450</b>	<b>774,795</b>	<b>-</b>	<b>-</b>	<b>774,795</b>
<b>Total credit risk exposure</b>	<b>30,997,052</b>	<b>1,627,031</b>	<b>-</b>	<b>32,624,083</b>	<b>6,031,396</b>	<b>51,132</b>	<b>-</b>	<b>6,082,528</b>

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### Credit risk quality according to type of financial assets (continued)

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows (continued):

Bank	Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Net exposure of portfolio after the effect of mitigation through collateral received Stage 1	Net exposure of portfolio after the effect of mitigation through collateral received Stage 2	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received POCI	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>												
Cash on hand and current accounts with banks	941,069	-	-	-	-	941,069	-	-	-	-	-	-
Deposits with other banks	261,925	-	-	-	-	261,925	-	-	-	-	-	-
Loans to financial institutions	10,064,840	137,737	32,411	-	-	10,234,988	-	-	-	-	-	-
Loans to other customers	9,408,775	1,141,971	1,728,419	231,521	-	12,510,686	2,930,911	127,418	278,948	1,372	-	3,338,649
Financial assets at fair value through profit or loss	-	-	-	-	2,045	2,045	-	-	-	-	2,045	2,045
Financial assets at fair value through other comprehensive income	2,765,595	-	768	-	-	2,766,363	2,765,595	-	768	-	-	2,766,363
Other assets	2,775	12	1,395	-	-	4,182	1,809	1	1,281	-	-	3,091
<b>Total</b>	<b>23,444,979</b>	<b>1,279,720</b>	<b>1,762,993</b>	<b>231,521</b>	<b>2,045</b>	<b>26,721,258</b>	<b>5,698,315</b>	<b>127,419</b>	<b>280,997</b>	<b>1,372</b>	<b>2,045</b>	<b>6,110,148</b>
<b>Guarantees and commitments</b>												
Guarantees issued in HRK	13,236	-	20,340	-	-	33,576	12,371	-	-	-	-	12,371
Issued guarantees in foreign currency	31,756	-	1,790,640	-	-	1,822,396	1,469	-	293,997	-	-	295,466
Undrawn loans	2,654,591	604,066	22,193	10,182	-	3,291,032	318,481	110,058	21,945	-	-	450,484
Other irrevocable contingent liabilities	93	-	-	-	-	93	93	-	-	-	-	93
<b>Total</b>	<b>2,699,676</b>	<b>604,066</b>	<b>1,833,173</b>	<b>10,182</b>	<b>-</b>	<b>5,147,097</b>	<b>332,414</b>	<b>110,058</b>	<b>315,942</b>	<b>-</b>	<b>-</b>	<b>758,414</b>
<b>Total credit risk exposure</b>	<b>26,144,655</b>	<b>1,883,786</b>	<b>3,596,166</b>	<b>241,703</b>	<b>2,045</b>	<b>31,868,355</b>	<b>6,030,729</b>	<b>237,477</b>	<b>596,939</b>	<b>1,372</b>	<b>2,045</b>	<b>6,868,562</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

**Credit risk quality according to type of financial assets (continued)**

In the total net highest exposure of the Group and the Bank after the effect of mitigation through collateral received, the amount of loans to other customers of HRK 2,520,298 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 1,571,622 thousand, local and regional authorities of HRK 647,039 thousand and public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 228,404 thousand. An additional amount of HRK 73,233 thousand relates to receivables from majority state-owned companies (controlling influence).

The amount of financial assets at fair value through other comprehensive income and debt instruments at amortised cost is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 2,803,585 thousand for the Group and HRK 2,765,595 thousand for the Bank.

Other assets of HRK 1,174 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

*I. Allowances*

**Cash on hand and current accounts with banks**

Bank	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	41	-	-	-	41	3,079
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Increase of loss allowance	2,200	-	-	-	2,200	-
Release of loss allowance	(592)	-	-	-	(592)	(2,221)
Net foreign exchange gains on loss allowances	2	-	-	-	2	-
<b>Balance at 31 December</b>	<b>1,651</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,651</b>	<b>858</b>

**Deposits with other banks**

Bank	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January	152	-	-	-	152	248
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Increase of loss allowance	1,465	-	-	-	1,465	106
Release of loss allowance	(249)	-	-	-	(249)	-
Net foreign exchange losses on loss allowances	(7)	-	-	-	(7)	-
<b>Balance at 31 December</b>	<b>1,361</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,361</b>	<b>354</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

*I. Allowances (continued)*

**Loans to financial institutions**

Bank	2018					2017
	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000	Total HRK '000
Balance at 1 January	76,581	33,937	20,502	-	131,020	363,317
Transfer to Stage 1	89	(89)	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	(727)	727	-	-	-
Increase of loss allowance	39,481	3,594	2,485	-	45,560	7,949
Release of loss allowance	(41,651)	(11,810)	(5,248)	-	(58,709)	(131,795)
Unwind – changes due to the lapse of time	-	-	275	-	275	-
Loss allowances transferred from/to loans to other customers	(4)	(24)	-	-	(28)	998
Acquisition of immovable property	-	-	-	-	-	(1,105)
Net foreign exchange losses on loss allowances	(553)	(272)	(139)	-	(964)	(1,438)
<b>Balance at 31 December</b>	<b>73,943</b>	<b>24,609</b>	<b>18,602</b>	<b>-</b>	<b>117,154</b>	<b>237,926</b>

**Loans to other customers**

Bank	2018					2017
	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000	Total HRK '000
Balance at 1 January	381,600	452,780	2,758,825	-	3,593,205	2,579,501
Transfer to Stage 1	22,243	(21,969)	(274)	-	-	-
Transfer to Stage 2	(379,180)	382,723	(3,543)	-	-	-
Transfer to Stage 3	(39,281)	(82,634)	121,915	-	-	-
Increase of loss allowance	211,756	416,830	415,807	93,000	1,137,393	553,952
Release of loss allowance	(445,286)	(104,673)	(714,670)	(83,925)	(1,348,554)	(216,064)
Write-offs	(2)	-	(42,028)	(1,228)	(43,258)	-
Unwind – changes due to the lapse of time	337	213	51,357	5,182	57,089	(7,610)
Loss allowances transferred to/from loans to financial institutions	4	24	-	-	28	(998)
Acquisition of immovable property	(5)	-	(984)	-	(989)	(284)
Interest transferred from the off-balance sheet records	-	-	496	-	496	-
Sale of receivables	-	-	-	-	-	(31,636)
Other	-	-	-	-	-	2,085
Net foreign exchange losses on loss allowances	(5,082)	(2,196)	(8,466)	630	(15,114)	(3,643)
<b>Balance at 31 December</b>	<b>(252,896)</b>	<b>1,041,098</b>	<b>2,578,435</b>	<b>13,659</b>	<b>3,380,296</b>	<b>2,875,303</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.3. Credit risk (continued)**

*I. Allowances (continued)*

**Financial assets at fair value through other comprehensive income**

Bank	2018					2017
	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000	Total HRK '000
Balance at 1 January	3,546	451	-	-	3,997	-
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	(1,739)	1,739	-	-	-
Increase of loss allowance	4,032	-	1,293	-	5,325	-
Release of loss allowance	(2,844)	-	-	-	(2,844)	-
Net foreign exchange losses on loss allowances	(14)	-	(5)	-	(19)	-
<b>Balance at 31 December</b>	<b>4,720</b>	<b>(1,288)</b>	<b>3,027</b>	<b>-</b>	<b>6,459</b>	<b>-</b>

**Other assets**

Bank	2018					2017
	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000	Total HRK '000
Balance at 1 January	4	4	13,079	-	13,087	4,537
Transfer to Stage 1	8	-	(8)	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	(9)	(9)	18	-	-	-
Increase of loss allowance	196	2	26,958	1	27,157	2,399
Release of loss allowance	(174)	(5)	(6,163)	(1)	(6,343)	(489)
Write-offs	-	-	(10)	-	(10)	(1)
Acquisition of immovable property	-	-	(14)	-	(14)	-
Net foreign exchange losses on loss allowances	-	-	6	-	6	-
<b>Balance at 31 December</b>	<b>25</b>	<b>(8)</b>	<b>33,866</b>	<b>-</b>	<b>33,883</b>	<b>6,446</b>

**Guarantees and commitments**

Bank	2018					2017
	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000	Total HRK '000
Balance at 1 January	20,203	749	28,395	-	49,347	75,103
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	(65,094)	65,094	-	-	-	-
Transfer to Stage 3	-	(1)	1	-	-	-
Increase of loss allowance	69,535	83,274	170,322	20,173	343,304	11,523
Release of loss allowance	(79,902)	(19,787)	(24,364)	(9,140)	(133,193)	(21,878)
Net foreign exchange losses on loss allowances	(193)	382	1,645	(9)	1,825	(388)
<b>Balance at 31 December</b>	<b>(55,451)</b>	<b>129,711</b>	<b>175,999</b>	<b>11,024</b>	<b>261,283</b>	<b>64,360</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### Credit risk quality according to type of financial assets (continued)

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows (continued):

Bank	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio	Net exposure of portfolio of risk group A after the effect of mitigation through collateral received	Net exposure of portfolio of risk group B after the effect of mitigation through collateral received	Net exposure of portfolio of risk group C after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
					HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	1,401,130	-	-	1,401,130	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Assets available for sale	2,443,699	-	-	2,443,699	2,443,699	-	-	2,443,699
Other assets	11,856	426	-	12,282	9,518	426	-	9,944
<b>Total</b>	<b>25,501,158</b>	<b>1,604,855</b>	<b>-</b>	<b>27,106,013</b>	<b>5,214,440</b>	<b>51,132</b>	<b>-</b>	<b>5,265,572</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>22,176</b>	<b>-</b>	<b>5,467,450</b>	<b>774,795</b>	<b>-</b>	<b>-</b>	<b>774,795</b>
<b>Total credit risk exposure</b>	<b>30,946,432</b>	<b>1,627,031</b>	<b>-</b>	<b>32,573,463</b>	<b>5,989,235</b>	<b>51,132</b>	<b>-</b>	<b>6,040,367</b>

In the total net highest exposure of the Group and the Bank, the amount of loans to other customers of HRK 1,521,624 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 618,596 thousand, local (regional) authorities of HRK 510,573 thousand and public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 240,099 thousand. An additional amount of HRK 152,356 thousand relates to receivables from majority state-owned companies (controlling influence).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.3. Credit risk (continued)

##### Credit risk quality according to type of financial assets (continued)

The amount of assets available for sale and held to maturity is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 2,483,310 thousand for the Group and HRK 2,443,010 thousand for the Bank.

Other assets of HRK 1,034 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.4. Liquidity risk

The table below provides an analysis of total assets, total liabilities and total guarantees and commitments as of 31 December 2018 and 31 December 2017 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	944,417	-	-	-	-	944,417
Deposits with other banks	261,925	-	-	-	-	261,925
Loans to financial institutions*	389,640	693,932	1,231,553	2,718,573	5,201,290	10,234,988
Loans to other customers	2,096,151	141,949	792,913	2,769,366	6,710,307	12,510,686
Financial assets at fair value through profit or loss	334,221	-	-	-	2,045	336,266
Financial assets at fair value through other comprehensive income	2,818,280	11,167	23	-	-	2,829,470
Debt instruments at amortised cost	-	9	4	-	1,350	1,363
Property, plant and equipment and intangible assets	-	-	-	-	50,832	50,832
Foreclosed assets	-	-	9,690	2,666	12,974	25,330
Other assets	6,050	8,294	7,607	1,753	-	23,704
<b>Total assets</b>	<b>6,850,684</b>	<b>855,351</b>	<b>2,041,790</b>	<b>5,492,358</b>	<b>11,978,798</b>	<b>27,218,981</b>
<b>Liabilities</b>						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	313,492	461,196**	1,454,492	3,966,550	8,682,257	14,877,987
Debt securities issued	-	43,347	-	1,107,210	-	1,150,557
Other liabilities	268,912	24,566	80,386	159,906	166,464	700,234
<b>Total liabilities</b>	<b>812,108</b>	<b>535,688</b>	<b>1,712,614</b>	<b>5,234,423</b>	<b>8,863,041</b>	<b>17,157,874</b>
<b>Liquidity gap</b>	<b>6,038,576</b>	<b>319,663</b>	<b>329,176</b>	<b>257,935</b>	<b>3,115,757</b>	<b>10,061,107</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
<b>Total guarantees and commitments</b>	<b>5,194,569</b>	-	-	-	-	<b>5,194,569</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 691,269 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 222,527 thousand was placed in the 3 months up to 1 year maturity category.

\*\* Accrued interest on loans not yet due is allocated to the category from 1 to 3 months

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.4. Liquidity risk (continued)

Group	Up to 1 month	1 - 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
31 December 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	1,403,680	-	-	-	-	1,403,680
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Financial assets at fair value through profit or loss	291	-	-	-	-	291
Assets available for sale	3,308,009	13,532	23	-	-	3,321,564
Assets held to maturity	-	9	5	-	1,385	1,399
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Foreclosed assets	-	-	1,932	2,827	11,938	16,697
Other assets	18,904	7,543	1,397	497	1,130	29,471
<b>Total assets</b>	<b>7,308,471</b>	<b>829,530</b>	<b>2,258,924</b>	<b>5,008,136</b>	<b>12,670,500</b>	<b>28,075,561</b>
<b>Liabilities</b>						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151**	1,155,999	3,853,447	9,902,974	15,387,881
Debt securities issued	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
<b>Total liabilities</b>	<b>606,438</b>	<b>373,504</b>	<b>1,408,775</b>	<b>5,335,102</b>	<b>10,075,955</b>	<b>17,799,774</b>
<b>Liquidity gap</b>	<b>6,702,033</b>	<b>456,026</b>	<b>850,149</b>	<b>(326,966)</b>	<b>2,594,545</b>	<b>10,275,787</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,993	-	-	-	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	-	-	2,446,324
Undrawn loans	2,986,798	-	-	-	-	2,986,798
EIF – subscribed, not called up capital	48,088	-	-	-	-	48,088
Other irrevocable contingent liabilities	335	-	-	-	-	335
<b>Total guarantees and commitments</b>	<b>5,515,538</b>	-	-	-	-	<b>5,515,538</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 236,400 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 150,000 thousand was placed in the 3 months up to 1 year maturity category.

\*\* Accrued interest on loans not yet due is allocated to the category from 1 to 3 months

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.4. Liquidity risk (continued)**

The table below provides an analysis of total assets, total liabilities and total guarantees and commitments as of 31 December 2018 and 31 December 2017 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

<b>Bank</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 months to 1 year</b>	<b>1 to 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
<b>31 December 2018</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Assets</b>						
Cash on hand and current accounts with banks	941,071	-	-	-	-	941,071
Deposits with other banks	261,925	-	-	-	-	261,925
Loans to financial institutions*	389,640	693,932	1,231,553	2,718,573	5,201,290	10,234,988
Loans to other customers	2,096,151	141,949	792,913	2,769,366	6,710,307	12,510,686
Financial assets at fair value through profit or loss	328,758	-	-	-	2,045	330,803
Financial assets at fair value through other comprehensive income	2,781,000	11,072	-	-	-	2,792,072
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	50,764	50,764
Foreclosed assets	-	-	9,690	2,666	12,974	25,330
Other assets	4,856	970	7,585	1,753	-	15,164
<b>Total assets</b>	<b>6,803,401</b>	<b>847,923</b>	<b>2,041,741</b>	<b>5,492,358</b>	<b>12,013,504</b>	<b>27,198,927</b>
<b>Liabilities</b>						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	313,492	461,196**	1,454,492	3,966,550	8,682,257	14,877,987
Debt securities issued	-	43,347	-	1,107,210	-	1,150,557
Other liabilities	268,222	22,039	75,893	152,199	168,922	687,275
<b>Total liabilities</b>	<b>811,418</b>	<b>533,161</b>	<b>1,708,121</b>	<b>5,226,716</b>	<b>8,865,499</b>	<b>17,144,915</b>
<b>Liquidity gap</b>	<b>5,991,983</b>	<b>314,762</b>	<b>333,620</b>	<b>265,642</b>	<b>3,148,005</b>	<b>10,054,012</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
<b>Total guarantees and commitments</b>	<b>5,194,569</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,194,569</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 691,269 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 222,527 thousand was placed in the 3 months up to 1 year maturity category.

\*\* Accrued interest on loans not yet due is allocated to the category from 1 to 3 months

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.4. Liquidity risk (continued)**

<b>Bank</b>	<b>Up to 1 month</b>	<b>1 to 3 months</b>	<b>3 months to 1 year</b>	<b>1 to 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
<b>31 December 2018</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Assets</b>						
Cash on hand and current accounts with banks	1,401,146	-	-	-	-	1,401,146
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Assets available for sale	3,263,758	13,436	-	-	-	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Foreclosed assets	-	-	1,932	2,827	11,938	16,697
Other assets	17,831	1,648	1,350	497	900	22,226
<b>Total assets</b>	<b>7,260,322</b>	<b>823,530</b>	<b>2,258,849</b>	<b>5,008,136</b>	<b>12,704,966</b>	<b>28,055,803</b>
<b>Liabilities</b>						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151**	1,155,999	3,853,447	9,902,974	15,387,881
Debt securities issued	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
<b>Total liabilities</b>	<b>605,431</b>	<b>372,329</b>	<b>1,404,162</b>	<b>5,326,443</b>	<b>10,078,607</b>	<b>17,786,972</b>
<b>Liquidity gap</b>	<b>6,654,891</b>	<b>451,201</b>	<b>854,687</b>	<b>(318,307)</b>	<b>2,626,359</b>	<b>10,268,831</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,993	-	-	-	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	-	-	2,446,324
Undrawn loans	2,986,798	-	-	-	-	2,986,798
EIF – subscribed, not called up capital	48,088	-	-	-	-	48,088
Other irrevocable contingent liabilities	<b>335</b>	-	-	-	-	<b>335</b>
<b>Total guarantees and commitments</b>	<b>5,515,538</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,515,538</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 691,269 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 222,527 thousand was placed in the 3 months up to 1 year maturity category.

\*\* Accrued interest on loans not yet due is allocated to the category from 1 to 3 months

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.4. Liquidity risk (continued)**

The table below indicates the remaining contractual maturity of financial liabilities and guarantees and commitments of the Group in undiscounted amounts:

Group	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Financial liabilities</b>						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	338,464	438,773	1,647,005	4,387,915	9,457,974	16,270,131
Debt securities issued	-	-	66,758	1,173,968	-	1,240,726
Other liabilities	268,912	24,566	80,386	159,906	166,464	700,234
<b>Total</b>	<b>837,080</b>	<b>469,918</b>	<b>1,971,885</b>	<b>5,722,546</b>	<b>9,638,758</b>	<b>18,640,187</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
<b>Total guarantees and commitments</b>	<b>5,194,569</b>	-	-	-	-	<b>5,194,569</b>
<b>Group</b>						
31 December 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Financial liabilities</b>						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Debt securities issued	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
<b>Total</b>	<b>635,270</b>	<b>305,604</b>	<b>1,679,071</b>	<b>5,909,535</b>	<b>10,931,705</b>	<b>19,461,185</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,993	-	-	-	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	-	-	2,446,324
Undrawn loans	2,986,798	-	-	-	-	2,986,798
EIF – subscribed, not called up capital	48,088	-	-	-	-	48,088
Other irrevocable contingent liabilities	335	-	-	-	-	335
<b>Total guarantees and commitments</b>	<b>5,515,538</b>	-	-	-	-	<b>5,515,538</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.4. Liquidity risk (continued)**

The table below indicates the remaining contractual maturity of financial liabilities and guarantees and commitments of the Bank in undiscounted amounts:

Bank	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Financial liabilities</b>						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	338,464	438,773	1,647,005	4,387,915	9,457,974	16,270,131
Debt securities issued	-	-	66,758	1,173,968	-	1,240,726
Other liabilities	268,222	22,039	75,893	152,199	168,922	687,275
<b>Total</b>	<b>836,390</b>	<b>467,391</b>	<b>1,967,392</b>	<b>5,714,839</b>	<b>9,641,216</b>	<b>18,627,228</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
<b>Total guarantees and commitments</b>	<b>5,194,569</b>	-	-	-	-	<b>5,194,569</b>
<b>Bank</b>						
31 December 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Financial liabilities</b>						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Debt securities issued	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
<b>Total</b>	<b>634,263</b>	<b>304,429</b>	<b>1,674,458</b>	<b>5,900,876</b>	<b>10,934,357</b>	<b>19,448,383</b>
<b>Guarantees and commitments</b>						
Guarantees issued in HRK	33,993	-	-	-	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	-	-	2,446,324
Undrawn loans	2,986,798	-	-	-	-	2,986,798
EIF – subscribed, not called up capital	48,088	-	-	-	-	48,088
Other irrevocable contingent liabilities	335	-	-	-	-	335
<b>Total guarantees and commitments</b>	<b>5,515,538</b>	-	-	-	-	<b>5,515,538</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.5. Market risk

Management of market risks at the Bank implies the reduction of interest rate risk and the currency risk to a minimal level.

##### 36.5.1. Interest rate risk

The following tables demonstrate the sensitivity of the Group to the interest rate risk as of 31 December 2018 and 2017 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter. Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of Group's interest rate risk exposure as of 31 December 2018 and 2017 which may not be indicative for the positions in other periods.

Group								
31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total	Fixed interest rate
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	24,290	-	-	-	-	920,127	944,417	24,290
Deposits with other banks	261,922	-	-	-	-	3	261,925	261,922
Loans to financial institutions	383,417	956,301	1,193,348	2,624,259	5,070,629	7,034	10,234,988	9,922,017
Loans to other customers	2,273,725	465,131	712,572	2,476,258	6,491,188	91,812	12,510,686	11,699,344
Financial assets at fair value through profit or loss	-	-	-	-	2,045	334,221	336,266	2,045
Financial assets at fair value through other comprehensive income	2,792,223	-	-	-	-	37,247	2,829,470	2,792,223
Debt instruments at amortised cost	-	-	-	-	1,350	13	1,363	1,350
Other assets	-	-	-	-	-	23,704	23,704	-
<b>Total assets</b>	<b>5,735,577</b>	<b>1,421,432</b>	<b>1,905,920</b>	<b>5,100,517</b>	<b>11,565,212</b>	<b>1,414,161</b>	<b>27,142,819</b>	<b>24,703,191</b>
<b>Liabilities</b>								
Deposits from customers	148,351	-	-	-	-	280,745	429,096	-
Borrowings	313,492	559,016	1,441,392	3,931,617	8,577,456	55,014	14,877,987	14,665,772
Debt securities issued	-	-	-	1,107,210	-	43,347	1,150,557	1,107,210
Other liabilities	-	-	-	-	-	700,234	700,234	-
<b>Total liabilities</b>	<b>461,843</b>	<b>559,016</b>	<b>1,441,392</b>	<b>5,038,827</b>	<b>8,577,456</b>	<b>1,079,340</b>	<b>17,157,874</b>	<b>15,772,982</b>
<b>Interest rate gap</b>	<b>5,273,734</b>	<b>862,416</b>	<b>464,528</b>	<b>61,690</b>	<b>2,987,756</b>	<b>334,821</b>	<b>9,984,945</b>	<b>8,930,209</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.5. Market risk (continued)

##### 36.5.1. Interest rate risk (continued)

Group								
31 December 2017	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total	Fiksna kamatna stopa
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	2,534	-	-	-	-	1,401,146	1,403,680	2,534
Deposits with other banks	29,114	-	-	-	-	24	29,138	29,114
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141	10,417,751
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623	11,426,307
Financial assets at fair value through profit or loss	-	-	-	-	-	291	291	-
Assets available for sale	2,473,578	-	-	-	-	847,986	3,321,564	2,473,578
Assets held to maturity	-	-	-	-	1,385	14	1,399	1,385
Other assets	-	-	-	-	-	29,471	29,471	-
<b>Total assets</b>	<b>5,084,061</b>	<b>1,479,280</b>	<b>2,272,796</b>	<b>4,607,794</b>	<b>12,187,368</b>	<b>2,374,008</b>	<b>28,005,307</b>	<b>24,350,669</b>
<b>Liabilities</b>								
Deposits from customers	150,273	-	169,057	169,057	-	156,354	644,741	-
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881	15,323,205
Debt securities issued	-	-	-	1,117,790	-	43,909	1,161,699	1,117,790
Other liabilities	-	-	-	-	-	605,453	605,453	-
<b>Total liabilities</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>869,453</b>	<b>17,799,774</b>	<b>16,440,995</b>
<b>Interest rate gap</b>	<b>4,765,478</b>	<b>1,235,866</b>	<b>947,740</b>	<b>(532,500)</b>	<b>2,284,394</b>	<b>1,504,555</b>	<b>10,205,533</b>	<b>7,909,674</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.1. Interest rate risk (continued)**

The following tables demonstrate the sensitivity of HBOR to the interest rate risk as of 31 December 2018 and 2017 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter. Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of HBOR's interest rate risk exposure as of 31 December 2018 and 2017 which may not be indicative for the positions in other periods.

Bank								
31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total	Fiksna kamatna stopa
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	20,944	-	-	-	-	920,127	941,071	20,944
Deposits with other banks	261,922	-	-	-	-	3	261,925	261,922
Loans to financial institutions	383,417	956,301	1,193,348	2,624,259	5,070,629	7,034	10,234,988	9,922,017
Loans to other customers	2,273,725	465,131	712,572	2,476,258	6,491,188	91,812	12,510,686	11,699,344
Financial assets at fair value through profit or loss	-	-	-	-	2,045	328,758	330,803	2,045
Financial assets at fair value through other comprehensive income	2,755,291	-	-	-	-	36,781	2,792,072	2,755,291
Other assets	-	-	-	-	-	15,164	15,164	-
<b>Total assets</b>	<b>5,695,299</b>	<b>1,421,432</b>	<b>1,905,920</b>	<b>5,100,517</b>	<b>11,563,862</b>	<b>1,399,679</b>	<b>27,086,709</b>	<b>24,661,563</b>
<b>Liabilities</b>								
Deposits from customers	148,351	-	-	-	-	280,745	429,096	-
Borrowings	313,492	559,016	1,441,392	3,931,617	8,577,456	55,014	14,877,987	14,665,772
Debt securities issued	-	-	-	1,107,210	-	43,347	1,150,557	1,107,210
Other liabilities	-	-	-	-	-	687,275	687,275	-
<b>Total liabilities</b>	<b>461,843</b>	<b>559,016</b>	<b>1,441,392</b>	<b>5,038,827</b>	<b>8,577,456</b>	<b>1,066,381</b>	<b>17,144,915</b>	<b>15,772,982</b>
<b>Interest rate gap</b>	<b>5,233,456</b>	<b>862,416</b>	<b>464,528</b>	<b>61,690</b>	<b>2,986,406</b>	<b>333,298</b>	<b>9,941,794</b>	<b>8,888,581</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.1. Interest rate risk (continued)**

Bank								
31 December 2017	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total	Fixed interest rate
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>								
Cash on hand and current accounts with banks	-	-	-	-	-	1,401,146	1,401,146	-
Deposits with other banks	29,114	-	-	-	-	24	29,138	29,114
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141	10,417,751
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623	11,426,307
Assets available for sale	2,430,262	-	-	-	-	846,932	3,277,194	2,430,262
Other assets	-	-	-	-	-	22,226	22,226	-
<b>Total assets</b>	<b>5,038,211</b>	<b>1,479,280</b>	<b>2,272,796</b>	<b>4,607,794</b>	<b>12,185,983</b>	<b>2,365,404</b>	<b>27,949,468</b>	<b>24,303,434</b>
<b>Liabilities</b>								
Deposits from customers	150,273	-	169,057	169,057	-	156,354	644,741	-
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881	15,323,205
Debt securities issued	-	-	-	1,117,790	-	43,909	1,161,699	1,117,790
<b>Other liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>592,651</b>	<b>592,651</b>	<b>-</b>
<b>Total liabilities</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>856,651</b>	<b>17,786,972</b>	<b>16,440,995</b>
<b>Interest rate gap</b>	<b>4,719,628</b>	<b>1,235,866</b>	<b>947,740</b>	<b>(532,500)</b>	<b>2,283,009</b>	<b>1,508,753</b>	<b>10,162,496</b>	<b>7,862,439</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.1. Interest rate risk (continued)**

Total assets and total liabilities on the basis of a possibility of changes in interest rates (fixed or variable):

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Fixed interest rate assets	24,703,191	24,350,669	24,661,563	24,303,434
Variable interest rate assets	1,025,467	1,280,630	1,025,467	1,280,630
Non-interest bearing	1,414,161	2,374,008	1,399,679	2,365,404
<b>Total assets</b>	<b>27,142,819</b>	<b>28,005,307</b>	<b>27,086,709</b>	<b>27,949,468</b>
<b>Liabilities</b>				
Fixed interest rate liabilities	15,772,982	16,440,995	15,772,982	16,440,995
Variable interest rate liabilities	305,552	489,326	305,552	489,326
Non-interest bearing	1,079,340	869,453	1,066,381	856,651
<b>Total liabilities</b>	<b>17,157,874</b>	<b>17,799,774</b>	<b>17,144,915</b>	<b>17,786,972</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.1. Interest rate risk (continued)**

**Sensitivity analysis**

Assumptions used in preparing the interest risk sensitivity analysis relate to possible changes in reference interest rates in order to assess the hypothetical effect on HBOR's profit.

Volatility of reference interest rates for 2018 has been determined using the standard deviation method on the daily changes of the reference interest rates linked to EUR and USD. On the basis of the above volatility, possible changes in reference interest rates linked to EUR and USD have been established and used in the sensitivity analysis.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points of variable interest rates. All other variables remain constant.

The sensitivity of profit is influenced by hypothetical changes in interest rates during a period of one year based on interest bearing assets and liabilities with a variable interest rate.

Currency	Increase in b.p. in 2018	Effect on profit in 2018	Increase in b.p. in 2017	Effect on profit in 2017
		HRK '000		HRK '000
EUR	+1	40	+1	93
USD	+17	599	+10	349
Currency	Decrease in b.p. in 2018	Effect on profit in 2018	Decrease in b.p. in 2017	Effect on profit in 2017
		HRK '000		HRK '000
EUR	-1	(40)	-1	(93)
USD	-17	(599)	-10	(349)

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.2. Currency risk**

Total assets and total liabilities as of 31 December 2018 and 31 December 2017 in HRK and foreign currencies can be shown as follows:

Group	USD		Other	Total	HRK	Total
	HRK '000	HRK '000	foreign currencies	foreign currencies		
<b>31 December 2018</b>						
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	4,824	15,188	1,391	21,403	923,014	944,417
Deposits with other banks	40,545	221,380	-	261,925	-	261,925
Loans to financial institutions	-	5,784,740	-	5,784,740	4,450,248	10,234,988
Loans to other customers	635,501	7,866,575	-	8,502,076	4,008,610	12,510,686
Financial assets at fair value through profit or loss	-	50,119	-	50,119	286,147	336,266
Financial assets at fair value through other comprehensive income	-	619,962	-	619,962	2,209,508	2,829,470
Debt instruments at amortised cost	-	1,363	-	1,363	-	1,363
Property, plant and equipment and intangible assets	-	-	-	-	50,832	50,832
Foreclosed assets	-	-	-	-	25,330	25,330
Other assets	-	7,395	-	7,395	16,309	23,704
<b>Total assets</b>	<b>680,870</b>	<b>14,566,722</b>	<b>1,391</b>	<b>15,248,983</b>	<b>11,969,998*</b>	<b>27,218,981</b>
<b>Liabilities</b>						
Deposits from customers	20,526	161,858	80	182,464	246,632	429,096
Borrowings	688,500	14,189,487	-	14,877,987	-	14,877,987
Debt securities issued	-	1,150,557	-	1,150,557	-	1,150,557
Other liabilities	58,575	126,288	302	185,165	515,069	700,234
<b>Total liabilities</b>	<b>767,601</b>	<b>15,628,190</b>	<b>382</b>	<b>16,396,173</b>	<b>761,701</b>	<b>17,157,874</b>
<b>Currency gap</b>	<b>(86,731)</b>	<b>(1,061,468)</b>	<b>1,009</b>	<b>(1,147,190)</b>	<b>11,208,297</b>	<b>10,061,107</b>

\*Amounts linked to a one-way currency clause represent HRK 90,776 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.2. Currency risk (continued)**

Group	USD		Other	Total	HRK	Total
	HRK '000	HRK '000	foreign currencies	foreign currencies		
<b>31 December 2017</b>						
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	239	82,947	1,424	84,610	1,319,070	1,403,680
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Financial assets at fair value through profit or loss	-	291	-	291	-	291
Assets available for sale	-	735,821	-	735,821	2,585,743	3,321,564
Assets held to maturity	-	1,399	-	1,399	-	1,399
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Foreclosed assets	-	-	-	-	16,697	16,697
Other assets	-	6,308	-	6,308	23,163	29,471
<b>Total assets</b>	<b>458,652</b>	<b>15,994,822</b>	<b>1,424</b>	<b>16,454,898</b>	<b>11,620,663*</b>	<b>28,075,561</b>
<b>Liabilities</b>						
Deposits from customers	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Debt securities issued	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,291	18,222	2,665	24,178	581,275	605,453
<b>Total liabilities</b>	<b>433,414</b>	<b>16,685,459</b>	<b>2,742</b>	<b>17,121,615</b>	<b>678,159</b>	<b>17,799,774</b>
<b>Currency gap</b>	<b>25,238</b>	<b>(690,637)</b>	<b>(1,318)**</b>	<b>(666,717)</b>	<b>10,942,504</b>	<b>10,275,787</b>

\* Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

\*\*Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.2. Currency risk (continued)**

Total assets and total liabilities as of 31 December 2018 and 31 December 2017 in HRK and foreign currencies can be shown as follows:

Bank						
31 December 2018	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	4,824	15,188	1,391	21,403	919,668	941,071
Deposits with other banks	40,545	221,380	-	261,925	-	261,925
Loans to financial institutions	-	5,784,740	-	5,784,740	4,450,248	10,234,988
Loans to other customers	635,501	7,866,575	-	8,502,076	4,008,610	12,510,686
Financial assets at fair value through profit or loss	-	46,807	-	46,807	283,996	330,803
Financial assets at fair value through other comprehensive income	-	611,072	-	611,072	2,181,000	2,792,072
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	50,764	50,764
Foreclosed assets	-	-	-	-	25,330	25,330
Other assets	-	110	-	110	15,054	15,164
<b>Total assets</b>	<b>680,870</b>	<b>14,545,872</b>	<b>1,391</b>	<b>15,228,133</b>	<b>11,970,794*</b>	<b>27,198,927</b>
<b>Liabilities</b>						
Deposits from customers	20,526	161,858	80	182,464	246,632	429,096
Borrowings	688,500	14,189,487	-	14,877,987	-	14,877,987
Debt securities issued	-	1,150,557	-	1,150,557	-	1,150,557
Other liabilities	58,379	118,213	268	176,860	510,415	687,275
<b>Total liabilities</b>	<b>767,405</b>	<b>15,620,115</b>	<b>348</b>	<b>16,387,868</b>	<b>757,047</b>	<b>17,144,915</b>
<b>Currency gap</b>	<b>(86,535)</b>	<b>(1,074,243)</b>	<b>1,043</b>	<b>(1,159,735)</b>	<b>11,213,747</b>	<b>10,054,012</b>

\*Amounts linked to a one-way currency clause represent HRK 90,776 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**36. Risk management (continued)**

**36.5. Market risk (continued)**

**36.5.2. Currency risk (continued)**

Bank						
31 December 2017	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and current accounts with banks	239	82,947	1,424	84,610	1,316,536	1,401,146
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Assets available for sale	-	724,243	-	724,243	2,552,951	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Foreclosed assets	-	-	-	-	16,697	16,697
Other assets	-	488	-	488	21,738	22,226
<b>Total assets</b>	<b>458,652</b>	<b>15,975,734</b>	<b>1,424</b>	<b>16,435,810</b>	<b>11,619,993*</b>	<b>28,055,803</b>
<b>Liabilities</b>						
Deposits from customers	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Debt securities issued	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,054	10,696	2,611	16,361	576,290	592,651
<b>Total liabilities</b>	<b>433,177</b>	<b>16,677,933</b>	<b>2,688</b>	<b>17,113,798</b>	<b>673,174</b>	<b>17,786,972</b>
<b>Currency gap</b>	<b>25,475</b>	<b>(702,199)</b>	<b>(1,264)**</b>	<b>(677,988)</b>	<b>10,946,819</b>	<b>10,268,831</b>

\* Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

\*\*Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 36. Risk management (continued)

#### 36.5. Market risk (continued)

##### 36.5.2. Currency risk (continued)

#### Sensitivity analysis

Sensitivity analysis of the Bank's total assets and total liabilities to fluctuations in foreign exchange rates is carried out for those foreign currencies that represent Bank's significant currencies as at the reporting date.

An assumption of reasonably possible fluctuations in EUR exchange rates against HRK was used in the foreign currency risk sensitivity analysis, with the other variables remaining stable, in order to assess the hypothetical effect on HBOR's profit as of 31 December 2018.

Volatility of the exchange rate EUR/HRK, determined using the standard deviation method on the changes of the foreign exchange rate EUR/HRK, equalled 1.97% in the last 12 months (2017:1.56%).

The effect of the assumed changes in the foreign exchange rate EUR/HRK by total asset and total liabilities items denominated or indexed to EUR on HBOR's profits is stated below.

	Change in currency rate in 2018	Effect on profit in 2018	Change in currency rate in 2017	Effect on profit in 2017
	%	HRK' 000	%	HRK' 000
EUR	+1.97	(14,207)	+1.56%	(190)
EUR	-1.97	15,217	-1.56%	1,697

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 37. Fair value of financial assets and financial liabilities

The accounting policy on fair value measurements is discussed in Note 4.2.

#### 37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value

Below is a breakdown of the financial assets at fair value based on IFRS 9 classification.

Group	31 December 2018		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
<b>Financial assets at fair value through profit or loss:</b>			
<b>Loans at FVPL:</b>			
Mezzanine loans	-	-	2,045
<b>Investments in investment funds:</b>			
Investments in investment funds at fair value through profit or loss	334,060	-	-
<b>Equity instruments:</b>			
<b>Listed equity instruments:</b>			
Investments in corporate shares	-	-	-
<b>Unlisted equity instruments:</b>			
Investments in corporate shares	-	-	-
Investment in financial institutions shares	-	161	-
<b>Total financial assets at fair value through profit or loss</b>	<b>334,060</b>	<b>161</b>	<b>2,045</b>
<b>Financial assets at fair value through other comprehensive income:</b>			
<b>Debt instruments:</b>			
<b>Listed debt instruments:</b>			
Bonds of the Republic of Croatia	1,124,611	-	-
Corporate bonds	770	-	-
Treasury bills of the Ministry of Finance	1,666,299	-	-
Accrued interest	11,313	-	-
<b>Unlisted debt instruments:</b>			
Corporate bonds	-	-	535
Accrued interest	-	-	233
<b>Total debt instruments</b>	<b>2,802,993</b>	<b>-</b>	<b>768</b>
<b>Unlisted equity instruments:</b>			
Investment in shares of foreign legal entities	-	38	-
Shares of foreign financial institutions – EIF	-	25,671	-
<b>Total equity instruments</b>	<b>-</b>	<b>25,709</b>	<b>-</b>
<b>Total financial assets at fair value through other comprehensive income</b>	<b>2,802,993</b>	<b>25,709</b>	<b>768</b>

Treasury Bills of the Ministry of Finance of the Republic of Croatia were classified within Level 1 of the fair value hierarchy because credit institutions in the country started to list prices at Bloomberg, and quoted market price is used as the valuation technique.

Debt Instruments: Corporate Bonds were classified within Level 3 of the fair value hierarchy. The valuation technique used was the method of the discounted cash flows based on market interest rates, spread linked to internal credit-rating and internally determined spread linked to financial instrument liquidity.

There were no transfers between the levels in the reporting period.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

Below we give an overview of investments in financial instruments as at 31 December 2017, pursuant to IAS 39 that have been reallocated to Financial assets at fair value through other comprehensive income and Financial assets at fair value through profit and loss according to IFRS 9:

Group	31 December 2017		
	Level 1	Level 2	Level 3
	HRK '000	HRK '000	HRK '000
<b>Financial assets at fair value through profit or loss:</b>			
Shares in investment funds	291	-	-
<b>Total financial assets at fair value through profit or loss</b>	<b>291</b>	<b>-</b>	<b>-</b>
<b>Assets available for sale:</b>			
<b>Debt instruments:</b>			
<b>Listed debt instruments:</b>			
Bonds of the Republic of Croatia	884,763	-	-
Financial institution bonds	-	-	-
Corporate bonds	770	-	-
Treasury bills of the Ministry of Finance	1,583,313	-	-
Accrued interest	13,836	-	-
<b>Unlisted debt instruments:</b>			
Corporate bonds	-	-	522
Accrued interest	-	-	167
<b>Total debt instruments</b>	<b>2,482,682</b>	<b>-</b>	<b>689</b>
<b>Equity instruments:</b>			
<b>Listed equity instruments:</b>			
Corporate shares	18,951	-	-
<b>Unlisted equity instruments:</b>			
Investment in shares of foreign legal entities – SWIFT	-	35	-
Investment in financial institutions shares	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-
Corporate shares	-	-	-
<b>Total equity instruments</b>	<b>18,951</b>	<b>25,623</b>	<b>-</b>
<b>Investments in investment funds:</b>			
Shares classified as assets available for sale	793,619	-	-
<b>Total equity instruments</b>	<b>793,619</b>	<b>-</b>	<b>-</b>
<b>Total assets available for sale</b>	<b>3,295,252</b>	<b>25,623</b>	<b>689</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

Bank	31 December 2018		
	Level 1	Level 2	Level 3
	HRK '000	HRK '000	HRK '000
<b>Financial assets at fair value through profit or loss:</b>			
<b>Loans at FVPL:</b>			
Mezzanine loans	-	-	2,045
<b>Investments in investment funds:</b>			
Investments in investment funds at fair value through profit or loss	328,597	-	-
<b>Equity instruments:</b>			
<b>Listed equity instruments:</b>			
Investments in companies' shares	-	-	-
<b>Unlisted equity instruments:</b>			
Investments in companies' shares	-	-	-
Investment in financial institutions shares	-	161	-
<b>Total financial assets at fair value through profit or loss</b>	<b>328,597</b>	<b>161</b>	<b>2,045</b>
<b>Financial assets at fair value through other comprehensive income:</b>			
<b>Debt instruments:</b>			
<b>Listed debt instruments:</b>			
Bonds of the Republic of Croatia	1,088,457	-	-
Treasury bills of the Ministry of Finance	1,666,299	-	-
Accrued interest	10,839	-	-
<b>Unlisted debt instruments:</b>			
Corporate bonds	-	-	535
Accrued interest	-	-	233
<b>Total debt instruments</b>	<b>2,765,595</b>	<b>-</b>	<b>768</b>
<b>Unlisted equity instruments:</b>			
Investment in shares of foreign legal entities – SWIFT	-	38	-
Shares of foreign financial institutions – EIF	-	25,671	-
<b>Total equity instruments</b>	<b>-</b>	<b>25,709</b>	<b>-</b>
<b>Total financial assets at fair value through other comprehensive income</b>	<b>2,765,595</b>	<b>25,709</b>	<b>768</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
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(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

Bank	31 December 2017		
	Level 1	Level 2	Level 3
	HRK '000	HRK '000	HRK '000
<b>Assets available for sale:</b>			
<b>Debt instruments:</b>	846,428	-	-
<b>Listed debt instruments:</b>	1,583,313	-	-
Bonds of the Republic of Croatia	13,269	-	-
Treasury bills of the Ministry of finance			
Accrued interest			
<b>Unlisted debt instruments:</b>			
Corporate bonds	-	-	522
Accrued interest	-	-	167
<b>Total debt instruments</b>	<b>2,443,010</b>	<b>-</b>	<b>689</b>
<b>Equity instruments:</b>			
<b>Listed equity instruments:</b>			
Corporate shares	18,951	-	-
<b>Unlisted equity instruments:</b>			
Investment in shares of foreign legal entities – SWIFT	-	35	-
Investment in financial institutions shares	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-
Corporate shares	-	-	-
<b>Total equity instruments</b>	<b>18,951</b>	<b>25,623</b>	
<b>Investments in investment funds:</b>			
Shares classified as assets available for sale	788,921	-	-
<b>Total investments in investment funds</b>	<b>788,921</b>	<b>-</b>	<b>-</b>
<b>Total assets available for sale</b>	<b>3,250,882</b>	<b>25,623</b>	<b>689</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

**37.1.1. Level 3 - fair value**

**a. Mezzanine loans**

For the assessment of fair value of mezzanine loans, the method of discounting expected future cash flows is used.

Due to their contractual characteristics, mezzanine loans do not pass the SPPI test. Characteristics due to which mezzanine loans do not pass the SPPI test are as follows:

- in the case of realisation of contractually defined performance indicators (net debt to EBITDA ratio) over the predetermined period, creditors have the option, but not the obligation, to convert a mezzanine loan to a „senior debt“,
- upon the final maturity of the mezzanine loan, creditors have the option, but not the obligation, to convert the loan into the debtor's equity and
- the debtor has the option, but not the obligation, to prematurely repay the loan at discount.

Due to the above-mentioned characteristics of the mezzanine loan, the assessment of fair value of these loans was carried out in accordance with the precautionary principle, according to which income is recognised only when it is actually incurred, and expenses also when they are possible, under the assumption that the regular operations of debtor are continued in the future. This is a situation in which the Group would, upon the final maturity of the mezzanine loan, convert its receivables into the debtor's equity.

On 28 December 2018, the market price of ordinary shares of the debtor that the Bank could subscribe amounted to HRK 7,222 thousand, assuming that the market price of the shares included all market expectations related to future operations of the issuer. Given that HBOR can subscribe ordinary shares not earlier than on 30 April 2030, the amount of market value is reduced to the current value by applying the appropriate discount rate. The present value of these shares in HBOR's expected ownership amounts to HRK 2,045 thousand, which represents the fair value of the mezzanine loan on 31 December 2018.

**b. Corporate bonds that are allocated to Stage 3**

*(i) Techniques of valuation and significant input data that are not visible*

For the assessment of fair value of illiquid corporate bonds in the HBOR portfolio, the method of discounted cash flow of bonds is used. The fair value of bonds is the present value of all future cash flows of bonds calculated by applying the discount rate defined as yield on risk-free investments increased by the premium of specific credit risk for the respective bond and the premium for bond liquidity risk.

The discount rate on risk-free investments is calculated as linearly interpolated/extrapolated yield of Croatian bonds of the same duration and of the same foreign currency as the bonds valued. The source of information on the yields on bonds of the Republic of Croatia is the Bloomberg information system.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

**37.1.1. Level 3 - fair value (continued)**

**b. Corporate bonds that are allocated to Stage 3 (continued)**

*(i) Techniques of valuation and significant input data that are not visible (continued)*

The premium of the specific risk amount for the respective bond depends on HBOR's internal credit rating of the bond issuer, i.e. if the issuer is a member of a business group, the risk premium depends on internal credit rating of the parent company.

*ii) Sensitivity analysis of corporate bond with the stated potential effect on profit/loss as at 31 December 2018, under the assumption of a change in discount rate (yield) of 2% and 10%*

Under the assumption that the market interest rates change by 2% compared with those in effect as at 31 December 2018, the impacts would be as follows:

- a. In the case of a decrease in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the respective bond) by 2%, the discount rate would equal 12.24%, the bond price would be 36.62%, which would result in an increase in HBOR's generated profits of HRK 16.72 thousand.
- b. In the case of an increase in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the corporate bond) by 2%, the discount rate would equal 16.24%, the bond price would be 34.46%, which would result in a decrease in HBOR's generated profits of HRK 15.82 thousand.

The change in interest rates defined in the "Decision on the Management of Interest Rate Risk in the Bank Book", which is applied when calculating standard interest rate shock, is used as the basis for the change in the market interest rate of 2% compared with the market terms and conditions in effect as at 31 December 2018. "Standard interest rate shock is a parallel positive or negative change in interest rates on a reference yield curve of 200 basis points by applying the lower limit rate of 0%, except for the cases in which negative interest rate can be achieved."

In the case of a decrease in expected cash flows on corporate bonds of 10%, the generated profit of HBOR would decrease by HRK 53.49 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)**

**37.1.1. Level 3 - fair value (continued)**

**c. Adjustment of fair value of Level 3\*:**

I. The fair value of Level 3 financial assets measured at fair value upon initial recognition – mezzanine loans:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Balance as at 1 January</b>	<b>4,016</b>	<b>n/a</b>	<b>4,016</b>	<b>n/p</b>
Decrease in fair value through profit or loss	(1,971)	n/a	(1,971)	n/a
<b>Balance as of 31 December</b>	<b>2,045</b>	<b>n/a</b>	<b>2,045</b>	<b>n/a</b>

II. The fair value of Level 3 financial assets measured at fair value upon initial recognition – unlisted debt securities:

	Group		Bank	
	2018	2017	2018	2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Balance as at 1 January</b>	<b>689</b>	<b>601</b>	<b>689</b>	<b>601</b>
Increase in fair value through other comprehensive income	33	29	33	29
Net foreign exchange	(20)	(9)	(20)	(9)
Accrued interest	66	68	66	68
<b>Balance as of 31 December</b>	<b>768</b>	<b>689</b>	<b>768</b>	<b>689</b>

\* Until 1 January 2018, mezzanine loans were classified as Loans to other customers, and debt securities – corporate bonds as Assets available for sale in accordance with IAS 39. Since 1 January 2018, mezzanine loans have been classified as Financial assets at fair value through profit or loss and debt securities as Financial assets at fair value through other comprehensive income in accordance with IFRS 9.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1.2 Financial instruments not measured at fair value**

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by level in the fair value hierarchy into which each fair value measurement is categorised.

Group	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>31 December 2018</b>					
<b>Assets</b>					
Cash on hand and current accounts with banks	944,417	-	-	944,417	944,417
Deposits with other banks	-	261,925	-	261,925	261,925
Loans to financial institutions	-	-	9,487,169	9,487,169	10,234,988
Loans to other customers	-	-	15,768,096	15,768,096	12,510,686
	<b>944,417</b>	<b>261,925</b>	<b>25,255,265</b>	<b>26,461,607</b>	<b>23,952,016</b>
<b>Liabilities</b>					
Deposits from customers	-	429,096	-	429,096	429,096
Borrowings	-	-	15,454,821	15,454,821	14,877,987
Debt securities issued	-	1,190,721	-	1,190,721	1,150,557
	<b>-</b>	<b>1,619,817</b>	<b>15,454,821</b>	<b>17,074,638</b>	<b>16,457,640</b>

Group	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>31 December 2017</b>					
<b>Assets</b>					
Cash on hand and current accounts with banks	1,403,680	-	-	1,403,680	1,403,680
Deposits with other banks	-	29,138	-	29,138	29,138
Loans to financial institutions	-	-	10,756,286	10,756,286	10,836,141
Loans to other customers	-	-	15,225,827	15,225,827	12,383,623
	<b>1,403,680</b>	<b>29,138</b>	<b>25,982,113</b>	<b>27,414,931</b>	<b>24,652,582</b>
<b>Liabilities</b>					
Deposits from customers	-	644,741	-	644,741	644,741
Borrowings	-	-	14,030,305	14,030,305	15,387,881
Debt securities issued	-	1,255,316	-	1,255,316	1,161,699
	<b>-</b>	<b>1,900,057</b>	<b>14,030,305</b>	<b>15,930,362</b>	<b>17,194,321</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**37. Fair value of financial assets and financial liabilities (continued)**

**37.1.2 Financial instruments not measured at fair value (continued)**

Bank	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>31 December 2018</b>					
<b>Assets</b>					
Cash on hand and current accounts with banks	941,071	-	-	941,017	941,017
Deposits with other banks	-	261,925	-	261,925	261,925
Loans to financial institutions	-	-	9,487,169	9,487,169	10,234,988
Loans to other customers	-	-	15,768,096	15,768,096	12,510,686
	<b>941,071</b>	<b>261,925</b>	<b>25,255,265</b>	<b>26,458,261</b>	<b>23,948,670</b>
<b>Liabilities</b>					
Deposits from customers	-	429,096	-	429,096	429,096
Borrowings	-	-	15,454,821	15,454,821	14,877,987
Debt securities issued	-	1,190,721	-	1,190,721	1,150,557
	<b>-</b>	<b>1,619,817</b>	<b>15,454,821</b>	<b>17,074,638</b>	<b>16,457,640</b>

Bank	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>31 December 2017</b>					
<b>Assets</b>					
Cash on hand and current accounts with banks	1,401,146	-	-	1,401,146	1,401,146
Deposits with other banks	-	29,138	-	29,138	29,138
Loans to financial institutions	-	-	10,756,286	10,756,286	10,836,141
Loans to other customers	-	-	15,225,827	15,225,827	12,383,623
	<b>1,401,146</b>	<b>29,138</b>	<b>25,982,113</b>	<b>27,412,397</b>	<b>24,650,048</b>
<b>Liabilities</b>					
Deposits from customers	-	644,741	-	644,741	644,741
Borrowings	-	-	14,030,305	14,030,305	15,387,881
Debt securities issued	-	1,255,316	-	1,255,316	1,161,699
	<b>-</b>	<b>1,900,057</b>	<b>14,030,305</b>	<b>15,930,362</b>	<b>17,194,321</b>

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 38. Reporting by segments

General information on segments is given in relation to business segments of the Group.

Since the Group does not allocate administrative costs and interest by segments, the profitability of segments is not presented.

Assets and liabilities by segments are presented in net terms, i.e. gross after impairment and provisioning, and before the effect of mitigation through collateral received.

Business operations of segments are divided in terms of organisation and management. Each segment as a whole provides various products and services and operates in various markets.

#### Business segments:

The Group has following business segments:

Segment:	Business activities of the segment include:
Banking activities	Financing reconstruction and development of the Croatian economy, financing of infrastructure, export promotion, support for the development of small and medium-sized companies, environmental protection, and export credit insurance of Croatian goods and services against non-market risks for and on behalf of the Republic of Croatia.
Insurance activities	Insurance of foreign and domestic short-term receivables of business entities relating to deliveries of goods and services.
Other	Preparation of analyses, credit risk assessment and providing information on creditworthiness.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

### 38. Reporting by segments (continued)

2018	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	375,642	1,375	-	-	377,017
Net fee income	38,650	1,281	1,274	-	41,205
Net income/(expenses) from financial operations	9,506	(272)	-	-	9,234
Net premiums earned	-	6,417	-	-	6,417
Other income	7,596	74	282	(271)	7,681
<b>Income from operating activities</b>	<b>431,394</b>	<b>8,875</b>	<b>1,556</b>	<b>(271)</b>	<b>441,554</b>
Operating costs	(161,160)	(5,747)	(1,268)	272	(167,903)
Impairment loss and provisions	(65,906)	(69)	84	-	(65,891)
Expenses for insured cases	-	(3,396)	-	-	(3,396)
Net change in provisions	-	658	-	-	658
Other expenses	-	(259)	-	-	(259)
<b>Operating expenses</b>	<b>(227,066)</b>	<b>(8,813)</b>	<b>(1,184)</b>	<b>272</b>	<b>(236,791)</b>
<b>Profit before income tax</b>	<b>204,328</b>	<b>62</b>	<b>372</b>	<b>1</b>	<b>204,763</b>
Income tax	-	-	(26)	-	(26)
<b>Profit for the year</b>	<b>204,328</b>	<b>62</b>	<b>346</b>	<b>1</b>	<b>204,737</b>
Assets of segment	27,198,927	55,340	1,363	(36,649)	27,218,981
<b>Total assets</b>	<b>27,198,927</b>	<b>55,340</b>	<b>1,363</b>	<b>(36,649)</b>	<b>27,218,981</b>
Liabilities of segment	17,144,915	12,845	137	(23)	17,157,874
Total equity	10,054,012	4,995	926	1,174	10,061,107
<b>Total liabilities and total equity</b>	<b>27,198,927</b>	<b>17,840</b>	<b>1,063</b>	<b>1,151</b>	<b>27,218,981</b>

Intra-group transactions are presented under "Unallocated".

The Group decided to apply a simple approach of stating operating segments by taking into consideration the main business model of each member of the Group as previously described in this Note.

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**38. Reporting by segments (continued)**

2017	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	475,738	1,627	-	-	477,365
Net fee income	42,395	1,398	1,188	-	44,981
Net income/(expenses) from financial operations	(20,625)	(96)	5	-	(20,716)
Net premiums earned	-	7,151	-	-	7,151
Other income	7,627	86	289	(293)	7,709
<b>Income from operating activities</b>	<b>505,135</b>	<b>10,166</b>	<b>1,482</b>	<b>(293)</b>	<b>516,490</b>
Operating costs	(149,432)	(6,120)	(1,117)	293	(156,376)
Impairment loss and provisions	(194,920)	(272)	5	-	(195,187)
Expenses for insured cases	-	(876)	-	-	(876)
Net change in provisions	-	(1,481)	-	-	(1,481)
Other expenses	-	(267)	-	-	(267)
<b>Operating expenses</b>	<b>(344,352)</b>	<b>(9,016)</b>	<b>(1,112)</b>	<b>293</b>	<b>(354,187)</b>
<b>Profit before income tax</b>	<b>160,783</b>	<b>1,150</b>	<b>370</b>	<b>-</b>	<b>162,303</b>
Income tax	-	(59)	(43)	-	(102)
<b>Profit for the year</b>	<b>160,783</b>	<b>1,091</b>	<b>327</b>	<b>-</b>	<b>162,201</b>
Assets of segment	28,055,803	55,213	1,201	(36,656)	28,075,561
<b>Total assets</b>	<b>28,055,803</b>	<b>55,213</b>	<b>1,201</b>	<b>(36,656)</b>	<b>28,075,561</b>
Liabilities of segment	17,786,972	12,680	152	(30)	17,799,774
Total equity	10,268,831	5,033	749	1,174	10,275,787
<b>Total liabilities and total equity</b>	<b>28,055,803</b>	<b>17,713</b>	<b>901</b>	<b>1,144</b>	<b>28,075,561</b>

Intra-group transactions are presented under "Unallocated"

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

**39. Capital management**

The primary objectives of the Group's capital management are to ensure the presumptions of going concern and to respect regulatory and contracted demands imposed by creditors regarding a certain capital adequacy level.

The Group has identified own funds as a manageable capital category.

Regulatory capital has to be, at every moment, at least at the level of share capital or at the level that ensures that the capital adequacy ratio is at least 12% and that is sufficient for covering capital requirements regarding business risks.

Regulatory capital is comprised of core capital minus debit items.

The Group has determined measures for the implementation and monitoring of the capital management policy as follows:

- At the reporting date, own funds have to be at least at the level of founder's capital for the reporting period.
- The capital adequacy ratio at the reporting date has to be at the level prescribed for the banks in the Republic of Croatia as well as at the level stated within regular financial covenants determined in loan contracts and contracts with special financial institutions that HBOR has concluded as a borrower.

Since 1 January 2018, the Group has calculated regulatory capital and capital requirements in accordance with Basel II requirements, whereas, until 31 December 2017, this was calculated in accordance with Basel I requirements. By the calculation in accordance with Basel II regulations, the capital adequacy ratio has been reduced, and below is a breakdown of capital adequacy ratio as at 31 December 2018 and 31 December 2017.

	Group		Bank	
	31 December 2018	31 December 2017	31 December 2018	31 December 2017
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Total regulatory capital</b>	<b>9,816,139</b>	<b>10,487,346</b>	<b>9,815,749</b>	<b>10,485,928</b>
Credit risk weighted exposure amount	15,519,739	n/a	15,504,641	n/a
Initial credit requirements for operating risk	897,363	n/a	877,863	n/a
Initial capital requirements for currency risk	725,300	n/a	706,112	n/a
Credit Risk weighted assets	n/a	16,159,625	n/a	16,183,382
Capital requirements for currency risk	n/a	129,933	n/a	113,018
<b>Total capital requirements</b>	<b>17,142,402</b>	<b>16,289,558</b>	<b>17,088,616</b>	<b>16,296,400</b>
	%	%	%	%
<b>Capital adequacy ratio</b>	<b>57.26</b>	<b>64.38</b>	<b>57.44</b>	<b>64.35</b>
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Own funds needed for ensuring capital adequacy according to regulatory requirements</b>	<b>2,057,088</b>	<b>1,303,165</b>	<b>2,050,634</b>	<b>1,303,712</b>

Minimum capital adequacy ratio as of the reporting date, i.e. 31 December 2018 was 12% (31 December 2017: 8%).

Notes to the Financial Statements which include significant accounting policies and other explanations  
for the year ended 31 December 2018 (continued)

(All amounts are expressed in HRK thousand)

#### 40. Earnings per share

Pursuant to the HBOR Act, the equity capital of the Bank consists of one share in the company that may not be divided, transferred or pledged and is owned solely by the Republic of Croatia.

For the purpose of calculation of earnings per share, earning is presented as net profit after taxation.

Appendix - financial performance of the HKO Group  
Statement of Profit or Loss and Other Comprehensive Income  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2018 HRK '000	2017 HRK '000
<b>Premium earned</b>		
Gross premium written	10,461	10,594
Premium impairment allowance originated and reserved on collection	(23)	(270)
Gross outward reinsurance premium	(4,430)	(3,877)
<b>Net premium written</b>	<b>6,008</b>	<b>6,447</b>
Changes in the gross unearned premium reserve	(99)	1,184
Changes in the gross unearned premium reserve, reinsurer's share	485	(750)
<b>Net premium earned</b>	<b>6,394</b>	<b>6,881</b>
Fee and commission income	2,555	2,586
Net investment income	1,257	1,540
Other operating income	85	82
<b>Net income</b>	<b>10,291</b>	<b>11,089</b>
Gross expense for returned premiums	(480)	(464)
Reinsurer's share	222	197
Gross reserve for returned premiums	(267)	(288)
Reinsurer's share	121	97
<b>Net expense and reserve for returned premiums</b>	<b>(404)</b>	<b>(458)</b>
Claims incurred	(9,777)	(6,213)
Claims incurred, reinsurer's share	6,381	5,337
Change in the claims provision	5,379	(3,397)
Change in the claims provision, reinsurer's share	(4,575)	2,107
<b>Net claims incurred</b>	<b>(2,592)</b>	<b>(2,166)</b>
Marketing and provision expenses	(908)	(886)
Administrative expenses	(5,597)	(5,949)
Other operating expenses	(183)	(107)
Net exchange differences other than those on financial instruments	(85)	(4)
<b>Profit before income tax</b>	<b>522</b>	<b>1,519</b>
Income tax	(41)	(102)
<b>Profit for the year</b>	<b>481</b>	<b>1,417</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Deferred tax – adjustment for previous period	(17)	-
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>(17)</b>	<b>-</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Gains on revaluation of financial assets available for sale	969	2,413
Decrease in the fair value of financial assets available for sale	(908)	(1,429)
Transfer of realized gains on asset available for sale to profit or loss	-	5
Deferred tax	(11)	(178)
<b>Total items that may be reclassified subsequently to profit or loss:</b>	<b>50</b>	<b>811</b>
<b>Other comprehensive income after income tax</b>	<b>50</b>	<b>811</b>
<b>Total comprehensive income after income tax</b>	<b>514</b>	<b>2,228</b>
<b>Attributable to:</b>		
Equity holder of the parent	514	2,228

Profit before and after taxation in the separate financial statements of the HKO Group differs from the result in the Consolidated Income Statement of HBOR Group, as IFRS 9 has not been applied in separate financial statements.

Appendix - financial performance of the HKO Group  
Statement of Financial Position  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2018	2017
	HRK '000	HRK '000
<b>Assets</b>		
<b>Non-current assets</b>		
Property and equipment	50	41
Intangible assets	18	2
Held to maturity investments	1,366	1,399
Deferred tax	-	231
<b>Total non-current assets</b>	<b>1,434</b>	<b>1,673</b>
<b>Current assets</b>		
Investments available for sale	42,569	44,370
Investments at fair value through profit or loss	291	291
Deposits with banks	-	-
Receivables from insurance operations	8,123	6,631
Other receivables	446	385
Cash and cash equivalents	3,363	2,534
<b>Total current assets</b>	<b>54,792</b>	<b>54,211</b>
<b>Total assets</b>	<b>56,226</b>	<b>55,884</b>
<b>Equity and liabilities</b>		
<b>Equity</b>		
Share capital	37,500	37,500
Accumulated losses	2,237	1,167
Other reserves	3,049	2,999
Profit for the year	481	1,417
<b>Total equity</b>	<b>43,267</b>	<b>43,083</b>
<b>Technical provisions</b>		
Gross technical provisions	16,969	16,726
Technical provisions, reinsurer's share	(8,721)	(7,873)
	<b>8,248</b>	<b>8,853</b>
<b>Current liabilities</b>		
Liabilities from insurance operations	2,549	1,183
Other liabilities	2,162	2,765
<b>Total liabilities</b>	<b>4,711</b>	<b>3,948</b>
<b>Total equity and liabilities</b>	<b>56,226</b>	<b>55,884</b>

Appendix - financial performance of the HKO Group  
Statement of Cash Flows  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2018	2017
	HRK '000	HRK '000
<b>Operating activities</b>		
Profit before income tax	522	1,520
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>		
Depreciation	45	58
Impairment loss and provisions	(32)	267
Income tax	41	102
Accrued interest	94	37
<i>Operating profit before working capital changes</i>	<i>670</i>	<i>1,984</i>
<b>Changes in operating assets and liabilities:</b>		
Net decrease in deposits with other banks	-	-
Net realized (gain)/loss on assets available for sale	(15)	5
Decrease of discount in assets available for sale and assets held to maturity	223	408
Net gain on financial assets at fair value through profit or loss	(3)	(7)
Premium receivables	(1,369)	(5,917)
Net decrease/(increase) in other assets	5	1,224
Net decrease of assets and liabilities from insurance operations	1,366	(7)
Net increase in technical provisions	(1,044)	1,046
Net increase in other liabilities	(527)	603
<b>Net cash used in operating activities</b>	<b>(694)</b>	<b>(661)</b>
<b>Investment activities</b>		
Net purchase of financial assets at fair value through profit or loss	-	-
Net sale of financial assets at fair value through profit or loss	-	-
Net purchase of assets available for sale	(4,526)	(6,590)
Net sale of assets available for sale	5,978	9,120
Purchase of assets held to maturity	-	-
Collection of assets held to maturity when due	-	-
Net purchase of property, plant and equipment and intangible assets	(70)	(10)
<b>Net cash provided investment activities</b>	<b>1,382</b>	<b>2,520</b>
<b>Effect of foreign currency to cash and cash equivalents</b>		
Net foreign exchange	141	124
<b>Net effect</b>	<b>141</b>	<b>124</b>
Net increase in cash and cash equivalents	829	1,983
Balance as of 1 January	2,534	551
Net increase in cash	829	1,983
<b>Balance as of 31 December</b>	<b>3,363</b>	<b>2,534</b>

Appendix - financial performance of the HKO Group  
Statement of Changes in Equity  
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	Share capital	Accumulated losses	Ostale Other reserves	Profit/(loss) for the year	Total equity attributable to the equity holders of the Company	Total equity
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Balance as of 1 January 2017</b>	<b>37,500</b>	<b>(148)</b>	<b>2,188</b>	<b>1,315</b>	<b>40,855</b>	<b>40,855</b>
Profit for the year	-	-	-	1,417	1,417	1,417
Other comprehensive income	-	-	811	-	811	811
Total comprehensive income	-	-	811	1,417	2,228	2,228
Transfer of profit 2016 to retained earnings	-	1,315	-	(1,315)	-	-
<b>Balance as of 31 December 2017</b>	<b>37,500</b>	<b>1,167</b>	<b>2,999</b>	<b>1,417</b>	<b>43,083</b>	<b>43,083</b>
Profit for the year	-	-	-	481	481	481
Other comprehensive income	-	-	50	-	50	50
Total comprehensive income	-	-	50	481	531	531
Balance adjustment of 1 January 2018	-	-	-	(347)	(347)	(347)
Transfer of profit 2017 to retained earnings	-	1,070	-	(1,070)	-	-
<b>Balance as of 31 December 2018</b>	<b>37,500</b>	<b>2,237</b>	<b>3,049</b>	<b>481</b>	<b>43,267</b>	<b>43,267</b>

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