Annual Report for HBOR Group for 2012

HBOR

CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

2012

Annual Report for HBOR Group for 2012

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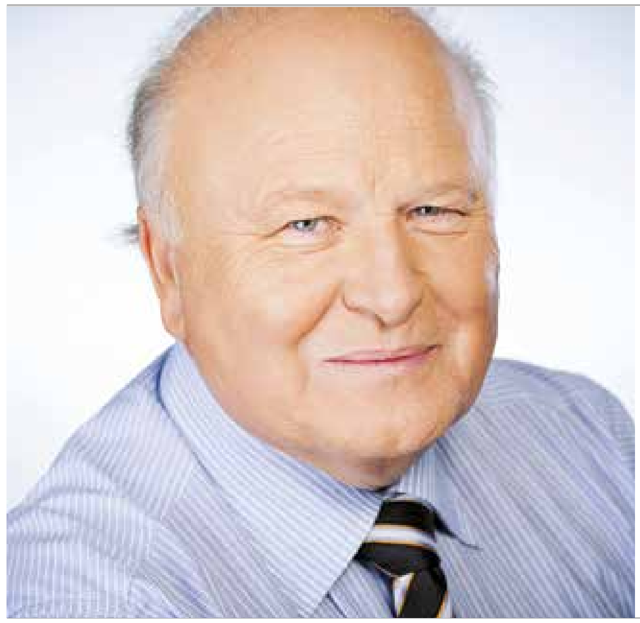


Slavko Linić

President of HBOR's Supervisory Board

Ladies and Gentlemen,

Despite negative economic circumstances in 2012, the Government of the Republic of Croatia put additional efforts into promoting the recovery of the Croatian economy. By the implementation of fiscal consolidation, disburdening of real sector and the improvement of business climate, preconditions for economic recovery and long-term sustainable development have been created. The efforts of the Croatian Government were directed not only towards solving the fiscal imbalance that is necessary for strengthening the sustainability of public finances and the improvement of Croatia's reputation in the domestic and international financial markets, but also towards the promotion of new investments and reduction of illiquidity problems by means of lending to the economy via HBOR.

HBOR is one of the key participants in the implementation of economic recovery. This is confirmed by the fact that at the very beginning of its mandate, the Government of the Republic of Croatia additionally capitalised HBOR with an amount of HRK 600 million, representing the triple amount of its contribution in 2011. In this way, the Government showed that it counted on the leading role of the state development and export bank.

During 2012, we invested more than HRK 10 billion through HBOR, and for the first time, we financed more investments than working capital, and particularly in export-oriented industries. One of the Government's measures was the implementation of the Programme for the Development of the Economy, through which, together with the Croatian National Bank and commercial banks via HBOR, we placed HRK 2.4 billion to business entities.

2012 was marked by numerous challenges, among others being the downgrade of Croatia's credit rating and consequently, the credit rating of the Croatian Bank for Reconstruction and Development.

However, thanks to the reputation of both HBOR and the Government as well as to HBOR's co-operation with international financial institutions, funds were procured for financing the Croatian entrepreneurs' activities under the equally favourable terms and conditions as in the past. In other words, this means that we managed to provide equally favourable terms and conditions for Croatian business entities and in this way, we will additionally support and promote their business activities.

At the end of July 2012, a EUR 50 million Loan Agreement was signed with the Council of Europe Development Bank (CEB), the proceeds of which were intended for the financing of projects implemented by SMEs, units of local and regional government as well as other public sector entities in the Republic of Croatia. In October 2012, HBOR continued its co-operation with the International Bank for Reconstruction and Development, when the Loan Agreement of EUR 50 million was signed for the financing of exports and tourism projects.

At the end of 2012, EIB approved a new loan to HBOR for the financing of projects promoted by SMEs and mid-cap companies in the amount of EUR 500 million. The mentioned amount represents the highest loan amount granted to HBOR since its establishment and is the evidence of the reputation of the Republic of Croatia and HBOR among the international financial institutions, since the loan was obtained under favourable terms and conditions.

After beginning of the accession process of the Republic of Croatia to the European Union, the domestic business entities obtained access to individual EU pre-accession funds, and HBOR was immediately and actively involved in their realisation and started with the implementation of loan programmes directed towards the utilisation of available funds. Therefore, on 15th February 2013, the Croatian Parliament passed the Act on Changes and Amendments to the Act on the Croatian Bank for Reconstruction and Development, by which the composition of the Supervisory Board was changed, i.e. the Supervisory Board of HBOR was increased by one member – the minister in charge of regional development and the EU funds so as to enable HBOR to play a more significant role in this field.

The main problem in Croatia has still remained an insufficient share of capital in the companies' balance sheets. The companies are mostly heavily indebted and this can be changed only through additional capitalisation. This problem has already been addressed through the programmes of economic co-operation funds. In 2012, among the companies invested in, there were several newly established ones which had innovative ideas and capital needs, but also those active for a longer period of time which, due to the circumstances in the economy, needed additional capital for the purpose of their restructuring and survival in the market.

In spite of generally negative movements at the beginning of 2013, we still expect the domestic economy to start to recover gradually. It is evident that the Government of the Republic of Croatia makes significant efforts to attract and enforce private sector investments. And it is exactly in this cycle that HBOR has to play a significant role in order to enable continued implementation of financing new investments through favourable loans in terms of price and maturity.

On behalf of the Supervisory Board of the Croatian Bank for Reconstruction and Development, I would like to express my satisfaction with the results achieved and the manner in which HBOR supported the development of the Croatian economy in the last year. I am confident that the Bank will continue to successfully support Croatian businessmen and contribute to the development of the Croatian economy. I would also like to thank all the members of the Supervisory Board for their kind co-operation. We all firmly believe that HBOR will continue its exceptional business operations in the time to come.

LETTER OF THE PRESIDENT OF THE MANAGING BOARD

Anton Kovačev

President of the Managing Board

Ladies and Gentlemen,

Despite challenging conditions in the domestic economy, HBOR increased its lending activities significantly in 2012. Altogether 1,622 loans were approved in the amount of HRK 10.2 billion, an increase of 56 per cent on 2011. In order to encourage economic recovery in the Republic of Croatia, in the reporting period, the focus was on the three following goals: enabling entrepreneurs to start a new investment cycle through the strengthening of entrepreneurial capacities, maintaining and improving liquidity, and enabling the financing of candidate projects nominated for the EU funds.

The above lending activities are the result of the measures implemented by HBOR during the past year for the purpose of granting loans to Croatian businessmen on favourable terms and conditions. Repayment and grace periods were extended and interest rates were temporarily reduced by 1 percentage point for new investment in agriculture, tourism, industry, environmental protection, energy efficiency and renewable energy resources. Approving of HRK loans was made possible under the majority of loan programmes and a new way of financing was introduced through the risk sharing model in cooperation with the commercial banks by assuming a higher risk compared to the previous period. HBOR managed again, in the times of economic and liquidity crisis, to confirm its capability to raise, in cooperation with special financial institutions, sufficient funds in international markets and offer favourable loans to our entrepreneurs.

In addition to an increase in the amount of loans approved, the measures taken resulted also in a rise in the share of investment loans. For the first time since 2008, the amount approved by HBOR for investment loans exceeded that approved for other purposes and reached 53 per cent of total loans.

The biggest rise in investment was recorded in the tourism industry and the municipal infrastructure sector where the investors were, beside public enterprises, also private entrepreneurs. Particularly significant results were achieved in the financing of candidate projects nominated for the EU funds, where the funds drawn down by small and medium-sized enterprises doubled in comparison to the previous year.

In the reporting period, five new loan programmes were introduced: the Programme for the Development of the Economy, the Loan Programme for IPA SME Grant Candidate Projects, the Loan Programme for the Financing of Manufacturing, the Loan Programme for the Financing of IPA Programme Candidate Projects, and the New Production loan programme.

Through its loan programmes for the financing of exports, HBOR contributes to the strengthening of competitiveness of Croatian entrepreneurs and directly affects their performance both in the domestic and international markets. Under all programmes, altogether 616 loans were approved to exporters totalling almost HRK 6 billion. Besides, there was a considerable increase in the export bank guarantees approved with 34 guarantees issued totalling HRK 244.2 million, a multiple increase compared to 2011 when 8 guarantees had been issued in the total amount of HRK 34.4 million.

These achievements were made as a result of HBOR's efforts aimed at meeting the needs of exporters that had used up the limits approved by commercial banks owing to the growing need for providing funding for their activities, maintaining liquidity and safeguarding their operations. By issuing bank guarantees, HBOR enabled them to participate in international tenders.

In 2012, HBOR marked the 20th anniversary of its operations. During the 20-year period, more than 48 thousand projects were financed and almost HRK 114 billion was provided for the Croatian economy. HBOR marked its anniversary by donating funds for the construction and equipment of the Counselling and Career Development Centre in Vukovar that was opened in the regional office of the Croatian Employment Service. In this way, HBOR wished to contribute to the efforts targeted at solving the unemployment problem that is one of the most difficult ones in the Republic of Croatia.

I would like to thank the President and the Members of the Supervisory Board for their confidence, support and contribution to the attainment of HBOR's results. I also thank the Croatian Parliament for the unanimous adoption of the Annual Report, and to the Government of the Republic of Croatia for their support. Gratitude is extended to all the employees of HBOR for their devoted work and efforts. In 2013, HBOR will continue to implement its existing programmes and will keep on adjusting them to the needs of the Croatian businessmen.

MEASURES FOR PROMOTION OF A NEW INVESTMENT CYCLE INTRODUCED:

The amount of commitments for new investment doubled compared to 2011

HBOR

Hrvatska banka za obnovu i razvitak

STATEMENT OF PERSONS RESPONSIBLE FOR THE PREPARATION OF THE ANNUAL REPORT

To the best of our knowledge, the 2012 Annual Report includes a fair review of the development, operating results and position of the Croatian Bank for Reconstruction and Development and the Group as well as a description of the principal risks and uncertainties to which the Croatian Bank for Reconstruction and Development and the Group are exposed.

Anton Kovačev
President of the Managing Board

Mladen Kober
Member of the Managing Board

Zagreb, 6th March 2013

ANNUAL REPORT | 2012 HBOR

Introduction

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 31st December 2012. Revised Financial Statements are shown for HBOR Group and Croatian Bank for Reconstruction and Development.

LEGAL STATUS

The annual Report includes annual financial statement prepared in accordance with the International Financial Reporting Standards and the Accounting Act and audited in accordance with the International Standards on Auditing.

EXCHANGE RATE

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

31st December 2012	1 EUR =7,545624 HRK	1 USD = 5,726794 HRK
31st December 2011	1 EUR = 7,530420 HRK	1 USD = 5,819940 HRK

ABBREVIATIONS

In the Annual Report, Croatian Bank for Reconstruction and Development is referred to as the Bank and/or HBOR, and the Croatian Bank for Reconstruction and Development Group as the Group or HBOR Group.

CEB	Council of Europe Development Bank
EAPB	European Association of Public Banks
EIB	European Investment Bank
EIF	European Investment Fund
EUR	Euro
FGS	Fondovi za gospodarsku suradnju
HAMAG INVEST	Hrvatska agencija za malo gospodarstvo i investicije (Croatian Agency for Small Business and Investment)
HNB	Hrvatska narodna banka (Croatian national Bank)
HRK	Croatian kuna
IDFC	International Development Finance Club
KfW	Kreditanstalt für Wiederaufbau
SME	Small and medium-sized enterprise
NEFI	Network of European Financial Institutions for SMEs
OeKB	Oesterreichische Kontrollbank AG

General Information

ESTABLISHMENT

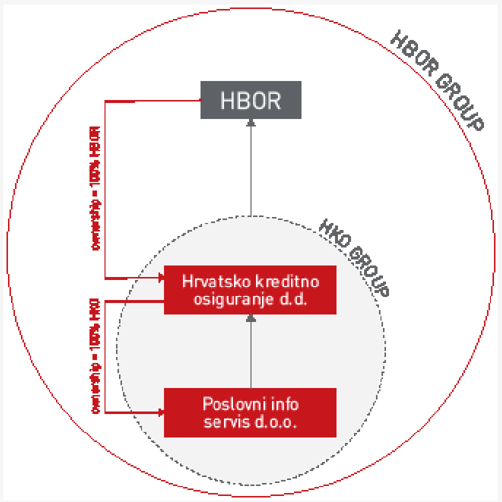
HBOR was established on 12th June 1992 by the Act on Hrvatska kreditna banka za obnovu (HKBO). The Bank was renamed Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development) by changes and amendments to the above Act in December 1995. In December 2006, the Croatian Parliament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

HBOR GROUP

HBOR is a parent company of the HBOR Group that was formed in 2010. The Group consists of the parent company, Hrvatsko kreditno osiguranje d.d. (HKO d.d.) and Poslovni info servis d.o.o. (PIS d.o.o.). At the establishment of HKO d.d., HBOR had the status of the majority owner with a 51% share in the company's capital and during 2012, the remaining share of 49% of equity was acquired, which made HBOR a 100% owner of the company. HKO d.d. is a 100% owner of the company Poslovni info servis d.o.o.

NAME	ROLE WITHIN THE GROUP	% OF ASSOCIATION	HEADQUARTERS	BUSINESS ACTIVITIES
Hrvatsko kreditno osiguranje d.d.	subsidiary, direct capital association	100% with HBOR	Republic of Croatia	Insurance of foreign and domestic short-term receivables of companies, related to delivery of goods and services
Poslovni info servis d.o.o.	subsidiary, indirect capital association	100% with Hrvatsko kreditno osiguranje d.d.	Republic of Croatia	Making analysis, credit risk assessment and providing information on creditworthiness

ILLUSTRATION OF THE GROUP STRUCTURE



STRATEGIC GOALS OF THE BANK

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.

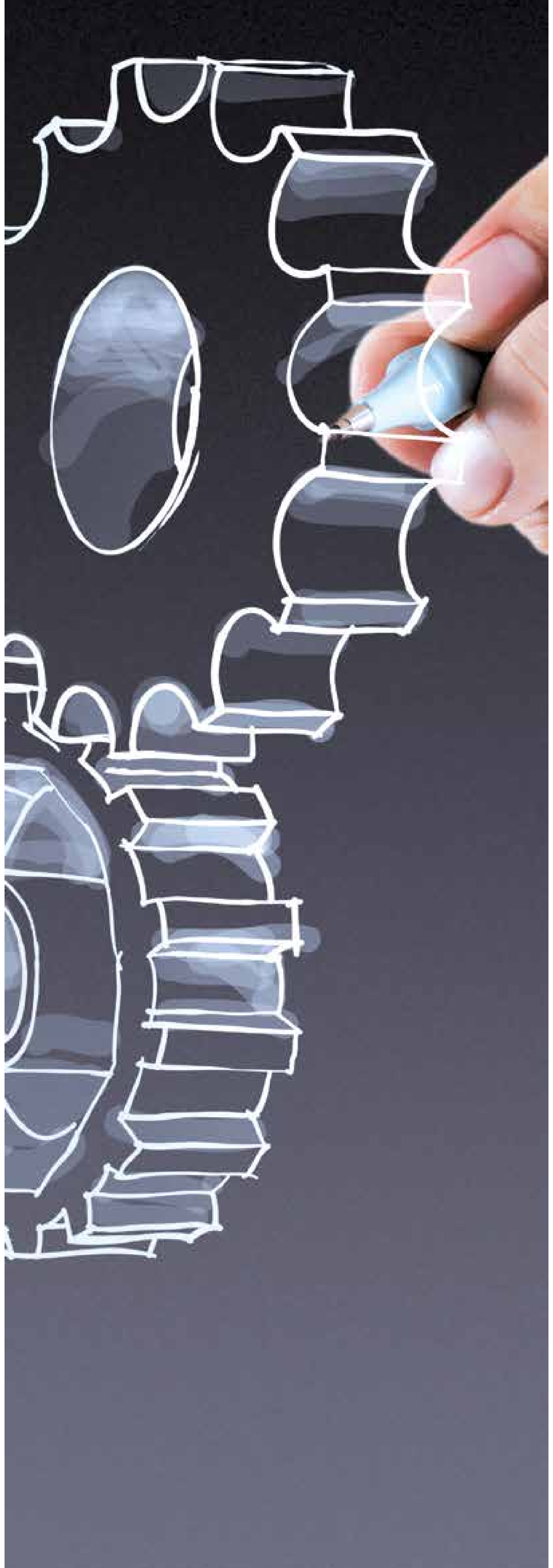
PRIORITY ACTIVITY AREAS

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

Breakdown of the most significant financial indicators over the period of five business years
- in HRK million – based on audited data

	2012	2011	2010	2009*	2008*
Total assets	25,767.2	22,012.9	22,942.1	20,789.7	18,751.7
Gross loans	24,107.0	23,005.9	23,567.7	22,382.1	19,717.7
Total equity	8,110.7	7,340.9	7,027.4	6,672.9	6,283.8
Total income	985.2	958.1	922.3	943.5	964.7
Total expense	(851.2)	(811.0)	(805.1)	(778.0)	(789.8)
Profit	134.0	147.1	117.2	165.5	174.9
Interest income	967.6	897.8	892.3	927.3	920.2
Interest expense	(555.8)	(563.9)	(604.9)	(593.0)	(514.5)
Net interest income	411.8	333.9	287.4	334.3	405.7

**HBOR Group was formed in 2010. The consolidated financial statements for 2010 were the first consolidated financial statements prepared by HBOR. Consequently, it is not practical to state comparable financial data for the previous years. The presented non-consolidated data for the previous years are to be considered as comparatives to the 2010 consolidated financial statements.*



AUDIT

HBOR's separate and consolidated Annual Financial Statements for 2012 were audited by the auditing firm Deloitte d.o.o., which expressed its unqualified opinion in an independent auditor's report.

CREDIT RATING

- Ba1 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 31st December 2012, there were 289 employees in HBOR. On 31st December 2012, there were 302 employees in HBOR Group.

Corporate governance

Compliance 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 best practice in the field of corporate governance and integrates corporate governance principles in its operations pursuant to sound banking practices.

In accordance with the principles of public business, financial statements of the Bank and the Group in the reporting period were published on the web sites of HBOR and of the Luxembourg Stock Exchange. HBOR's annual financial statements on an unconsolidated and consolidated basis are confirmed by the Supervisory Board and submitted to the Croatian Parliament for approval. Annually, HBOR's rating is assessed by two international independent rating agencies (Standard & Poor's, Moody's). Pursuant to the Freedom of Information Act, reports on received inquiries about HBOR's operations are submitted to the Croatian Personal Data Protection Agency, on an annual basis.

In the reporting period the duties, responsibilities and powers of the members of the Managing Board and the Supervisory Board were regulated by the Act on HBOR (Official Gazette of the Republic of Croatia, No. 138/06) and further elaborated in the By-laws of HBOR. The Managing 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 prior consent of the Supervisory Board.

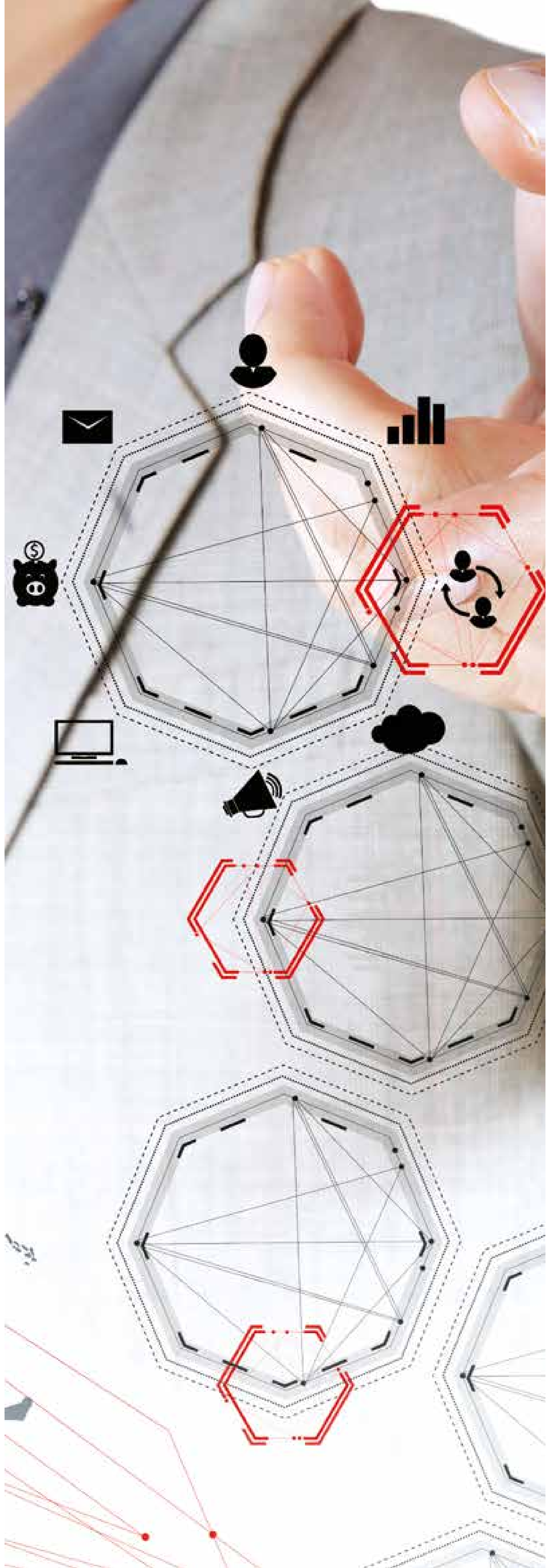
The Supervisory Board determines the principles of operating policy and strategy, supervises the business activities of the Bank, adopts HBOR's lending policies, adopts the Annual Financial Statements and considers Internal Audit reports and reports drafted by external independent auditors and by the State Audit Office. The Supervisory Board monitors and controls the legality of the business activities of the Managing Board, and appoints and dismisses the President and the members of the Managing Board. In the reporting period, the Supervisory Board consisted of nine members: five ministers in the Government of the Republic of Croatia[1], three Members of Parliament and the President of the Croatian Chamber of Economy. In the reporting period, pursuant to the Audit Act, along with the Supervisory Board, the Audit Committee was active, established by the Supervisory Board.

The Managing Board of HBOR consists of three members one of whom is the President of the Managing Board. The Managing Board represents HBOR, conducts the Bank's business and administers its assets, it 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 Managing Board include adopting normative acts that determine the manner of operations and the internal organisation of HBOR. They also include 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 rights and obligations of employees and reporting to the Supervisory Board.

For the purpose of ensuring efficient and effective risk management procedures and minimising the risk, the following bodies have been established adjacent to the Managing Board: Asset and Liability Management Committee, Credit Committee, Credit Risk Assessment and Measurement Committee and IT System Management Committee.
Internal control system is organised in independent organisational units:

- An independent organisational unit for risk management ensures permanent monitoring, measuring, assessment and management of all risks, HBOR is 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 risk management procedures and the internal control system, including risk monitoring, compatibility with regulations and the code of professional conduct, and implementing internal policies and Bank procedures as well as anti-money laundering activities.
- An independent compliance function organizes, coordinates and directs the activities concerning the compliance 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 task of the compliance function is to prevent the possible negative effects and ensure compliance of all business processes with the relevant regulations and to promote the principles of ethical business.

1 In early-2013, the Act on Amendments to the HBOR Act entered into force (Official Gazette of the Republic of Croatia, No. 25/13) changing the number of ministers in the Supervisory Board by increasing it to six.



Code of Conduct of HBOR prescribes specific values and rules for the prevention and insurance of professional conduct, and provides for the possibility of filing a report on the grounds of violation of the Code. The report form, e-mail address for filing of reports and the description of the filing are available on HBOR's Internet and intranet sites. The person in charge of compliance monitoring reports annually on reports filed and initiate proceedings in respect of filed reports on the grounds of violation of the Code of Conduct. Up to now, no reports were filed and no proceedings were initiated on the grounds of violation of the HBOR's Code of Conduct.

In the reporting period, HBOR has worked on preparations of the Code of Corporate Governance, which was adopted at the beginning of 2013. The aim of the Code is to establish, maintain and improve the standards of corporate governance and transparency of HBOR's operations for effective and responsible management of public capital and activities of special social significance in development of the Croatian economy. In order to achieve the standard of corporate governance, HBOR's Code describes relationships with governing bodies and stakeholders, and adopted business principles aimed at mitigating risks of operating in adverse market conditions.


STRENGTHENING OF ENTREPRENEURIAL CAPACITIES:
1,352 loans approved
for the start-up and development
of small and medium-sized businesses

Overview of operations of HBOR Group in 2012

Croatian Bank for Reconstruction and Development

THE MAIN OBJECTIVES IN 2012 BUSINESS YEAR - STARTING A NEW INVESTMENT CYCLE

The reporting year 2012 was another challenging year for the financial industry and real economy, both in Europe and in Croatia. Complex conditions in the Croatian and global markets adversely affected the Croatian economy and further reduced both the preparedness and capacity of Croatian entrepreneurs for new investments. To support economic activity and thereby mitigate the effects of adverse economic environment, HBOR's operations in 2012 have been focused on the following three objectives:

- Enabling entrepreneurs to start a new investment cycle,
- Strengthening entrepreneurial capacity, maintaining and improving liquidity,
- Providing funding for projects that are EU funds candidates.

During the past year, HBOR strengthened its advisory role, to find the best way for supporting people in overcoming the difficult operating environment, investing in their knowledge, adapting its programmes and accompanying them in their business ventures.

Both Croatia and HBOR recorded a fall in credit rating. Despite that fact and thanks to HBOR's reputation and co-operation with international financial institutions, it has provided funds for lending activities of Croatian entrepreneurs by equally favourable terms as before. This ultimately meant that equally favourable, and in some cases even more favourable lending conditions may be transmitted to Croatian businesses and thus support and boost their business activities.

MEASURES TAKEN AND NEW PRODUCTS

As stated above, HBOR's priority in the reporting period was the launch of a new investment cycle. In 2012, with this aim, HBOR has taken a number of measures:

Lowering interest rates

In November 2011, HBOR extended repayment periods and lowered interest rates on loan programmes for environmental protection, infrastructure and innovations and in mid February 2012, it introduced an interim measure, lowering the interest rates further by one percentage point under eleven loan programmes. Interest rate reduction was valid for loans approved until the end of 2012 for new investments in agriculture and fisheries, tourism, industry and for investments in energy efficiency, environmental protection and renewable energy resources. With some modifications, the duration of this measure was extended to 30th June 2013.

Extending loans without foreign currency indexing

In April 2012, HBOR introduced the possibility of extending loans in HRK, which are not foreign currency indexed for all loans approved by the end of the year except for loans with an interest rate linked to EURIBOR.

Risk sharing

In May, a new way of financing was introduced in co-operation with commercial banks under the existing HBOR's loan programmes, in the form of risk sharing. HBOR's aim is to encourage commercial banks to increase lending to businesses. This method of funding is intended for entrepreneurs with new investments contributing to increased employment, exports, achieving higher added value and enhancing competitiveness both in Croatian and international market in the following industries - agriculture, processing, tourism and industries related to projects in renewable energy resources and energy efficiency. For large investments (over HRK 9 million) HBOR assumes 50% of the risk and the bank assumes the other 50% for the total loan amount, collateralised according to usual banking practices. For small and medium-sized enterprises, HBOR assumes 40% of the risk for the total loan amount, against a guarantee by HAMAG INVEST and a commercial bank assumes 60% of the risk for the total loan amount, collateralised in accordance with its internal regulations.

Support for farmers

In mid-2012, HBOR introduced changes to the loan programme "Financial Restructuring" in such a way that farmers were enabled to apply for a loan in case they were keeping books in accordance with the Income Tax Act, and the loans were available at a lower interest rate than for other applicants. Granting loans to farmers under this programme is aimed at refinancing unfavourable loans approved by commercial banks and leasing institutions. Loans are granted via commercial banks for a period of up to 10 years including a 2-year grace period at an interest rate of 5 per cent. In addition to this modification, HBOR provided the possibility of rescheduling or moratorium on credit obligations for borrowers who were granted loans in recent years for raising of and equipment for perennial crops and which have suffered damage to crops due to natural disasters during 2012.

New programmes and services

In 2012, HBOR launched five new loan programmes:

1. Loan Programme for IPA SME Grant Candidate Projects (January 2012) – Loan programme for financing SMEs that nominate their projects for the award of grant funds out of the IPA pre-accession fund, component III C "Support for Increasing the Competitiveness of Croatian SMEs". Loans are approved with a maturity period of 5 years and an interest rate of 2% p.a.

2. Manufacturing Finance (February 2012) – loan programme for Croatian exporters and manufacturers for financing working capital needed for the manufacturing process. Loan funds can be used for the settling of obligations towards suppliers, for the payment of employee costs, overhead expenses and other expenses. Under this loan programme, loans are extended in HRK and are not foreign currency indexed. The interest rate stands at 4 per cent p.a. for a term of up to 1 year with a possibility of rolling over. Loans are on lent through commercial banks.

3. Loan Programme for IPA Candidate Projects (May 2012) – in addition to the Loan Programme for Candidate Projects under IPARD measures 101, 103, 301 and 302 and IPA SME Grant Candidate Projects, HBOR introduced a new

Loan Programme for IPA Candidate Projects covering all projects not covered by existing HBOR's loan programmes. Loans are approved in HRK with an up to 3-year grace period and an up to 15-year repayment period. Interest rate stands at 4% p.a. (or 3% in accordance with HBOR's decision to temporarily lower interest rates). The purpose of the loans is to finance eligible expenditures pursuant to the requirements contained in the Invitation to Submit Project Proposals and to finance those expenditures that are part of the project but cannot be nominated for the financing under the IPA programme pursuant to the Invitation to Submit Project Proposals. Eligible borrowers under the programme are units of local and regional government, companies majority-owned by units of local and regional government or the state, borrowers that meet the requirements of the IPA programme, e.g. citizens' associations.

4. Development of the Economy (May 2012) – for the purpose of strengthening entrepreneurial capacities, maintaining and improving liquidity, the programme was introduced in co-operation with the Government of the Republic of Croatia, the Croatian National Bank and commercial banks. The Programme is primarily aiming to finance working capital of entrepreneurs with development potential and loan proceeds may be applied for strengthening the company's competitiveness; achieving, maintaining and improving liquidity as well as maintaining or expanding its operations. Loans are extended in co-operation with commercial banks in such a way that 50% of the loan amount is financed from HBOR's funds (quota) and the rest is financed by the commercial bank. Loans are granted with a three-year repayment term including up to one-year grace period. The share of a loan financed from HBOR's funds will be approved in HRK at a 1.8% rate of interest per annum. For the purpose of implementing the programme, HBOR signed a syndicated loan with local banks in the amount of HRK 3.4 billion, and the programme is implemented until full utilisation of these funds. By 31st December 2012, 205 loan applications were approved in the amount of HRK 1.15 billion that represents, including the funds from commercial banks, the amount of HRK 2.3 billion marketed under this programme.

5. Loan Programme for Financing New Production (December 2012) – loan programme is intended for strengthening local production, increasing employment and exports by investing in new products and technology, obtaining certificates/verifications for products and services, networking among Croatian entrepreneurs. Loans are granted in HRK or in HRK indexed to a foreign currency at an interest rate of 2 to 4% with a 14-year repayment term (including up to 3 years grace period). As a rule, 30% of the loan amount can be used for working capital, but the percentage may be higher in case the entrepreneur contracts merchandise credit with the client.

In addition to new programmes, entrepreneurs investing in raising the level of energy efficiency have been given the possibility of utilisation of the European Commission Contribution funds developed and implemented in co-operation with the European Investment Bank (EIB). The Contribution funds can be utilised with the disbursement of loan funds out of EIB's sources, directly through HBOR or via commercial banks with which HBOR has established business co-operation. Loans are intended for the financing of fixed assets within the framework of investments contributing to energy savings and/or reduction in CO_2 emissions, or investments improving the energy efficiency of the facilities in the building sector and industry. The Contribution intended for final borrowers is 15% of the loan amount invested in improving the energy efficiency (maximum amounts of reduction of the loan principal are determined by the type of project). The approved Contribution funds are used exclusively for loan principal reduction. Eligible investments are those investments which will, upon investment completion, contribute to the improvement of energy efficiency of the existing facilities in the building sector - projects that achieve at least 30% of energy saving and in the industry sector - projects that achieve at least 20% of energy saving and/or reduction in CO_2 emission. Within the framework of the Contribution, consultants' assistance is also provided. Their task would be to evaluate and confirm the achieved levels of energy saving and/or reductions of CO_2 emissions or confirm the successfulness of investment in renewable energy resources, respectively.

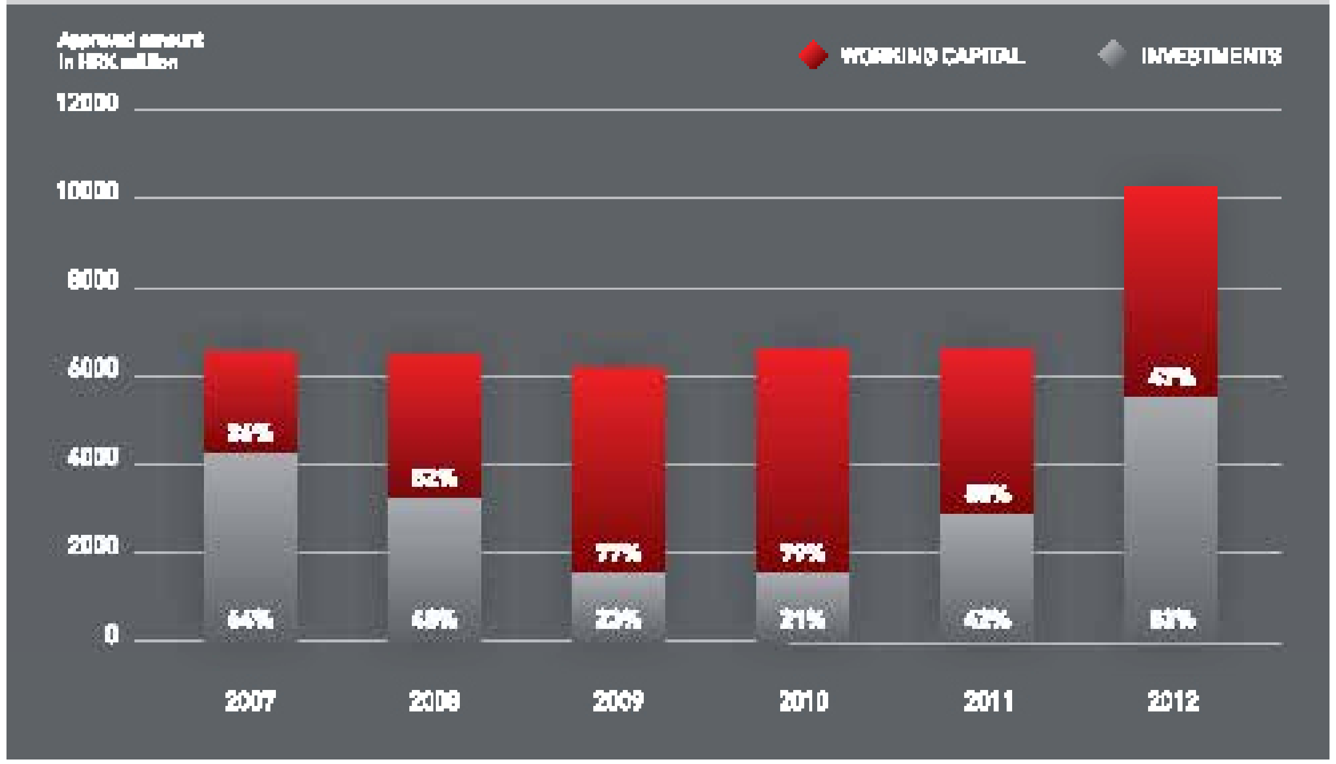
RESULTS: 56 PER CENT MORE APPROVALS, 93 PER CENT MORE INVESTMENT APPROVALS

In 2012, HBOR approved 1,622 loans, totalling HRK 10.2 billion, showing a 56 per cent rise compared to 2011. In addition to increasing the amount of approvals, the structure of approvals changed significantly. Before the outbreak of crisis, HBOR's priorities were aimed at financing long-term projects, which increase the level of competitiveness in the economy. During the crisis, HBOR launched a number of loan programmes aimed at alleviating the difficulties with liquidity. In the period, most of the funds were allocated under those programmes, financing working capital. As a result of described measures taken by HBOR over the past year, the structure of approvals allocated for investment and working capital turned in favour of investment funding after a four year period. In 2012, 53 per cent of total approvals were allocated for investments and 47 per cent for working capital. In the reporting period, investment-funding approvals rose by 93 per cent, compared to 2011.

HBOR extends its loans either directly or via on-lending banks. In 2012, the increase in approvals of direct loans amounted to HRK 2.5 billion compared to 2011, whereas the increase in approvals via on-lending banks amounted to HRK 1.16 billion.

The most significant increase in investments was recorded in the tourism industry and communal infrastructure and investors were public companies and private entrepreneurs.

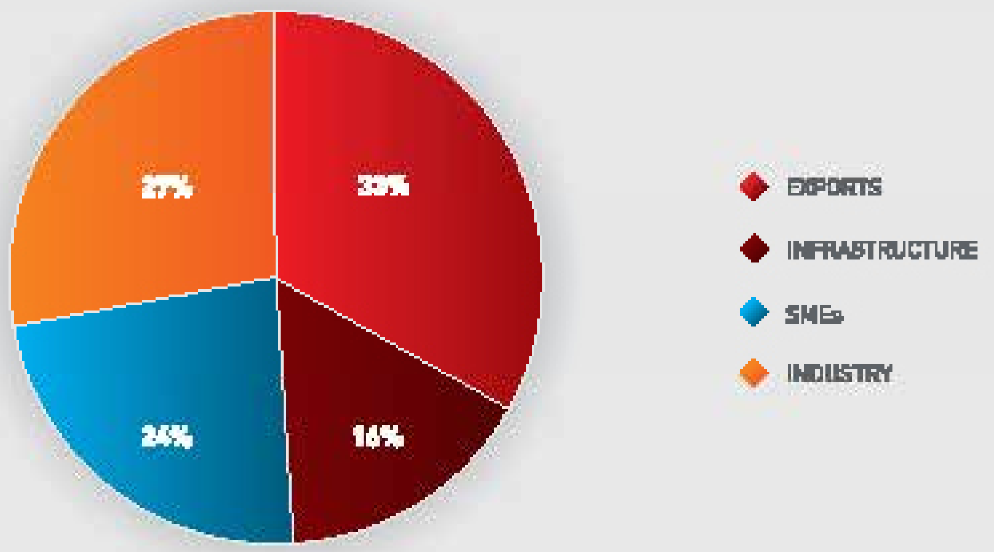
BREAKDOWN OF APPROVED FUNDS BY PURPOSE 2007 – 2012



OVERVIEW OF LENDING ACTIVITIES OF HBOR IN 2012* (by loan programme groups)

No.		APPROVED IN EUR	APPROVED IN HRK	LOANS
1.	INDUSTRY	371,155,391	2,800,599,029	362
2.	EXPORTS AND TOURISM	452,578,906	3,414,990,254	329
3.	INFRASTRUCTURE	213,983,921	1,614,642,211	72
4.	SMEs	317,919,301	2,398,899,505	859
	TOTAL LENDING ACTIVITIES (1+2+3+4)	**1,355,637,519**	**10,229,130,999**	**1,622**

OVERVIEW OF LENDING ACTIVITIES OF HBOR IN 2012



** This overview of lending activities refers to loan approvals under loan programmes designed exclusively for specific target groups of businesses. Further on, the report lists total approvals by target groups under all programmes.*

SMALL AND MEDIUM-SIZED ENTERPRISES: 27 PER CENT MORE APPROVALS

In 2012, one of HBOR's primary goals was to increase the availability of credit facilities to small and medium-sized enterprises with favourable interest rates and thus directly affect their competitiveness and liquidity as well as to encourage start-ups and development of SMEs. In 2012, loans were extended to small and medium-sized enterprises under 23 loan programmes that are implemented both directly and via commercial banks.

In 2012, there were 1,352 loans approved for small and medium-sized enterprises, i.e. 83 per cent of all approved loans. It amounted to HRK 4.6 billion, which is 27 per cent more than in the year 2011. The increase was recorded under all programmes. However, most significant results are shown in financing projects nominated for the award of EU funds, which shows an over 100 per cent increase in approvals to SMEs.

TOURISM: 2.2 TIMES MORE APPROVALS FOR INVESTMENTS

In 2012, HBOR lowered the interest rates, in order to encourage investments in new tourism projects. By the end of 2011, HBOR extended repayment terms from 15 (including a 2-year grace period) to 17 years (including a 4-year grace period) which provided longer maturity and easier loan repayment to borrowers investing in tourism.

Launch of new investments resulted from these measures. In 2012, HBOR approved HRK 1.8 billion for investments in the tourism industry which represents 2.2 times more investments than in the year 2011. Proceeds are mostly allocated for new investment projects aiming at increasing the capacity and quality of accommodation, equipment and upgrading the category of tourist facilities.

EU FUNDS: MOST OF THE APPROVED PROJECTS FUNDED BY HBOR'S LOANS

From the outset of EU funds availability, HBOR started with the implementation of the loan programme aimed at encouraging the use of available resources. The goal of the launched loan programme was to provide applicants with affordable loans for financing investments that qualify for the use of EU funds.

In 2012, HBOR made available to economic entities loan programmes for financing candidate projects for funds under the IPARD Measure 1.1. and 1.2., measure 101 and 103, measure 301, measure 302, MSP IPA and IPA. Under the above programmes, the total of 100 loans in the amount of HRK 671.3 million were approved, an increase of 134 per cent compared to the year 2011.

So far, pursuant to the tenders for measure 101 and 103 implemented by the Paying Agency for Agriculture, 72 per cent of approved projects were financed by HBOR, whereas, in case of measure 302, 61.5 per cent of approved projects were financed by HBOR and in case of measure 301, 46.7 per cent of approved projects were financed by HBOR. The data show the number of borrowers, since the loan amounts are generally higher than eligible expenditures accepted by the Agency.

ECONOMIC CO-OPERATION FUNDS: INVESTMENTS IN START-UPS

In the second half of 2010, by the Decision of the Croatian Government, HBOR was appointed qualified investor for participation in the establishment of the Economic Co-operation Funds (ECFs), investing for itself and on behalf of the Croatian Government in each of the ECFs an amount equal to the amount invested in the ECF in question by private investor. The field of investment of ECFs are companies with the seat in the Republic of Croatia that are active exclusively or predominantly in the Republic of Croatia. The envisaged duration of investment is 10 years with the possibility of maximum extension of up to 2 years. The maximum investment obligation of the Croatian Government towards one ECF amounts to HRK 300 million.

ECFs are established and operate in accordance with the Investment Funds Act (Official Gazette of the Republic of Croatia, No. 150/05), as open-end investment funds of private venture capital. At the beginning of 2011, 5 ECFs were established which met all the prescribed requirements and obtained HANFA's (Croatian Financial Services Supervisory Agency) approval for operation.

In 2012, six decisions on investment were made that received consent by the Ministry for Entrepreneurship and Trade. The approved investments in business entities through ECFs totalled HRK 234.34 million, of which HRK 117.17 million out of HBOR's funds. Funds were invested in companies active in the IT sector, financial, wood processing, textile and chemistry sectors. The total number of employees of the companies invested in was 829. It is necessary to point out that the companies included both small companies that employed up to 20 employees and companies with more than 300 employees. Among the companies invested in, there were start-up companies which had innovative ideas and capital needs, but also those active for a long period of time which needed additional capital for the purpose of restructuring and survival in the market due to the circumstances in the economy.

EXPORT FINANCE AND ISSUING OF BANK GUARANTEES: SUPPLEMENT TO COMMERCIAL BANKS' SERVICES

In the field of export promotion, HBOR developed a system of providing exporters with financial support through loan programmes, insurance and bank guarantees modelled on other export banks and export-credit agencies in order to provide Croatian exporters with equal competitive conditions in international markets.

Through its export finance programmes, HBOR contributes to the competitiveness of Croatian entrepreneurs and directly influences their success both in the domestic and in the foreign market. HBOR participates in all segments of the process of creating Croatian export products – from pre-shipment to the collection of payment for an export

transaction. In 2012, 616 loans amounting to almost HRK 6 billion were approved under all loan programmes.

Through the Programme for issuing bank guarantees at the request of an exporter, HBOR provides support to Croatian exporters for the purpose of winning or performing export contracts. The objective of the Programme is issuing of bank guarantees for the purpose of winning and performing contracts for the export of goods, works and services. In 2012, there was an increased rise in the approved bank guarantees supporting exports. During the reporting year, 34 guarantees were issued totalling HRK 244.2 million, a multiple increase in comparison with 2011, when 8 guarantees were issued totalling HRK 34.4 million. This increase is a result of HBOR's efforts to provide support to exporters which, due to the increased needs for funding their activities and maintaining their liquidity and business operations, used their limits at commercial banks and by issuing bank guarantees made possible their participation in international bidding procedures.

EXPORT CREDIT INSURANCE AGAINST NON-MARKETABLE RISKS: VALUE OF INSURED EXPORT TRANSACTIONS INCREASED BY 51 PER CENT

HBOR as the Croatian export-credit agency has been carrying out the activities of insurance of export receivables and export credits against political and commercial risks that are not provided in the private insurance market (so-called non-marketable risks) for 14 years.

The goal of all programmes offered by HBOR within the framework of export credit insurance business is to promote Croatian exports and increase the competitiveness of Croatian exporters in the foreign markets. HBOR provides to Croatian exporters a comprehensive service through the insurance of exporter's receivables against the risk of non-payment by foreign buyers for delivered goods and services or through the programmes intended for banks, such as the insurance of financial loans for pre-shipment. In this way, banks are given the opportunity to increase the capacities for financing exporters' liquidity in the production phase of goods intended for exports, the insurance of buyer credits and the insurance of export bank guarantees relating to export transactions.

HBOR also provides reinsurance of short-term non-marketable risks for private credit insurers. In 2012, pursuant to the Decision of the Croatian Competition Agency on the application of the exclusion clause to export credit insurance transactions, HBOR also reinsured the so-called „temporarily non-marketable risks", and indirectly gave additional impetus to Croatian exports through creating preconditions for the protection of receivables of Croatian exporters and for risks that may not be insured in the private insurance market. In this way, HBOR as the national export-credit agency supplemented the lacking services in the credit insurance market and simultaneously observed the rules of market competition.

In order to provide comprehensive services of export credit insurance, HBOR co-operates with other foreign export-credit agencies in the projects in which Croatian exporters co-operate with foreign partners in third markets.

Total insured export turnover backed by HBOR within the export credit insurance activities in 2012 amounted to HRK 2.56 billion, which stands for 3.54% of Croatia's total exports.

The insured export turnover in 2012 recorded a 51% increase compared to 2011, which is a result of increased interest of exporters for the insurance of export of capital goods.

In the challenging business environment characterized by the financial crisis, illiquidity and difficult access to finance, HBOR approved, in 2012, a new cover for export transactions in the amount of HRK 1.35 billion for Croatian exporters and financial institutions, an increase of almost 150% compared to 2011.

Through its insurance programmes, HBOR provided support for the export of Croatian goods and services to 53 countries for altogether 758 foreign buyers. The most important export markets with new insured transactions in 2012 were the Russian Federation, Bosnia and Herzegovina, the United Kingdom, Norway and Turkmenistan.

The amount of HRK 340.64 million was approved for the insurance and reinsurance of exports of consumer goods, which provided cover for an export turnover of HRK 1.55 billion, mostly for exporters in the metal, non-metal, paper, pharmaceutical, textile, wood and construction industries.

The amount of HRK 637.45 million was approved for the insurance of exports of capital goods and services, mostly for the exports of telecommunication equipment and computer servers.

Through the pre-shipment export finance programme, the amount of HRK 84.30 million was approved, by which banks were provided financing of exporters in the production phase of goods for exports, mostly for the construction, wood as well as machinery and devices industries.

Through the programme of issuing bank guarantees, HBOR approved a cover to banks for issuing export bank guarantees in the total amount of HRK 288.88 million. In this way, the realisation of export transactions of exporters in the construction, shipbuilding and metal industries in the foreign markets was facilitated.

In 2012, the following capital projects of Croatian exporters were supported through export credit insurance programmes:

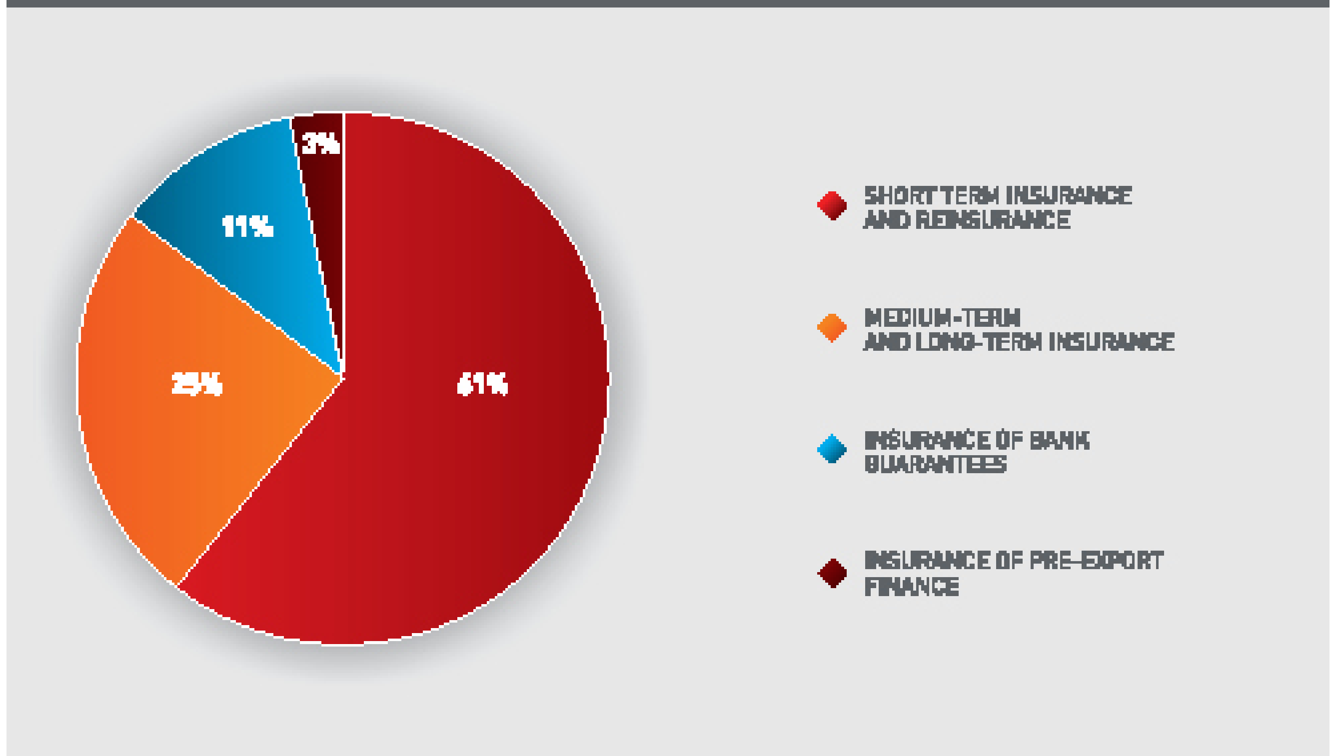
- Delivery and installation of pressure boilers to treat waste thermally in Switzerland and the United Kingdom;
- Delivery of telecommunications equipment and computer servers to Belarus, the Russian Federation, Bosnia and Herzegovina and Cyprus;
- Delivery of axle counters for railways to Indonesia;
- Delivery of generators to the Russian Federation;
- Delivery of mining micro dozers in South Africa;
- Construction of transmission line in Norway;
- Construction of viaduct in Algeria;
- Construction and delivery of two Ro-Pax vessels into Turkmenistan.

In 2012, altogether 9 indemnities were paid by HBOR to the insured parties totalling HRK 55.33 million, an increase of 300% in terms of the indemnities amount as compared to 2011.

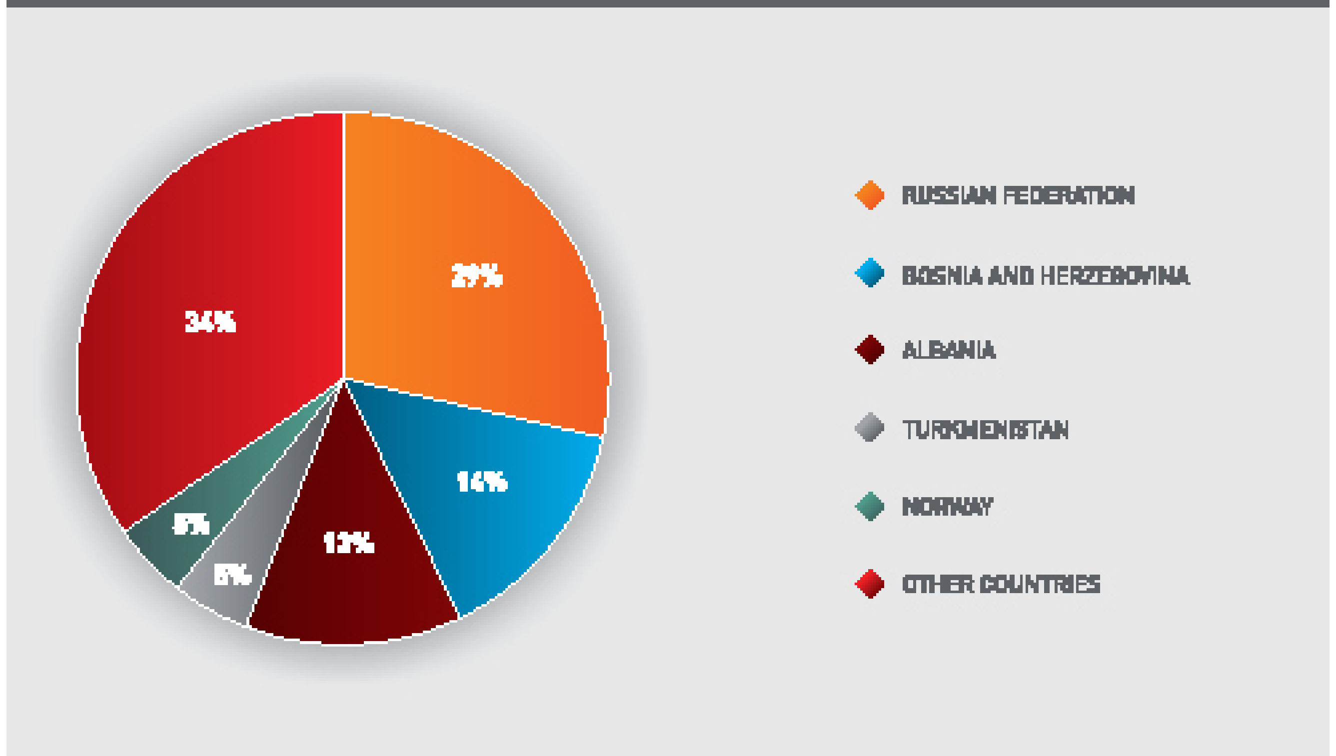
In 2012, altogether 9 indemnities were paid by HBOR to the insured parties totalling HRK 55.33 million, an increase of 300% in terms of the indemnities amount as compared to 2011.

The rise in paid indemnities in 2012 is a result of damage arising due to the commercial risk of non-payment by buy-

INSURED EXPORT TURNOVER IN 2012 BY TYPE OF INSURANCE

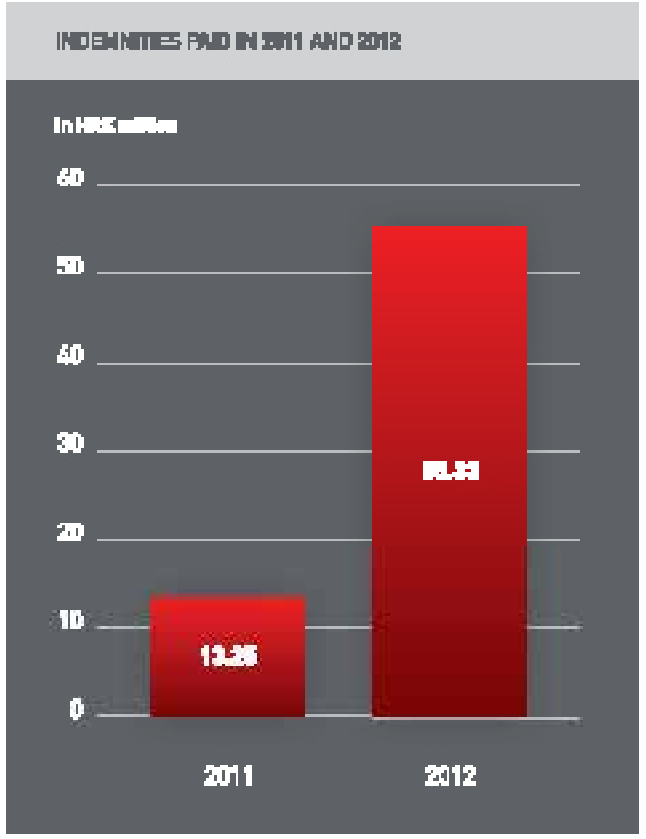


EXPOSURE BY COUNTRIES AS AT 31ST DECEMBER 2012



ers from Bosnia and Herzegovina. Other indemnities paid by HBOR in 2012 due to the realisation of commercial risks relate to deliveries of consumer goods and are the result of consequences of illiquidity of foreign buyers from Slovenia, Italy, France and Turkey.

The total amount of HBOR's recoveries in 2012 amounted to HRK 2.05 million, of which HRK 1.17 million relate to the recovery from debtor in Libya due to the occurrence of political risk, whereas other recoveries relate to collected payments from debtors in Bosnia and Herzegovina and debtors in Italy under indemnities paid due to the occurrence of commercial risks.



FUND RAISING: FAVOURABLE SOURCES OF FINANCE PROVIDED

The successful co-operation of the European Investment Bank (EIB) and HBOR started in 2001. So far, EIB and HBOR concluded nine finance contracts in the total amount of EUR 1.1 billion. In February 2012, HBOR and EIB concluded the first tranche of the Finance Contract in the amount of EUR 150 million to finance projects of small and medium-sized companies and mid-cap companies. The second tranche of the Finance Contract in the amount of EUR 100 million was concluded in September 2012.

In June, HBOR signed a Syndicated Loan Agreement with domestic banks for the requirements of the Programme for the Development of the Economy amounting to HRK 3.4 billion.

At the end of June, a EUR 50 million Loan Agreement was signed with the Council of Europe Development Bank (CEB) intended for the financing of projects of SMEs, units of local and regional government and other public sector entities in the Republic of Croatia. By signing this agreement, CEB and HBOR continued their co-operation that started in 2001. Since then, four loan agreements were signed totalling EUR 158 million.

In October 2012, HBOR also continued its co-operation with the International Bank for Reconstruction and Development when the Loan Agreement in the amount of EUR 50 million was signed for the financing of projects in the export and tourism sectors. This is the second Loan Agreement for projects under these sectors that was signed between HBOR and the International Bank for Reconstruction and Development.

At the end of 2012, EIB approved a new loan to HBOR for the financing of SMEs and mid-caps in the amount of EUR 500 million. The first tranche of this loan was signed in January 2013 in the amount of EUR 250 million, whereas signing of the second tranche in the same amount is expected until the end of 2013.

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 controls, identifies, assesses, measures and supervises all risks it is exposed to in its operations. The manner, actions and frequency of measurements and assessments in risk management are prescribed by the Bank's general documents. In its day-to-day operations, the Bank manages credit risk, liquidity risk, interest rate risk in the banking book, currency risk and operational risk through appropriate policies, procedures, limits, committees and controls.

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

When assessing and measuring risks, the Bank takes into account historical data, business plans, market conditions and the specific features of the Bank as a special financial institution. The results of measurements/assessments and analyses conducted in the field of risks are presented at the meetings of the risk management committees, the Managing 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 monitors risks by means of scenario analyses, sensitivity analyses in regular and stressful circumstances of operations. Systems of proactive risk management are developed for the purpose of preventing the occurrence of potential risks.

The Managing Board of HBOR is responsible for implementing a risk management strategy and establishing and implementing an effective and reliable system for the management of all risks. For the purpose of accomplishing its function, the Managing Board has delegated its powers to three risk management committees:

- The Asset and Liability Management Committee – manages liquidity risk, interest rate risk in the banking book and currency risk within the prescribed policies and procedures regulating this area;
- The Credit Risk Assessment and Measurement Committee – manages credit risk within the prescribed policies, procedures and other internal documents related to credit risk;
- HBOR Information System Management Committee – manages the resources of the information system and adequately manages the risks arising from the use of information technology.

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 (CNB) and the Basel Committee applicable to HBOR as a special financial institution.

Credit risk

Credit risk encompasses a loss derived from full or partial default, i.e. an untimely discharge of a financial obligation by the client.

The Bank controls credit risk by way of credit policies and prescribed procedures that determine the internal control systems aiming to act preventively.

HBOR's Managing 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 Procedures that applies to all phases of the credit process (from the development of new banking products, loan applications to final loan repayments). The Credit Risk Management Procedures represent a comprehensive document comprised of separate methodologies aimed at evaluating 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. Generally, all direct placements are secured by mortgage on immovable property, and, if possible, the Bank requires guarantees issued by HAMAG INVEST and other first-class guarantees and warranties. The bank determines the required ratio between placement value and insurance coverage according to the type of collateral, the loan programme, the general terms and conditions of insurance 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 with special state concern. Credit risk is diversified by geographical regions, activities, sectors and loan programmes. By providing more favourable terms and conditions and by creating new loan programmes, the Bank aims at preventing the excessive concentration of credit risk and supporting 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 the management of liquidity, currency and interest rate risk in the banking book through the Asset and Liability Management Committee. The management of these risks implies the minimising of interest rate risk in the banking book, currency risk and liquidity risk. By including a significant number of Bank's organisational units directly and indirectly in the Asset and Liability Management Committee a high-quality, integrated and comprehensive risk management system is ensured.

Liquidity risk

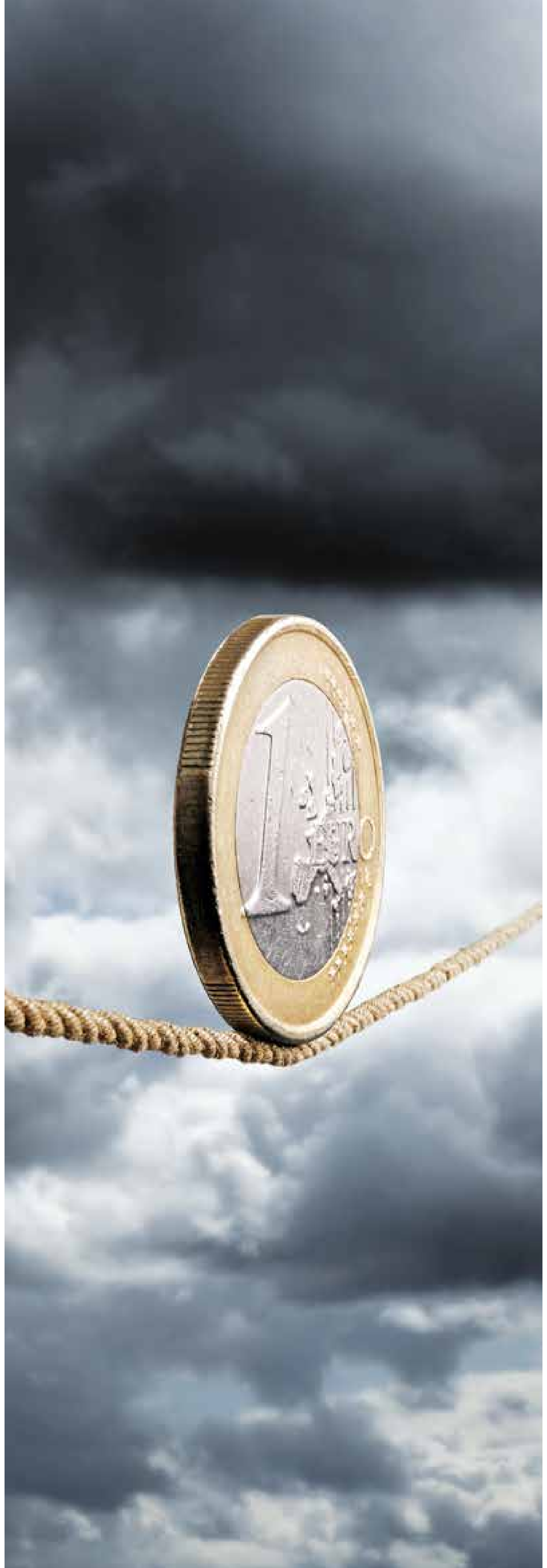
Liquidity risk is a risk of financial loss arising from the Bank's present or expected inability to meet its financial liabilities when due. The basic principles for managing HBOR's liquidity risk are defined in an internal document as well as in the decisions and conclusions made by the Supervisory Board, the Managing Board and the Asset and Liability Management Committee.

For the purpose of managing liquidity risk, i.e. in order to operate within the limits prescribed for liquidity risk management purposes, the Bank maintains the necessary level of liquidity reserves, continuously monitors current and planned liquidity, and provides sufficient kuna and foreign currency funds necessary for timely settlement of obligations and disbursements under committed loans and planned commitments. In terms of liquidity risk management, the Bank monitors and strives to achieve compatibility of existing and planned placements and sources according to maturity. The Bank monitors liquidity risk also through scenario analyses, sensitivity analyses and stress tests in both regular business operations and under stress. Early warning signals and procedures for liquidity crisis indication or occurrence are determined.

HBOR, as a special financial institution, is not profit oriented and does not use derivatives. Derivatives may only be used for the protection of its own positions.

Interest rate risk in the banking book

Interest rate risk in the banking book is the financial risk that occurs due to interest rate mismatch in the value and maturity of interest-sensitive assets, liabilities and off-



balance sheet items. The basic principles for managing the Bank's interest rate risk are defined by a separate internal document as well as by the decisions and conclusions made by the Supervisory Board, the Managing 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 by specific periods on the basis of possibility of change 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 value of interest rates, and projections of developments in average weighted interest rates for Bank's sources and placements are prepared. Depending on the level of the interest rate gap, the type of interest rates on future borrowings and placements is determined in order to reduce the gap to the lowest level possible. Besides the matching of interest rates on sources and placements, the current market conditions and development projections for basic market indicators are also monitored.

Currency risk

Currency risk represents the exposure of the Bank to changes in foreign exchange rates and it arises, above all, out of asset and liability currency mismatch that could result in higher expenses and/or not realised projected income. The basic concepts and principles of HBOR's currency risk management are defined by the procedures, decisions and conclusions made by the Managing 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 management have been defined.

For the measurement of currency risk exposure, the Bank monitors the open foreign currency position. In addition to the daily monitoring of the open foreign currency position, the Bank uses VAR model for the purpose of assessing and measuring currency risk and reports on maximum possible losses by significant currencies to the bodies in charge regularly. Scenario analyses, sensitivity analyses and stress tests are conducted.

Operational risk

Operational risk is the risk of loss arising from inadequate or unsuccessful internal processes, human errors, systems or external events.

The specific feature of operational risk in comparison with other types of risks is that it is present in the entire organisation and applied in all organisational units of the Bank.

In order to be able to manage the operational risk in a complete and comprehensive manner, in 2012 the Bank established the framework for managing operational risk out of EU grant funds for technical assistance in co-operation with KfW. By this framework, the Bank complied its operations and good banking practices with the CNB regulations in the field of risk management for the purpose of minimising the operational risk exposure.

The basic principles of operational risk management are determined by the Operational Risk Management Procedures, by which the management structure and responsibilities in the system were set up, and the approach for the calculation of capital requirements for operational risk and the reporting system established.

For the supervision and monitoring of the IT system, HBOR's Information System Management Committee was established, whose main task is to manage information system resources and establish an adequate level of efficiency and security of the IT system in order to adequately manage risks arising from the use of IT technology. The supervision of the IT system security is performed by the IT system security control function.

CONTROL AND AUDIT

The unit Control and Audit is part of HBOR's supervision system in charge of monitoring overall operations based on the principles of legality, application of Croatian internal audit standards and HBOR internal documents. Control and Audit, as an organisation unit, carries out its tasks independently and determines the manner of operating and reporting as well as preparing its finding, opinions, recommendations and suggestions on its own. It is directly responsible to the Managing Board, the Audit Committee and the Supervisory Board of HBOR, to which reports are submitted quarterly or semi-annually. Based on the audit report and according to the recommendations of the Control and Audit, the Managing Board makes the necessary decisions to take corrective measures and activities. The 2012 audit findings, as well as the status of recommendations given and actions taken were submitted to the Managing Board, the Audit Committee and the Supervisory Board within the Control and Audit regular reporting scheme.

COMPLIANCE MONITORING FUNCTION

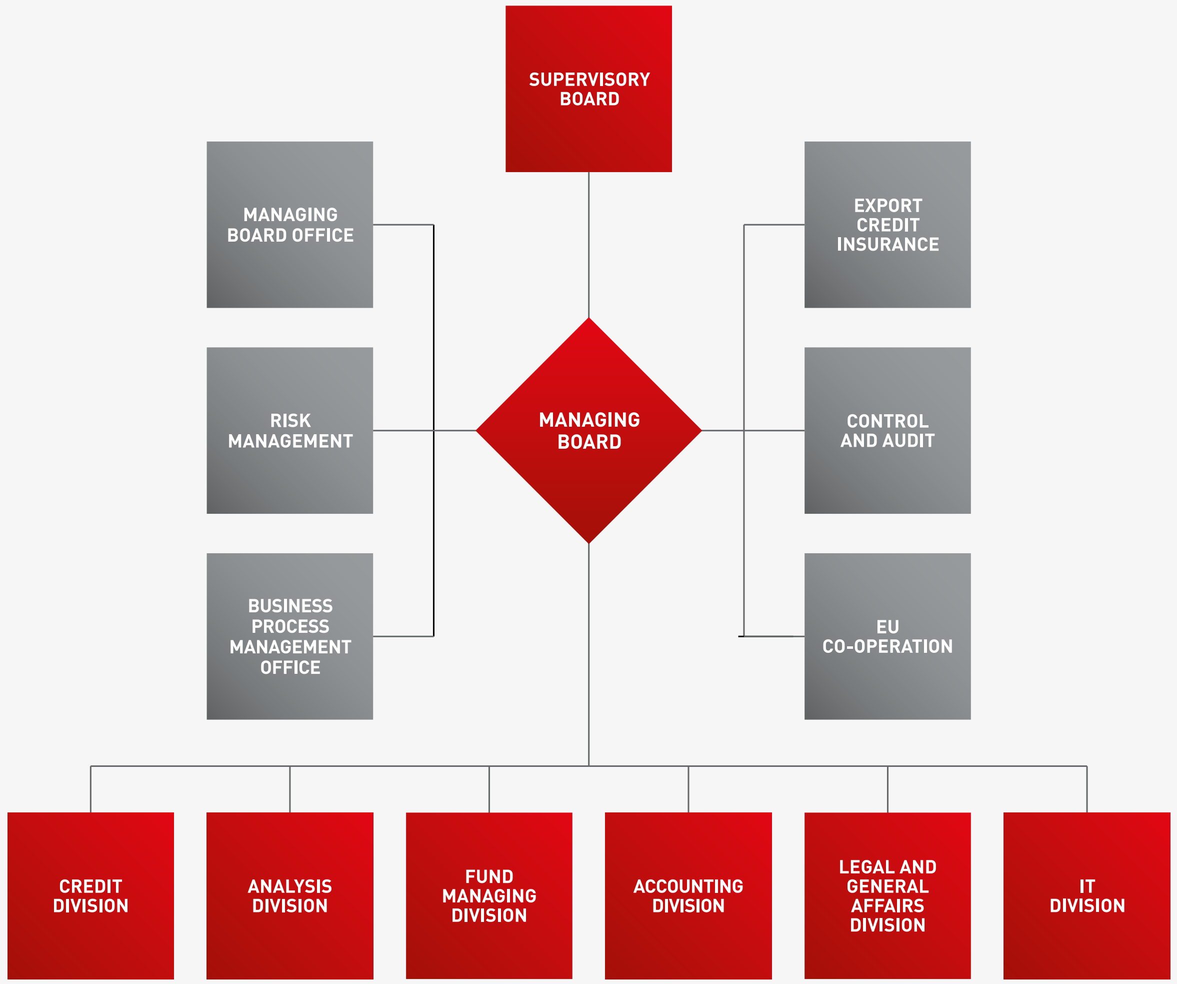
The function of monitoring compliance has been established as an independent and permanent function adjacent to the Managing Board of HBOR. Compliance monitoring activities include the identification and assessment of compliance risks to which HBOR is or might be exposed, the advising to the Managing Board and other responsible persons on the manner of applying relevant laws, standards and regulations, 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 procedures with the relevant acts and regulations and with the amendments to the regulations, provides advice during the preparation of compliance-related training programmes and deals with the clients' complaints procedures. The compliance monitoring function periodically reports to the Managing Board, the Audit Committee and the Supervisory Board of HBOR.

HUMAN RESOURCES

In the human resources development strategy, each individual should be given the opportunity to realise his/her personal and professional potentials so as to develop and keep

ORGANISATIONAL STRUCTURE OF HBOR



professional, motivated and satisfied employees who are an important segment of the process of socially responsible financing and 20 year old successful operations of the Bank.

Beside numerous measures of human resources management that have been implemented and improved by HBOR for a number of years, for the last two years, an in-house training of new employees and trainees has been implemented with the purpose to introduce employees to work and to exchange know-how and skills among employees. Through various internally developed programmes, especially trained employees (in-house trainers) from various organisational units transfer important information from their field of work to co-workers, thus enhancing communication, understanding and co-operation within the bank, and providing a broader picture on the purpose and manner of operations of the entire organisation to employees.

As recognition for excellent implementation of HR processes, Croatian Bank for Reconstruction and Development regularly implements the recertification process for retaining its Employer-Partner Certificate that is assigned by Selectio d.o.o. for excellence in human resources management.

HBOR retains the structure of highly educated employees, and their share is highly increasing from year to year. On 31st December 2012, there were 289 employees, of which 83.05% with a university degree. The average age of employees in 2012 is 41.

OTHER ACTIVITIES

In 2012, HBOR, on the occasion of marking the 20th anniversary of its operations, financially supported the construction and equipping of the Advisory and Career Development Centre that was opened in the regional office of the Croatian Employment Service in Vukovar. The goal of this Centre is to provide support to unemployed persons, other persons looking for a job, pupils and students in order to develop competences necessary for career development through high-quality and professional counselling and career advising.

In February 2012, the third HBOR's social responsibility report was published, i.e. the communication on progress on the implementation of the UN Global Compact principles in the area of human rights, labour standards, environment and anti-corruption.

Regional offices

In 2012, in addition to their regular activities relating to the provision of information and advice to entrepreneurs on loan programmes and lending activities, the provision of support in the preparation of loan application documentation, site visits

for the purpose of project control and preparation as well as contacts and agreements with commercial banks in the area, the regional offices participated in the presentations of HBOR's programmes and training of entrepreneurs.

In 2012, Regional office for Lika with the location in Gospić extended its activities to other 2 counties (Sisačko-moslavačka and Karlovačka). In this way, the information on HBOR's activities and lending opportunities are now available to entrepreneurs in altogether 14 counties through Regional offices, either through direct enquiries in the offices or in the agreed meetings held on the occasion of Info days in other counties.

During 2012, regional offices held altogether 122 presentations on HBOR loan programmes and participated in 9 fairs as follows:

REGIONAL OFFICE	PRESENTATIONS	FAIRS	INFO-DAYS
Regional office for Dalmatia, Split	22	3	20
Regional office for Primorje and Gorski Kotar, Rijeka	33	-	-
Regional office for Istra, Pula	18	2	-
Regional office for Lika, Gospić	14	-	10
Regional office for Slavonija and Baranja, Osijek	35	4	24
TOTAL	**122**	**9**	**54**

At the end of the year, Regional offices started to hold education workshops on the preparation of documentation and utilisation of loans for financing operations for small and start-up companies starting their independent businesses.

The goal of the workshop is to make entrepreneurs familiar with the ending procedures, the manner of submitting loan applications, the assessment of creditworthiness and the control of repayment of assumed long-term liabilities.

The workshop consists of 2 parts:

1. Presentation of lending process and the preparation of loan documentation
2. Practical exercises of preparation and presentation of loan applications, the assessment of creditworthiness.

The first workshop was held as a pilot-project of the Regional office in Split at the beginning of November 2012. After that, workshops organised by the Regional offices in Rijeka and Osijek and at HBOR headquarters in Zagreb were held. In 2013, workshops will be held in other county centres covered by Regional offices, and the dynamics and contents of workshops will be adjusted to the needs and interest of entrepreneurs.

International co-operation

HBOR participates actively as a member in the operations of numerous associations, clubs and chambers such as the European Association of Public Banks (EAPB), the Banking Association for Central and Eastern Europe (BACEE), the Prague Club, the United Nations Environment Programme Finance Initiative (UNEP FI), the UN Global Compact, the Network of European Financial Institutions for SMEs (NEFI), numerous bilateral chambers of commerce and, as an associate member, the Club of Institutions of the European Union Specialising in Long-Term Credit (ISLTC).

The reporting period was particularly characterised by the activities performed within the framework of the EAPB, the European Investment Fund (EIF) and the International Development Finance Club (IDFC). In May 2012, HBOR hosted the EAPB General Assembly and the Meeting of the Administrative Board that took place in Dubrovnik. In 2012, the President of HBOR's Managing Board, as the President of EAPB, represented the interests of the EAPB members towards the bodies of the European Union, particularly the European Commission, the European Parliament, the Committee of European Banking Supervisors and other bodies with regard to the banking business, the banking regulations and the role of state-owned development banks and financial institutions. In addition to the interests of the member institutions, also the interests of HBOR and the interests of the Republic of Croatia were represented, particularly in the field of the instruments of balanced

regional development and the utilisation of EU funds intended for small and medium-sized enterprises. Although the President of HBOR's Managing Board did not accept the offer of a second two-year term of office as EAPB President due to an increased volume of HBOR's operations, he accepted, at the EAPB General Assembly that took place in December 2012, the position of a member of the Administrative Board of the EAPB in order to ensure the continuity of operations and contribute to the results achieved by the Association.

In March 2012, HBOR signed the Memorandum of Understanding with the Investment and Development Fund of Montenegro. The purpose of the Memorandum of Understanding is to establish a framework for future co-operation between HBOR and IDF with regard to participating in and rendering of services for joint projects in third country markets. HBOR also organised a two-day workshop for IDF representatives on the financing of entrepreneurship.

HBOR joined the delegation of the Republic of Croatia at the Spring Meetings and the Annual Meetings of the World Bank and International Monetary Fund in April and October 2012, and at the EBRD Annual Meeting & Business Forum in May 2012.

On the occasion of the Annual Meetings of the World Bank and International Monetary Fund that took place in Japan in October 2012, HBOR participated in the First Annual Meeting of the International Development Finance Club (IDFC), at which the Steering Group adopted the new work programme for 2013. The activities will be targeted at sustainable development, particularly at green (environmental) and social development, with an objective of providing a significant contribution to the promotion of climate change mitigation efforts in the countries where the members are active and to the promotion of infrastructure finance, social development and poverty reduction, i.e. the so called green banking and innovation financing.

In September 2012, the representatives of HBOR participated in the summit meeting of the members of NEFI that took place in Warsaw, and HBOR organised and hosted the annual shareholders' meeting of the European Investment Fund (EIF). In September, the 11th International Conference on Export Promotion took place. It was attended by renowned speakers from European institutions, distinguished representatives of Croatian exporters, banks, export credit agencies and international financial institutions that exchanged experiences and practices, made contacts and explored cooperation opportunities. At the Conference, the participants discussed the challenges facing the Croatian exporters after Croatia's becoming a member of the European Union, exchanged ideas pertaining to the preparation of entrepreneurs for new operating conditions with a view of strengthening their competitiveness in the foreign markets, enhancing the cooperation between exporters and banks, and exchanging experiences of exporters with regard to the tapping of foreign markets.

In December 2012, HBOR received the representatives of an Albanian delegation and organised a meeting on the Croatian strategy for the development of female entrepreneurship, its implementation and HBOR's role in its promotion.

Public disclosure of activities

Public disclosure of activities is considered by HBOR to be an important precondition for the credibility of its operations, and a special focus is on providing complete and understandable information to the public about its goals and the measures for their attainment as well as about the results of its activities. Therefore, through various forms of providing information, HBOR regularly informed the public about all important activities in 2012. In the reporting period, HBOR published thirty-two press releases. Seven press conferences took place for the purpose of informing the public about operations, attained results, new loan programmes and amendments to the existing ones. All business information can be accessed by the public on HBOR's websites, except for the information subject to Articles 168 and 169 of the Credit Institutions Act. During the reporting year, thirty-three public procurement procedures were published in the Electronic Public Procurement Classifieds, whereas, since August 2010, all bidding announcements have been published on HBOR's websites: www.hbor.hr. In 2012, no requests for access to information pursuant to Article 25 of the Act on the Right of Access to Information were received.


PROMOTING THE TOURISM OFFER:
HRK 1.8 billion
committed for investment in the expansion of capacities
and the upgrading of the quality of accommodation as well as
for investment in the upgrading of tourism facilities

Hrvatsko kreditno osiguranje Group

Hrvatsko kreditno osiguranje d.d. and Poslovni info servis d.o.o.

Hrvatsko kreditno osiguranje d.d. (hereinafter: HKO or the Company) is a joint-stock insurance company specialised exclusively in the insurance of short-term receivables (payment terms up to 180 days, exceptionally up to 1 year) arisen from the sale of goods and services among business entities. The insurance covers political and commercial risks.

In 2012, HKO offered two main insurance products: insurance of export receivables and insurance of domestic receivables.

On 26th October 2010, HKO established Poslovni info servis d.o.o. By establishing this company, HKO started to operate as the Hrvatsko kreditno osiguranje Group (hereinafter: the HKO Group) and to prepare its consolidated financials. Poslovni info servis d.o.o. (hereinafter: PIS) is in charge of analysing and assessing credit risks relating to the insurance transactions within the Group.

As of 31st December 2012, there were 13 employees in the HKO Group, of which Hrvatsko kreditno osiguranje d.d. employed 10, and PIS 3. All employees of the HKO Group have a university degree.

Ownership structure
On 25th September 2012, the ownership structure was changed: HBOR became the 100% owner of HKO.

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

Company management bodies:
- The Managing Board
- The Supervisory Board
- The Shareholders' Meeting

THE MANAGING BOARD

The Managing Board of HKO was changed on 17th October 2012 in accordance with the changes in the ownership structure of HKO as follows:

The Managing Board of HKO after 17th October 2012:
- Edvard Ribarić, Chairman of the Managing Board
- Branka Perišić, Deputy Chairman of the Managing Board
- Ružica Adamović, Authorised Representative

The Managing Board of HKO until 17th October 2012:
- Edvard Ribarić, Chairman of the Managing Board
- Anton Ludwig Steffko, Member of the Managing Board
- Ružica Adamović, Authorised Representative

THE SUPERVISORY BOARD OF HKO

The Supervisory Board of HKO was changed on 17th October 2012 in accordance with the changes in the ownership structure of HKO as follows:

The Supervisory Board of HKO after 17th October 2012:
- Branimir Berković, Chairman of the Supervisory Board
- Ante Artuković, Deputy Chairman of the Supervisory Board
- Branka Perišić*, Member of the Supervisory Board
- Marija Jerkić, Member of the Supervisory Board
- Andreja Mergeduš, Member of the Supervisory Board

The Supervisory Board of HKO until 17th October 2012:
- Branimir Berković, Chairman of the Supervisory Board
- Helmut Hans Altenburger, Deputy Chairman of the Supervisory Board
- Ante Artuković, Member of the Supervisory Board

*Branka Perišić – does not perform the function of a Member of the Supervisory Board while performing the function of the Deputy Chairman of the Managing Board.

POSLOVNI INFO SERVIS D.O.O.

In 2012, PIS management was changed as follows: Ivana Paić-Mikulek was the Manager of PIS until 18th December 2012, whereas Ružica Adamović performed this function from that date.

HKO AUDIT COMMITTEE

The Audit Committee of HKO was changed on 17th October 2012 in accordance with the changes in the ownership structure of HKO as follows:

The Audit Committee of HKO after 17th October 2012:
- Branimir Berković, Chairman
- Ante Artuković, Deputy Chairman
- Branka Perišić, Member
- Marija Jerkić, Member
- Andreja Mergeduš, Member
- Katica Smojver, Member

The Audit Committee of HKO until 17th October 2012:
- Branimir Berković, Chairman
- Helmut Hans Altenburger, Deputy Chairman
- Ante Artuković, Member
- Katica Smojver, Member

REPORTING TO THE SUPERVISORY BODIES

In 2012, the Company provided regular reports to the supervisory bodies on all relevant facts and changes in the Company pursuant to the Insurance Act, the regulations 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, without any objection from the supervisory bodies.

OPERATIONS IN 2012

In 2012, Hrvatsko kreditno osiguranje d.d. concluded 35 insurance contracts, of which 31 insurance contracts relating to the insurance of export receivables and 4 insurance contracts relating to the insurance of domestic receivables. Altogether 992 credit limits were covered by the insurance, i.e. 7.12 per cent more than in the previous year. Within the total structure of limits, 177 credit limits relate to domestic receivables, and 815 credit limits relate to export receivables towards 45 countries.

The total volume of insured transactions in 2012 amounted to HRK 2,444.0 million, which represents 2.32 per cent of the total exports of the Republic of Croatia.

In 2012, the total charged premium amounted to HRK 7.7 million, an increase of 14.8 per cent on 2011 when it stood at HRK 6.7 million.

In 2012, the share of reinsurance in the total charged premium stood at 70.81 per cent, which is slightly lower than in 2011 when the share of reinsurance stood at 72.89 per cent.

In 2012, the net premium earned amounted to HRK 1.7 million (HRK 1.2 million in 2011).

In the reporting period, the Company paid 6 indemnities, and the total amount of payments for insured events amounted to HRK 820.4 thousand. The paid indemnities relate to buyers in Hungary, Slovenia, Bosnia and Herzegovina and Croatia. In 2012, the loss ratio stood at 41.6 per cent.

INDICATORS OF INSURANCE BUSINESS

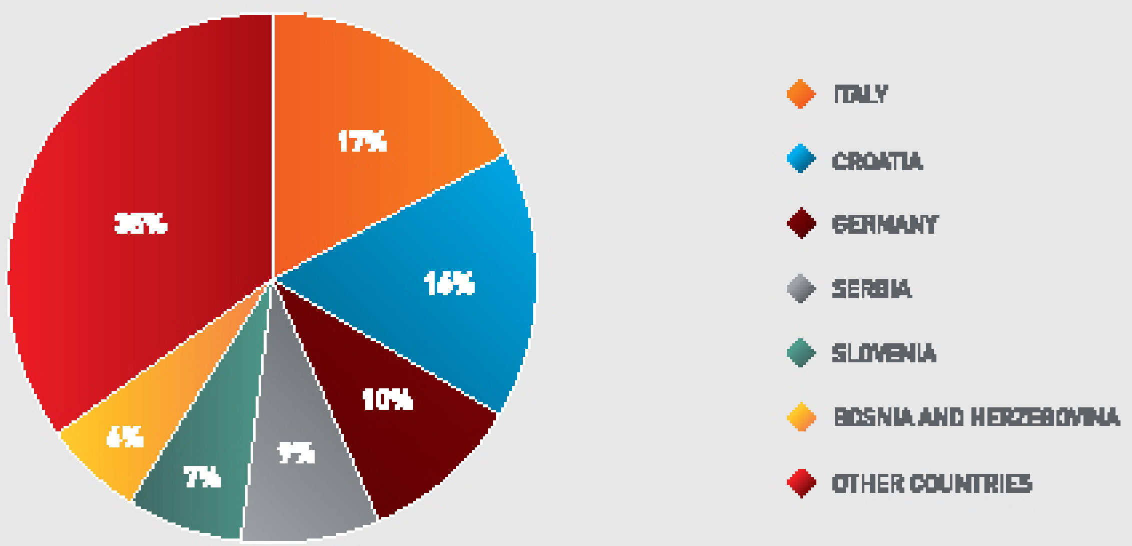
	2010	2011	2012
Volume of insured transactions (in HRK '000)	802,041	2,284,219	2,443,969
Exposure, as at 31st December (in HRK '000)	671,694	842,704	875,127
Gross premium charged (in HRK '000)	1,551	6,687	7,678
Paid indemnities (in HRK '000)	-	766	820
Number of active limits as of 31st December	771	926	992

Acquisition costs, marketing costs, administration costs and other operating expenses of the Group in 2012 amounted to HRK 5.1 million, whereas, at the Company level, they amounted to HRK 4.4 million.

The business year 2012 is the second full year of operations, and the Group recorded the expected loss for the year in the amount of HRK 0.61 million, a decrease of 44.9 per cent compared to the loss of HRK 1.1 million in the previous year.

As at 31st December 2012, the total assets of the HKO Group amounted to HRK 40.1 million, an increase of 2.7 per cent on the previous year. As at 31st December 2012, the total capital amounted to HRK 35.2 million, and technical reserves net of reinsurance amounted to HRK 2.8 million.

EXPOSURE BY COUNTRIES (ACCORDING TO LIMIT AMOUNTS) as at 31 December 2012



PRINCIPLES OF FINANCIAL REPORTING

The HBOR Group prepares:

1. Separate financial statements of the parent company – Croatian Bank for Reconstruction and Development (HBOR), and

2. Consolidated financial statements that include HBOR and the companies under its control – subsidiary companies.

When preparing and presenting its annual financial statements, the HBOR Group applies the International Financial Reporting Standards (IFRS). Consequently, all data and financial statements for consolidation are prepared by the members of the Group in accordance with the IFRSs.

Financial statements are prepared and presented with the objective to provide information on 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.

Financial statements are prepared and presented with the purpose of availability of the information on financial position, success in operations and changes in the financial position of HBOR and the HBOR Group available to their users on a regular basis as well as giving financial information about how the strategy of HBOR's 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 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 the up-to-date international trends in financial reporting, as well as market requirements.

OVERVIEW OF FINANCIAL PERFORMANCE IN 2012

The HBOR Group was formed in 2010. It consists of the Croatian Bank for Reconstruction and Development as the parent company and of subsidiary companies Hrvatsko kreditno osiguranje d.d. and Poslovni info servis d.o.o. that constitute the Hrvatsko kreditno osiguranje Group (HKO Group).

The first consolidated financial statements prepared and presented by HBOR were those prepared for the year 2010.

The financial statements include both HBOR and the Group. The financial statements of the Group consist of the consolidated financial statements of HBOR and its subsidiaries. However, the separate, non-consolidated financial statements of the parent company are also presented.

The separate and consolidated Annual Financial Statements of HBOR for 2012, which can be found enclosed, have been audited by the audit company Deloitte d.o.o. which expressed an unqualified opinion in the Independent auditor's report.

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

OVERVIEW OF OPERATIONS OF THE 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 in the first years of the Group 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.

Results of the Group

In 2012, the HBOR Group made a profit after taxation in the amount of HRK 134.0 million.

Pursuant to the HBOR Act, the parent company is exempted from profit tax; therefore, profit tax obligations arise exclusively from the activities of other members of the Group.

The consolidated total income in 2012 amounted to HRK 985.2 million, and total expenses amounted to HRK 851.2 million.

In the structure of income of the Group, the major portion, i.e. 98% relates to interest income as a result of the operations of the parent company.

The major portion of total expenses, i.e. 65% relates to interest expenses arising from the operations of the parent company.

The consolidated operating expenses in 2012 amounted to HRK 117.0 million, and consisted of general and administrative expenses and other operating expenses.

As at 31st December 2012, there were 302 employees in the Group, whereas there were 281 employees at the end of 2011.

Assets and liabilities of the Group

The Group's assets on consolidated basis amount to HRK 25,767.2 million and are by 17% higher in comparison with the beginning of the year.

In the structure of assets, the major portion relates to the lending activities of the parent company, i.e. net loans account for 83% of assets.

Liabilities of the Group, in the major portion, i.e. 64%, consist of borrowings and bonds payable of the parent company. At the end of 2012, total equity on consolidated basis amounted to HRK 8,110.7 million and accounted for 31% of total liabilities and total equity of the Group.

OVERVIEW OF OPERATIONS OF HBOR

In the text to follow, there is an overview and description of significant changes in business operations and of the performance in the reporting year.

Operating performance

In 2012, HBOR generated a total income of HRK 979.4 million, expenses of HRK 845.0 million and profits of HRK 134.4 million.

Net interest income

Net interest income amounted to HRK 410.1 million, an increase of 23% on the previous year.

Interest income amounted to HRK 965.9 million, an increase of 8% on the previous year. Such trend is a result of an increased volume of lending activity and investment into instruments of liquidity reserve. It is necessary to point out that HBOR, during 2012, also decreased its interest rates charged for certain categories of final borrowers and investments, giving up a portion of its profits with the aim of supporting to Croatian entrepreneurs in the period of crisis conditions.

Interest expenses amounted to HRK 555.8 million, a decrease of 1% on the previous year as a result of increased borrowings from special financial institutions with lower interest rates and redemption of bonds on their maturity.

Net fee income

Net fee income amounted to HRK 10.1 million, a decrease of 8% compared with the previous year because of reduced fee income generated from agent transactions for and on behalf of the principal.

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 loan contracts with embedded call option, gains/(losses) of value adjustments of assets at fair value through profit and loss and realised gains/(losses) on assets available for sale. In the reporting period, net losses from financial activities amounted to HRK 0.1 million, whereas, in the previous year, net gains amounted to HRK 44.4 million.

On a year-on-year level, the Croatian kuna depreciated by 0.2% against the EURO and appreciated by 1.6% against the USD.

Foreign currency or foreign currency indexed assets and sources of funds are converted by HBOR into HRK equivalent value by applying the 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 110.9 million, an increase of 17% compared with the last year, but fully in line with the planned increase in the volume of activities and in the general operating expenses.

There were 289 employees on 31st December 2012 and 270 employees on 31st December 2011.

Impairment loss and provisions

In accordance with the regulations and internal acts, HBOR determines the amount of impairment loss and provisions, and maintains it at the level it considers adequate for the coverage of possible future risks.

In the reporting period, net impairment loss amounted to HRK 177.3 million.

Significant changes in business activities

Total assets as at 31st December 2012 amounted to HRK 25,763.2 million, an increase of 17% compared to the beginning of the year. This increase was caused by the drawn-down of funds of a syndicated loan from domestic commercial banks to the special purposes transaction account with the Croatian National Bank in the amount of HRK 3,415.6 million for the implementation of the Programme for the Development of the Economy.

Cash on hand and due from banks

At the end of 2012, cash on hand and due from banks amounted to HRK 2,881.7 million, representing 11% of total assets. Cash on hand in the amount of HRK 2,719.0 million relates to the withdrawn funds of a syndicated loan from domestic commercial banks to the special purposes transaction account with the Croatian National Bank intended to the realisation of the Programme for the Development of the Economy. The purpose of this Programme is to finance working capital of entrepreneurs faced with difficulties due to objective reasons - the influence of the financial and economic crisis. Funds are provided to the borrower by a commercial bank and HBOR in proportion 50%:50%. The Programme will be in effect until the disbursement of available funds, but not later than 31st December 2013 and is implemented through auctions for commercial banks.

The syndicated loan funds have been provided by releasing a portion of the mandatory reserve requirements to commercial banks, pursuant to the decision made by the Croatian National Bank on decreasing the mandatory reserve requirements by one and a half percentage point.

Undisbursed funds of the mentioned borrowing will be deposited on the transaction account of the Croatian National Bank during the entire disbursement period or until their final placement into long-term loans for specified purpose under the above Programme.

Loans
Total net loans at the end of 2012 stood at HRK 21,457.4 million, an increase of 5% compared to the previous year. In the total assets, total net loans accounted for 83%.

Total gross loans amounted to HRK 24,107.0 million, 5 % up on the beginning of the year.

Slower growth in gross loans compared to the increase in total assets was caused by the regular redemption of long-term bond issue out of the portion of the Bank's liquidity reserve partly placed in short-term placements.

Assets available for sale
Assets available for sale were comprised primarily of liquidity reserve funds.

Further to this, assets available for sale were comprised primarily of debt instruments and, to a lesser extent, of equity instruments.

This item amounted to HRK 1,282.5 million, an increase of 19% compared with the beginning of the year due to the investment of available funds in treasury bills, cash investment funds in the Republic of Croatia and bonds of the Ministry of Finance as a part of liquidity reserve instruments in accordance with the Liquidity Risk Management Procedures and pursuant to the covenants in the contracts with foreign creditors.

Investment in subsidiary
This item relates to the HBOR's 51% share in the equity of the company Hrvatsko kreditno osiguranje d.d., Zagreb which was founded in 2010. The equity of the company amounts to HRK 37.5 million.

On 25th September 2012, HBOR acquired the remaining 49% share in the equity of the subsidiary Hrvatsko kreditno osiguranje d.d. through a purchase transaction and thus became a 100% owner of the company. The fee paid for the purchase of 49% share in the company's equity amounted to EUR 2.3 million, and the payment was effected in cash.

This represented a subsequent acquisition of a non-controlling interest and not a business combination and is accounted for as an equity transaction.

Total liabilities
At the end of 2012, total liabilities amounted to HRK 17,651.8 million, which represents 69% of total liabilities and total equity.

The major portion of total liabilities consists of HBOR's foreign borrowings and bonds payable in the total amount of HRK 16,404.7 million.

Liabilities under loans taken rose by 65% compared to the beginning of the year as a result of funds drawndown under loans contracted in previous years and the funds drawdown under the syndicated loan of domestic commercial banks.

In 2012, HBOR maintained to raise funds for the specified purposes by borrowing from similar special financial institutions, and the following loan agreements were concluded with the:

- European Investment Bank (EIB): a loan of EUR 150.0 million as the first tranche and a loan of EUR 100.0 million as the second tranche for the financing of projects of small and medium-sized companies and mid-cap companies in the Republic of Croatia,
- Council of Europe Development Bank: a loan of EUR 50.0 million for the financing of projects implemented by SMEs, units of local and regional government and other public sector entities in the Republic of Croatia,
- World Bank: a loan of EUR 50.0 million for the additional financing of the Croatia Export Finance Intermediation Project (CEFIL).

In the reporting period, on 3rd September 2012, HBOR made a bullet repayment of the issued bonds in the amount of HRK 1,867.0 million, together with interest of HRK 135.4 million.

The bonds were issued on 3rd September 2009 pursuant to the agreement between HBOR and Deutsche Bank AG London in the amount of EUR 250.0 million, with the maturity of 3 years and the fixed interest rate of 7.25%.

On 3rd December 2012, HBOR paid the last principal repayment instalment under the issued bonds in the amount of EUR 100.0 million on 4th December 2002 in accordance with the agreement between HBOR and J.P. Morgan Europe Limited under the EMTN Programme guaranteed by the Republic of Croatia with the maturity period of 10 years, the fixed interest rate of 5.75% and the amortising repayment from 2008 to 2012.

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

In the reporting period, contributions from the budget of the Republic of Croatia amounted to HRK 600.0 million. At the end of 2012, the total amount of capital contributed from the budget of the Republic of Croatia stood at HRK 5,517.1 million. The amount of capital to be paid in from the budget of the Republic of Croatia to the amount of Founder's capital set by the HBOR Act (HRK 7,000.0 million) is HRK 1,482.9 million.

The total profit of the Bank generated for the business year is allocated to reserves, pursuant to the HBOR Act.

ENCOURAGING THE USE OF EU FUNDS

The majority of the approved projects

were financed by HBOR's loans

Annual financial statements for 2012

Contents

Responsibility for the Financial Statements

Pursuant to the Accounting Act of the Republic of Croatia, the Managing Board of the Bank and the Group are obliged to ensure that the financial statements for each financial year are prepared in accordance with the International Financial Reporting Standards (IFRS), as published by the International Accounting Standards Board (IASB), so as to give a fair view of the position and operating results of the Croatian Bank for Reconstruction and Development (the Bank) and the Group for that period.

The Managing Board has a reasonable expectation that the Bank and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Managing Board continues to adopt the going concern basis in preparing the financial statements.

In preparing the consolidated and separate financial statements, the responsibilities of the Managing Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed; and
- the financial statements are prepared on the going concern basis, unless it is inappropriate to presume that the Bank and the Group will continue in business.

The Managing Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and the Group, and must also ensure that the financial statements comply with the Croatian Accounting Act. The Managing Board is also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Managing Board:

HRVATSKA BANKA ZA OBNOVU I RAZVITAK
HBOR
ZAGREB
1

Anton Kovačev

President of the Managing Board

Croatian Bank for Reconstruction and Development

Strossmayerov trg 9

10 000 Zagreb

Zagreb, 06 March 2013

Deloitte.

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www.deloitte.com/hr

Independent Auditor's Report

To the owner of the Croatian Bank for Reconstruction and Development:

We have audited the accompanying unconsolidated and consolidated financial statements of the Croatian Bank for Reconstruction and Development ("the Bank") and its subsidiaries ("the Group"), respectively which comprise the Statement of Financial Position as at 31 December 2012, and Statement of Profit or Loss, Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Responsibility for the Financial Statements

The Managing Board is responsible for the preparation and fair presentation of these financial statements in accordance with accounting legislation in the Republic of Croatia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion the accompanying unconsolidated and consolidated financial statements present fairly, in all material respects the financial position of the Bank and the Group, respectively as at 31 December 2012 and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Branislav Vrtačnik, Member of the Board and Certified Auditor
Deloitte d.o.o.

Zagreb, 6 March 2013

The company was registered at Zagreb Commercial Court: MBS 030022053; paid-in initial capital: Kn 44,900.00; Board Members: Eric Daniel Olcott and Branislav Vrtačnik; Bank: Zagrebačka banka Zagreb d.d., Paromlinska 2, 10 000 Zagreb, bank account no. 2360000-1101896313; SWIFT Code: ZABAHR2X IBAN: HR27 2360 0001 1018 9631 3; Privredna banka Zagreb d.d., Račkoga 6, 10 000 Zagreb, bank account no. 2340009–1110098294; SWIFT Code: PBZGHR2X IBAN: HR38 2340 0091 1100 9829 4; Raiffeisenbank Austria d.d., Petrinjska 59, 10 000 Zagreb, bank account no. 2484008–1100240905; SWIFT Code: RZBHHR2X IBAN: HR10 2484 0081 1002 4090 5

Financial statements of the Group Consolidated Statement of Profit or Loss for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	Notes	2012 HRK '000	2011 HRK '000
Interest income	3	967,548	897,723
Interest expense	4	(555,786)	(563,861)
Net interest income		**411,762**	**333,862**
Fee income	5	12,510	13,614
Fee expense	5	(927)	(1,236)
Net fee income		**11,583**	**12,378**
Net gains/(losses) on financial operations	6	(73)	44,422
Other income		5,118	2,270
		428,390	392,932
Operating expenses	7	(117,041)	(100,148)
Impairment loss and provisions	8	(177,487)	(145,946)
Profit before income tax		**133,862**	**146,838**
Income tax	9	95	252
Profit for the year		**133,957**	**147,090**
Attributable to:			
Equity holders of the parent		134,079	147,626
Non-controlling interests		(122)	(536)
		133,957	**147,090**

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss.

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	2012 HRK '000	2011 HRK '000
Profit for the year	**133,957**	**147,090**
Other comprehensive income		
Increase in fair value of assets available for sale	63,825	19,924
Decrease in fair value of assets available for sale	(15,137)	(32,046)
Net foreign exchange on available for sale equity instruments	23	249
Transfer of realized gains on assets available for sale to statement of profit or loss	(400)	(1,966)
Transfer of realized losses on assets available for sale to statement of profit or loss	4,541	-
Deferred tax - other comprehensive income	(35)	1
Other comprehensive income	**52,817**	**(13,838)**
Total comprehensive income after income tax	**186,774**	**133,252**
Attributable to:		
Equity holders of the parent	186,856	133,791
Non-controlling interests	(82)	(539)
	186,774	**133,252**

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss and Other Comprehensive Income.

Consolidated Statement of Financial Position as of 31 December 2012

(All amounts are expressed in HRK thousand)

	Notes	2012 HRK '000	2011 HRK '000
Assets			
Cash on hand and due from banks	10	2,851,655	267,723
Deposits with other banks	11	62,253	67,377
Loans to banks	12	14,749,251	14,299,705
Loans to other customers	13	6,708,076	6,184,717
Financial assets at fair value through profit or loss	14	948	519
Assets available for sale	15	1,285,795	1,083,467
Assets held to maturity	16	1,087	1,092
Investments in associates	18	-	-
Property, plant and equipment and intangible assets	19	68,323	68,401
Non-current assets held for sale	20	34,130	34,432
Other assets	21	5,703	5,430
Total assets		**25,767,221**	**22,012,863**
Liabilities			
Deposits	22	167,410	154,243
Borrowings	23	13,546,358	8,197,363
Bonds payable	24	2,858,293	5,144,724
Other liabilities	25	1,084,438	1,175,611
Total liabilities		**17,656,499**	**14,671,941**
Equity			
Founder's capital	26	5,943,739	5,343,739
Retained earnings and reserves		1,983,293	1,836,565
Other reserves		37,256	(16,813)
Profit for the year		134,079	147,626
Total equity attributable to equity holders of the parent		**8,098,367**	**7,311,117**
Non-controlling interests		-	17,475
Capital		**8,098,367**	**7,328,592**
Guarantee fund	27	12,355	12,330
Total equity		**8,110,722**	**7,340,922**
Total liabilities and total equity		**25,767,221**	**22,012,863**

The accompanying accounting policies and notes are an integral part of this Statement of Financial Position.

Signed on behalf of the Croatian Bank for Reconstruction and Development on 06 March 2013 by:

HRVATSKA BANKA ZA OBNOVU I RAZVITAK HBOR ZAGREB 1

Irena Adžić-Jagodić

Anton Kovačev
President of the Managing Board

Irena Adžić-Jagodić
Accounting Division Executive Director

Consolidated Statement of Cash Flows for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	2012 HRK '000	2011 HRK '000
Operating activities		
Profit before income tax	133,862	146,838
Adjustments to reconcile to net cash from and used in operating activities:		
Depreciation	7,162	6,515
Income tax	(60)	(253)
Impairment loss and provisions	177,487	145,946
Accrued interest	(11,152)	(129,077)
Deferred fees	22,696	10,680
Operating profit before working capital changes	329,995	180,649
Changes in operating assets and liabilities:		
Net decrease in deposits with other banks, before provision for impairment	5,018	71,486
Net (increase)/decrease in loans to banks, before provision for impairment	(545,931)	1,101,044
Net (increase) in loans to other customers, before provision for impairment	(599,451)	(484,510)
Net (gain)/losses on financial assets at fair value through profit or loss	(24)	(26)
Net realized losses /(gain) on assets available for sale	4,141	(1,966)
(Increase)/decrease of discount in assets available for sale, assets held to maturity and bonds payable	(6,047)	9,347
Net decrease/(increase) in non-current assets held for sale	190	(1,390)
Net (increase)/decrease in other assets, before provision for impairment	(66)	306
Net increase/(decrease) in deposits from banks and companies	13,167	(68,415)
Net (decrease)/increase in other liabilities, before provisions	(121,839)	33,509
Net cash used in operating activities	**(920,847)**	**840,034**
Investment activities		
Acquisition of non-controlling interests	(16,999)	-
(Purchase) of financial assets at fair value through profit or loss	(2,630)	(1,600)
Sale of financial assets at fair value through profit or loss	2,224	1,630
Net (purchase) of assets available for sale	(1,646,084)	(1,442,570)
Sale of assets available for sale	1,521,868	557,966
Net (purchase) of property, plant and equipment and intangible assets	(7,084)	(4,584)
Net cash (used in)/ provided by investment activities	**(148,705)**	**(889,158)**
Financing activities		
Increase in founder's capital	600,000	180,000
Increase in borrowings - withdrawn funds	5,810,058	1,547,066
(Decrease) in borrowings - repayments of principal	(499,936)	(516,386)
(Decrease) in bonds payable - repayment	(2,242,422)	(2,373,992)
Net cash provided by financing activities	**3,667,700**	**(1,163,312)**
Effect of foreign currency to cash and cash equivalents		
Net foreign exchange	11,237	212,331
Net effect	**11,237**	**212,331**
Net increase /(decrease) in cash and cash equivalents	2,609,385	(1,000,105)
Balance as of 1 January, before provisions	270,421	1,270,526
Net increase/(decrease) in cash	2,609,385	(1,000,105)
Balance as of 31 December, before provisions	**2,879,806**	**270,421**
Additional note - Operational cash flows		
Interest paid	571,747	628,131
Interest received	750,650	634,449

The accompanying accounting policies and notes are an integral part of this Statement of Cash Flows.

Consolidated Statement of Changes in Equity for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	Founder's capital	Retained earnings and reserves	Other reserves	Net profit for the year	Non-controlling interests	Total equity
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January 2011	**5,163,739**	**1,718,962**	**(2,978)**	**117,603**	**18,014**	**7,015,340**
Profit for the year	-	-	-	147,626	(536)	147,090
Other comprehensive income	-	-	(13,835)	-	(3)	(13,838)
Total comprehensive income	-	-	(13,835)	147,626	(539)	133,252
Capital paid-in from the State Budget (Note 26)	180,000	-	-	-	-	180,000
Transfer of profit 2010 to retained earnings	-	117,603	-	(117,603)	-	-
Balance as of 31 December 2011	**5,343,739**	**1,836,565**	**(16,813)**	**147,626**	**17,475**	**7,328,592**
Profit for the year	-	-	-	134,079	(122)	133,957
Other comprehensive income	-	-	52,777	-	40	52,817
Total comprehensive income	-	-	52,777	134,079	(82)	186,774
Capital paid-in from the State Budget (Note 26)	600,000	-	-	-	-	600,000
Transfer of profit 2011 to retained earnings	-	147,626	-	(147,626)	-	-
Decrease in non-controlling interests	-	(898)	(2)	-	(17,393)	(18,293)
Positive movement in parent equity (Note 17)	-	-	1,294	-	-	1,294
Balance as of 31 December 2012	**5,943,739**	**1,983,293**	**37,256**	**134,079**	**-**	**8,098,367**

The accompanying accounting policies and notes are an integral part of this Statement of Changes in Equity.

Financial statements of the Bank
Unconsolidated Statement of Profit or Loss for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	Notes	2012 HRK '000	2011 HRK '000
Interest income	3	965,853	896,174
Interest expense	4	(555,786)	(563,861)
Net interest income		**410,067**	**332,313**
Fee income	5	11,039	12,247
Fee expense	5	(927)	(1,236)
Net fee income		**10,112**	**11,011**
Net gains/(losses) on financial operations	6	(118)	44,351
Other income		2,501	1,007
		422,562	**388,682**
Operating expenses	7	(110,871)	(94,756)
Impairment loss and provisions	8	(177,273)	(145,866)
Profit before income tax		**134,418**	**148,060**
Income tax	2	-	-
Profit for the year		**134,418**	**148,060**
Attributable to:			
Equity holders of the parent		**134,418**	**148,060**

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss.

Unconsolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	2012 HRK '000	2011 HRK '000
Profit for the year	**134,418**	**148,060**
Other comprehensive income		
Increase in fair value of assets available for sale	63,670	19,840
Decrease in fair value of assets available for sale	(15,125)	(31,956)
Net foreign exchange on available for sale equity instruments	23	249
Transfer of realized gains on assets available for sale to statement of profit or loss	(385)	(1,966)
Transfer of realized losses on assets available for sale to statement of profit or loss	4,541	-
Other comprehensive income	**52,724**	**(13,833)**
Total comprehensive income after income tax	**187,142**	**134,227**
Attributable to:		
Equity holders of the parent	**187,142**	**134,227**

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss and Other Comprehensive Income.

Unconsolidated Statement of Financial Position as of 31 December 2012

(All amounts are expressed in HRK thousand)

	Notes	2012 HRK '000	2011 HRK '000
Assets			
Cash on hand and due from banks	10	2,851,310	267,219
Deposits with other banks	11	30,419	34,811
Loans to banks	12	14,749,251	14,299,705
Loans to other customers	13	6,708,076	6,184,717
Assets available for sale	15	1,282,528	1,081,385
Investments in subsidiaries	17	36,124	19,125
Investments in associates	18	-	-
Property, plant and equipment and intangible assets	19	68,058	68,106
Non-current assets held for sale	20	34,130	34,432
Other assets	21	3,335	3,424
Total assets		**25,763,231**	**21,992,924**
Liabilities			
Deposits	22	167,410	154,243
Borrowings	23	13,546,358	8,197,363
Bonds payable	24	2,858,293	5,144,724
Other liabilities	25	1,079,762	1,172,353
Total liabilities		**17,651,823**	**14,668,683**
Equity			
Founder's capital	26	5,943,739	5,343,739
Retained earnings and reserves		1,984,984	1,836,924
Other reserves		35,912	(16,812)
Profit for the year		134,418	148,060
Capital		**8,099,053**	**7,311,911**
Guarantee fund	27	12,355	12,330
Total equity		**8,111,408**	**7,324,241**
Total liabilities and total equity		**25,763,231**	**21,992,924**

The accompanying accounting policies and notes are an integral part of this Statement of Financial Position.

Signed on behalf of the Croatian Bank for Reconstruction and Development on 06 March 2013 by:

HRVATSKA BANKA ZA OBNOVU I RAZVITAK HBOR ZAGREB 1

Anton Kovačev
President of the Managing Board

Irena Adžić-Jagodić
Accounting Division Executive Director

Unconsolidated Statement of Cash Flows for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	2012 HRK '000	2011 HRK '000
Operating activities		
Profit before income tax	134,418	148,060
Adjustments to reconcile to net cash from and used in operating activities:		
Depreciation	6,988	6,359
Impairment loss and provisions	177,273	145,866
Accrued interest	(11,251)	(128,511)
Deferred fees	22,696	10,680
Operating profit before working capital changes	330,124	182,454
Changes in operating assets and liabilities:		
Net decrease in deposits with other banks, before provision for impairment	4,405	69,235
Net (increase)/decrease in loans to banks, before provision for impairment	(545,931)	1,101,044
Net (increase) in loans to other customers, before provision for impairment	(599,451)	(484,510)
Net realized losses/(gain) on assets available for sale	4,156	(1,966)
(Increase)/decrease of discount in assets available for sale and bonds payable	(6,045)	9,347
Net decrease/(increase) in non-current assets held for sale	190	(1,390)
Net decrease in other assets, before provision for impairment	348	1,048
Net increase/(decrease) in deposits form banks and companies	13,167	(68,415)
Net (decrease)/increase in other liabilities, before provisions	(123,217)	32,414
Net cash used in operating activities	**(922,254)**	**839,261**
Investment activities		
Acquisition of non-controlling interests	(16,999)	-
Net (purchase) of assets available for sale	(1,644,561)	(1,441,624)
Sale of assets available for sale	1,521,353	557,966
Net (purchase) of property, plant and equipment and intangible assets	(6,940)	(4,554)
Net cash (used/in) provided by investment activities	**(147,147)**	**(888,212)**
Financing activities		
Increase in founder's capital	600,000	180,000
Increase in borrowings - withdrawn funds	5,810,058	1,547,066
(Decrease) in borrowings - repayments of principal	(499,936)	(516,386)
(Decrease) in bonds payable - repayment	(2,242,422)	(2,373,992)
Net cash provided by financing activities	**3,667,700**	**(1,163,312)**
Effect of foreign currency to cash and cash equivalents		
Net foreign exchange	11,245	212,371
Net effect	**11,245**	**212,371**
Net increase/(decrease) in cash and cash equivalents	2,609,544	(999,892)
Balance as of 1 January, before provisions	269,917	1,269,809
Net increase/(decrease) in cash	2,609,544	(999,892)
Balance as of 31 December, before provisions	**2,879,461**	**269,917**
Additional note - Operational cash flows		
Interest paid	571,747	628,131
Interest received	748,850	633,458

The accompanying accounting policies and notes are an integral part of this Statement of Cash Flows.

Unconsolidated Statement of Changes in Equity for the year ended 31 December 2012

(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Net profit for the year HRK '000	Total equity HRK '000
Balance as of 1 January 2011	**5,163,739**	**1,718,962**	**(2,979)**	**117,962**	**6,997,684**
Profit for the year	-	-	-	148,060	148,060
Other comprehensive income	-	-	(13,833)	-	(13,833)
Total comprehensive income	-	-	(13,833)	148,060	134,227
Capital paid-in from the State Budget (Note 26)	180,000	-	-	-	180,000
Transfer of profit 2010 to retained earnings	-	117,962	-	(117,962)	-
Balance as of 31 December 2011	**5,343,739**	**1,836,924**	**(16,812)**	**148,060**	**7,311,911**
Profit for the year	-	-	-	134,418	134,418
Other comprehensive income	-	-	52,724	-	52,724
Total comprehensive income	-	-	52,724	134,418	187,142
Capital paid-in from the State Budget (Note 26)	600,000	-	-	-	600,000
Transfer of profit 2011 to retained earnings	-	148,060	-	(148,060)	-
Balance as of 31 December 2012	**5,943,739**	**1,984,984**	**35,912**	**134,418**	**8,099,053**

The accompanying accounting policies and notes are an integral part of this Statement of Changes in Equity.

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 as defined in the International Accounting Standard 27: Consolidated and Separate Financial Statements.

The legal address of the Bank is 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").

On 25 September 2012, HBOR acquired the remaining 49% share in the equity of the subsidiary Hrvatsko kreditno osiguranje d.d. through a purchase transaction and thus became the 100% owner of the company.

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

As of 31 December 2012, the Group had 302 employees (31 December 2011: 281 employees).

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.

As of 31 December 2012, there were 289 employees at the Bank (31 December 2011: 270 employees).

1.2.1. Activities of the Bank:

The principal activities of the Bank comprise the following:

- financing of the 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.

1. General information

(continued)

1.3. BODIES OF THE BANK AND THE GROUP:

During 2012, the Supervisory Board members were as follows:

- Slavko Linić, Minister of Finance – ex officio President of the Supervisory Board,
- Radimir Čačić, First Deputy Prime Minister and Minister of Economy – ex officio Vice President of the Supervisory Board (until 21 November 2012),
- Ivan Vrdoljak, Minister of Economy – ex officio Vice President of the Supervisory Board (since 21 November 2012),
- Gordan Maras, Minister for Entrepreneurship and Crafts,
- Veljko Ostojić, Minister of Tourism,
- Tihomir Jakovina, Minister of Agriculture,
- Nadan Vidošević, President of the Croatian Chamber of Economy, ex officio Member of the Supervisory Board,
- Dragica Zgrebec, Deputy Speaker of the Croatian Parliament,
- Srđan Gjurković, MSc, Member of the Croatian Parliament,
- Ivan Šuker, Member of the Croatian Parliament.

Pursuant to the Act on Croatian Bank for Reconstruction and Development, the Supervisory Board consists of five ministers of the Government of the Republic of Croatia. The minister in charge of finances and the minister in charge of the economy are obligatory members of the Supervisory Board, whereas other three ministers are appointed to the Supervisory Board by the Government of the Republic of Croatia among the ministers in charge of development, tourism, agriculture, environmental protection and construction. The Croatian Parliament appoints three members of the Supervisory Board and their permanent deputies among the members of the Croatian Parliament. The President of the Croatian Chamber of Economy is ex officio member of the Supervisory Board.

On 15th February 2013, the Croatian Parliament passed the Act on the Amendments to the Act on the Croatian Bank for Reconstruction and Development (Official Gazette of the Republic of Croatia, No. 25/2013).

Further to this Act, the Minister in charge of regional development and EU funds shall be a member of the Supervisory Board of HBOR.

By these changes, the Supervisory Board of HBOR has been increased by one member, and it now consists of ten instead of nine members.

MANAGING BOARD

In 2012, members of the Managing Board were as follows:

- Anton Kovačev, President of the Managing Board,
- Emilija Nagj, Member of the Managing Board,
- Mladen Kober, Member of the Managing Board.

Audit Committee:

On 13 February 2012, the Supervisory Board appointed new members of the Audit Committee as follows:

- Slavko Linić, Minister of Finance, President of the Supervisory Board of HBOR, President of the Audit Committee,
- Srđan Gjurković, MSc, Member of the Croatian Parliament, Vice President of the Audit Committee,
- Ante Artuković, Executive Director of HBOR's Analysis Division, Member of the Audit Committee.

1. General information

(continued)

1.4. CURRENT ECONOMIC SITUATION AND ITS IMPACT ON THE BANK

So far, the economic situation in Croatia has not had a significant impact on the financial position and performance of the Bank. The Bank monitors closely the credit, liquidity, interest rate and foreign exchange risk on a regular basis. The highest exposure of credit portfolio is the one towards banks, which minimizes the level of credit risk due to strictly regulated banking sector by the central bank.

The economic environment in 2013 is difficult to fully predict, but the financial crisis will probably further impact certain industries (i.e. tourism, construction, processing industries, real estate sector) and the abilities of some customers to meet their loan obligations. Due to that, the Managing Board continues to expect an increase in applications for loan restructuring as it was the case in 2011 and 2012 (see Note 31.2. Credit risk – Loan restructuring). Such a prediction is supported by the Act on Financial Operations and Pre-Bankruptcy Settlement (Official Gazette No.108/2012) and the Decree on Changes and Amendments to the Act on Financial Operations and Pre-Bankruptcy Settlement (Official Gazette No.144/2012) that came into force at the end of 2012. The main objectives of the respective regulations is to enable any debtor that became illiquid and/or insolvent to make financial restructuring, and to provide to creditors more favourable terms and conditions of settlement of their receivables than those that would have been realised if a bankruptcy procedure had been initiated against such debtor. The mentioned circumstances may consequently influence the amount of the provisions for impairment losses in 2013, including the valuation of collateral.

Due to the impact of the economic and financial crisis, in 2012 HBOR launched a new loan program - The Program for the Development of the Economy intended for the financing of working capital for entrepreneurs faced with difficulties due to objective reasons – the influence of financial and economic crisis. Funds are provided to the borrower by a commercial bank and HBOR in proportion 50% : 50%. The Program will be in effect until the disbursement of available funds, but not later than 31 December 2013. Financing is being implemented out of the syndicated loan funds provided by domestic banks in the amount of HRK 3,415,620 thousand, the funds of which have been provided by releasing a portion of mandatory reserve requirements to commercial banks.

The Bank has sufficient funds and high level of liquidity for financing planned loan activities, meeting obligations and liabilities and maintaining required level of liquidity.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies

2.1. ACCOUNTING POLICIES

Principal accounting policies applied when preparing these financial statements are summarized below. Accounting policies were consistently applied to all periods presented in these financial statements.

Basis of accounting

The Bank and the Group maintain their accounting records in HRK in accordance with Croatian law and the accounting principles and practices observed by financial institutions in the Republic of Croatia.

Statement of compliance

These consolidated and separate financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as published by the International Accounting Standards Board.

Basis of financial statements presentation

The financial statements are prepared under the historical cost convention, with an exception of certain financial assets and financial liabilities that are measured at fair value.

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

Reporting currency

The financial statements of the Bank and the Group are prepared in Croatian Kuna (HRK) as the functional and reporting currency of the Bank and the Group.

Amounts presented are rounded to a nearest thousand, unless otherwise stated.

The effective exchange rate of HRK as of 31 December 2012 was HRK 7.545624 per 1 Euro and HRK 5.726794 per 1 United States dollar (31 December 2011: HRK 7.530420 per 1 Euro and HRK 5.819940 per 1 United States dollar), unless otherwise contracted.

Basis of consolidation

The financial statements include the Bank and the Group. The financial statements of the Group include the consolidated financial statements of the Bank and its subsidiary companies. Separate non-consolidated financial statements of the parent company are also stated.

Subsidiary companies

Subsidiary companies are all those companies, in which the Bank is entitled to govern the financial and operating policies, i.e. in which it holds more than a half of voting rights.

Subsidiary companies are included into consolidated financial statements in accordance with the full consolidation method from the moment when the actual control is transferred to the Bank. The consolidation ceases from the moment they are sold or liquidated, i.e. from the moment when the control is lost.

Investments in subsidiary companies are stated at investment cost, i.e. in accordance with the cost method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Basis of consolidation (continued)

Subsidiary companies (continued)
When preparing data and consolidated financial statements, the amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated, and intragroup balances and transactions, revenues and expenditures as well as unrealised gains and losses are eliminated in full.

The accounting policies of subsidiary companies are in line with those of the parent company in order to ensure comparability at the level of the Group.

The acquisition of subsidiaries is accounted by using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed and equity instruments issued in exchange for control over the acquiree. Acquisition costs incurred are expensed and included in operating costs.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the parent's ownership interests in them. Non-controlling interests in the net assets consist of the amount of those non-controlling interests at the date of the initial recognition of investment in the subsidiary company and the non-controlling interests' share of changes in equity since the date of acquisition of the interest. Losses incurred by a subsidiary company will be allocated between controlling and non-controlling interests even if losses exceed the non-controlling equity investment in the subsidiary.

Subsequent acquisition of a non-controlling interest is not a business combination and is accounted for as an equity transaction.

For measurement of changes in relative interests of the parent and non-controlling interest in the subsidiary on the date of acquisition, the Group used the approach of taking into account the proportionate share of the acquiree's identifiable net assets. The amount of positive movements in the parent equity is recognised in other reserves.

When the subsidiary company ceases to meet the criteria of this definition, and it has still not become an associated company, such investment will be recognized pursuant to the International Accounting Standard 39 – Financial Instruments: Recognition and Measurement from the date when the company ceases to be a subsidiary company. In such case, the carrying amount of investment shall be deemed an investment cost on initial measurement pursuant to IAS 39.

Associated companies
Associated companies are all those companies, in which the Group has a significant influence, i.e. is entitled to participate in decisions on the financial and operating policies of the investee, but does not have control over such policies. The Group has a significant influence if it holds, directly or indirectly, between 20 % and 50 % of voting rights of a company.

Investments in associated companies are recognised using the equity method in the consolidated financial statements, i.e. at acquisition cost in the non-consolidated financial statements of the parent company.

Unrealized gains on transactions with associated companies are eliminated to the extent of the Group's interest in such companies. Unrealised losses are eliminated in the same way as unrealised gains, but only if there are no indications of investment value impairment.

2.1. ACCOUNTING POLICIES (CONTINUED)

Basis of consolidation (continued)

Associated companies (continued)
The operating results of associated companies are included into the consolidated financial statements until the date when the investment in the company is sold, i.e. until the date when the parent company loses its significant influence over the related company.

When the associated company ceases to meet the criteria of this definition, such investment shall be recognised pursuant to the International Accounting Standard 39 – Financial Instruments: Recognition and Measurement from the date when the company ceases to be an associated company. In such case, the carrying amount of investment shall be deemed an investment cost on initial measurement pursuant to IAS 39.

Interest income and expense
Interest income and expense are recognized in the statement of profit or loss when earned or incurred. Interest income and expense are recognized in the statement of 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 statement of profit or loss upon collection.

Fee and commission income
Fee and commission income is comprised mainly of fees receivable 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. Fees and commissions are generally recognized in the period when the related service is rendered.

Fees on issued financial/payment guarantees are deferred and proportionally recognized as income over the term of guarantee.

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 statement of profit or loss on the principle of invoiced services.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Employee benefits
Pursuant to local legislation, the Group is obliged to pay contributions to the State Pension and Health Insurance Funds. This obligation relates to full-time employees and provides for paying contributions as certain percentages determined on the basis of the gross salary as follows:

	2012	2011
Contributions for state health insurance fund	13.00%*	15.00%
Contributions for employment fund	1.60%	1.60%
Special contribution for employment of disabled persons	0.20%	0.20%
Contribution for health protection at work	0.50%	0.50%

*The new rate is effective since 01 May 2012.

The Group is also obliged to withhold and pay contributions from gross pay on behalf of the employees to the State Pension Fund and Mandatory Pension Fund.

The Group does not have pension arrangements separate from the state pension system of the Republic of Croatia. This system requires that current contributions by the employer be calculated as a percentage of current gross salary payments; these expenses are charged to the statement of profit or loss in the period the related compensation is earned by the employee. The contributions on behalf of employees and on behalf of the employer are charged to expense in the period to which they relate. The Group calculates and pays required personal income tax and surtax on personal income tax from gross salary for each employee.

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.

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 Statement of Financial Position date or at the contract exchange rates. Income and expense arising in foreign currencies are converted at the rate of exchange on the transaction date. The resulting foreign exchange gains and losses are recorded in the statement of 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.

Changes arising from one-way currency clause contracts, based on which the value of receivables and liabilities denominated in a functional currency is changed with regard to the respective contract foreign currency (embedded derivatives – weighted exchange rate) imply changes in the fair value of embedded derivatives.

2.1. ACCOUNTING POLICIES (CONTINUED)

Foreign currency transactions and foreign currency clause (continued)

The Bank has assets originated in HRK that are linked to a foreign currency with two-way currency clause. These assets are translated to HRK as if they were originated in foreign currency.

The principal rates of exchange 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 2012	EUR 1 = HRK 7.545624	USD 1 = HRK 5.726794
31 December 2011	EUR 1 = HRK 7.530420	USD 1 = HRK 5.819940

Taxation
Based on Article 9 of the Act on the Croatian Bank for Reconstruction and Development, the parent company is exempt from income tax.

Income tax liabilities arise exclusively from the activities of the other members of the Group.

Income tax is charged on taxable profits in accordance with tax regulations and at the statutory tax rate.
Income tax expense is comprised of current and deferred tax. The amount of the income tax is reported in the statement of profit or loss except for the income tax that relates to the items that are recognised directly in equity and reserves when income tax is recognised in equity and reserves.

Current tax is the expected tax payable charged on the taxable amount of profits for the year by applying the tax rates in effect at the reporting date and all tax liability adjustments for previous periods.

The amount of deferred tax is calculated by applying the balance sheet liability method, providing for all temporary differences between the carrying amounts of assets and liabilities recorded for reporting purposes and the amounts used for tax calculation purposes. Deferred tax is calculated at the tax rates that are expected to apply on temporary differences when remunerated or settled in accordance with the regulations in force or in effect at the Statement of Financial Position date.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax liabilities are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefits will be realisable.

Deferred tax assets and liabilities are not discounted; they are recognised as long-term assets and/or long-term liabilities.

Cash and cash equivalents
For the purposes of the cash flows reporting, cash and cash equivalents comprise cash and current accounts with the Croatian National Bank and other banks less provisions for impairment and un-collectable amounts.

2. Summary of significant accounting policies (continued)

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2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Financial instruments

Financial assets and financial liabilities presented in the Statement of Financial Position include cash and cash equivalents, debt instruments, trade and other accounts receivable and payable, long-term loans and leases, deposits and investments.

The Group classifies its own financial instruments into following categories:

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

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 Managing 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 statement of profit or loss.

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

a) Financial assets at fair value through profit or loss

The above category is divided into two sub-categories: financial instruments held for trading purposes and those initially classified by the management into this category that are not traded actively. Financial assets classified into this category that are not intended for trading purposes have been acquired primarily for the purpose of maintaining the liquidity reserve and managing the short-term liquidity.

Upon initial recognition, financial assets carried at fair value through profit or loss are accounted for and presented at fair value which corresponds to the quoted prices or amounts obtained by the application of acceptable valuation models. When measuring the fair value of shares in cash investment funds, the price that is applied is the price of the share in the fund as of a given date acquired from the investment fund management company. The Group includes unrealized gains and losses in 'Net gains/(losses) on financial operations'.

b) 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

22.1. ACCOUNTING POLICIES (CONTINUED)

2. Summary of significant accounting policies (continued)

Financial instruments (continued)

b) 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 original maturity over 90 days that are held for an unlimited period and shares in investment funds (bond-based, equity instruments-based or combined) that the Bank intends to held for a period of over 30 days.

Subsequent to initial recognition, available-for-sale financial assets are remeasured 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 equity, until their disposal or impairment, at which time the cumulative gain or loss previously recognized in equity is included in the statement of profit or loss for the period.

Impairment losses on assets available for sale are presented in the statement of profit or loss. If the fair value of an equity instrument subsequently increases, the increase will be recognized in equity, and will not be subsequently reversed in the statement of profit or loss. Impairment losses recognized in statement of 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 equity and there is an objective evidence that the asset is impaired according to IAS 39 provisions, the cumulative loss that has been recognized in equity shall be reclassified from equity to statement of profit or loss as a reclassification adjustment, even though the financial asset has not been derecognized.

Impairment losses on investments in equity instrument recognized in the profit or loss are not reversed through profit or loss. If in the coming period the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to the event occurred after the recognition of impairment loss into profit or loss, impairment loss shall be reversed, with the amount of the reversal recognized profit or loss. All subsequent changes in the fair value of equity instruments classified into this category of financial assets are recognized in the equity.

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.

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

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

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

Interest earned whilst holding available for sale instruments is accrued on a daily basis and is reported as 'Interest income' in the statement of 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 equity until the financial asset is sold. Foreign exchange gains/(losses) related to available-for-sale debt instruments in foreign currency are reported in the statement of profit or loss.

c) 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.

If the issuer of securities indicates the method of revaluation, the carrying amount is stated pursuant to the conditions of issuer until its maturity.

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 the statement of profit or loss under 'Impairment loss and provisions'.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

d) Loans to banks 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.

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 the statement of 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 Managing Board of HBOR determines the adequacy of the provision based upon analysis of various factors, the structure of the loan portfolio and past experience (see Note 31.2. Risk management – Credit risk).

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 statement of profit or loss.

Securities purchased under agreements to purchase and resell ('reverse repos') are recorded as assets in the Statement of Financial Position under 'Loans to banks'. 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 the statement of profit or loss.

At the end of 2012, the Group's REPO deals amounted to HRK 1,445,910 thousand (2011: HRK 2,712,136 thousand) collateralized by securities in the amount of HRK 1,550,771 thousand (2011: HRK 2,943,272 thousand).

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment and intangible assets
Property, plant and equipment and intangible assets are initially recognized and subsequently measured at acquisition cost. Depreciation is charged using the linear method, by applying the annual rates ranging from 3.03% to 33.3% to the cost of assets over their estimated useful lives.

Estimated useful lives are as follows:

	2012 years	2011 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 is not charged on property, plant and equipment and intangible assets in the course of construction, until they are available for use. Repairs and maintenance are expensed in the statement of profit or loss as incurred. Expenditure that increases the future economic benefits of existing tangible and intangible assets (improvements) is capitalized.

Impairment of assets
An assessment of financial assets is made at the reporting date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset and any impairment loss, based on the net present value of future anticipated cash flows including anticipated recoveries from guarantees and collateral instruments, discounted by the original effective interest rate, is recognized in the statement of profit or loss.

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in the statement of profit or loss for items of property, plant and equipment and intangible assets carried at cost, or it is treated as a revaluation decrease for assets that are presented at re-valued amount to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for the same assets. The recoverable amount is the higher of an asset's net selling price and its value in use.

Non-current assets held for sale
Non-current assets held for sale 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.

This category of assets is initially stated at fair value less estimated expected costs to sell.

2.1. ACCOUNTING POLICIES (CONTINUED)

Non-current assets held for sale (continued)

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 Bank 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 the statement of profit or loss, as well as gains/losses upon subsequent measurement and on sale of the non-current assets.

The cases in which due to more difficult circumstances of sale because of objective circumstances and events beyond the Bank'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 Bank has remained consistent with the plan of sale of such type of assets, do not exclude that the assets are still classified as non-current assets held-for-sale.

Bank's borrowings and bonds payable
Financial liabilities of the Bank and the Group arise from received loans and securities issued.

Financial liabilities are initially recognized at fair value, adjusted by transaction costs. After initial recognition, financial liabilities are measured at amortized cost determined using the effective interest rate method.

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.

The Group recognises interest expense related to borrowings and bonds payable in the statement of profit or loss.

Government grants
Interest for the borrowers qualifying for subsidized interest under the Programme of Preferential Financing through HBOR's Loan Programmes, the Development and Employment Programme, the Programme for Regional Development of the Republic of Croatia, the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet, the Renewable Energy Resources Project, the Loan Programme for the Financing of Female Entrepreneurship and investments into entrepreneurial zones is subsidized by the Republic of Croatia – the Ministry of Finance, Ministry of the Economy, the Ministry of Regional Development and EU Funds, the Ministry of Agriculture, the Ministry for Maritime Affairs, Transport and Infrastructure, the Ministry for Entrepreneurship and Crafts and the Environment and Energy Efficiency Fund 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 statement of 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 (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2. Summary of significant accounting policies (continued)

2.1. ACCOUNTING POLICIES (CONTINUED)

Guarantees and other loan related commitments
In the ordinary course of business, the Bank issues financial guarantees, including letters of credit that are recorded off-balance sheet. Financial guarantee contracts are initially measured at their fair values. Subsequent to initial recognition, guarantees are measured at fair value at the higher of the amount of the obligation under the contract and the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Contingent liabilities under guarantees are, to the extent of 84%, collateralized by the guarantees issued by the Republic of Croatia or the liability was taken over by the Republic of Croatia. Letters of credit are entirely covered by deposits.

Provisions for commitments upon undrawn loans and issued guarantees are maintained at a level considered as adequate by the Managing Board in order to absorb potential losses.

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

Segment reporting
The Segment is a unique component of the Group and its operations are the supply of products or services (business segment) or the supply of products or services within a certain business environment (geographical segment) subject to unique risks and benefits, different from the ones in other segments.

The general format of business segments is based on the decision of the Managing Board and the stated segments are in line with financial statements which are prepared in accordance with the International Financial Reporting Standards.

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.

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, Ministry for Entrepreneurship and Crafts, Ministry for Maritime Affairs, Transport and Infrastructure, Ministry of Agriculture, Ministry of Regional Development and EU Funds, the Environment and Energy Efficiency Fund, Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for Small Business and Investments ("HAMAG INVEST"), 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 29).

2.2. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

For the preparation of financial statements in accordance with IFRS's, the Managing Board is required to give estimations and make assumptions that influence the reported balances of assets and liabilities and to disclose contingent amounts of assets and liabilities at the date of financial statements, and present income and expense for the reporting period. As a result of uncertainties which inherent in business activities, some items in the financial statements cannot be measured with precision but can only be estimated. The procedure of estimation includes the judgements based on latest reliable information available at the reporting date, so that actual amounts may differ from those estimated.

The changes in accounting estimates are adjustments of the carrying amount of some assets or liabilities or the pattern of consumption during useful life arising through the estimation of the current situation and expected future benefits and obligations associated with these assets and liabilities.

The use of reasonable estimations is essential part of the preparation of financial statements and does not undermine their reliability.

The changes in accounting estimates occur if there are changes in circumstances based on which the estimation was based as a result of new information or more experience. The changes in estimates do not relate to prior periods and is not the correction of an error.

In the process of applying the Bank's accounting policies, the management has made judgments and estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

a) Fair value of financial instruments
If there is no active market for a certain financial instrument, or if for any other reason the fair value of financial assets and financial liabilities presented in the Statement of Financial Position cannot be reliably measured by the market price, the Group determines the fair value by using various valuation techniques including the use of mathematical models. The input data for these models are taken from other recognizable markets where possible, but if it is not possible, there is a certain degree of judgment required in determining fair values.

b) Valuation of financial instruments
The Bank's accounting policy on fair value measurements is discussed in Note 32 Fair Value of Financial Instruments.

c) Loan impairment provisions
The Bank regularly monitors its loans and receivables to assess impairment. The Bank uses its experience of judgments to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are several available sources of historical data relating to similar borrowers.

Similarly, the Bank estimates changes in future cash flows using the data indicating an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

The management uses estimates based on the historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables.

2. Summary of significant accounting policies (continued)

2.2. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES (CONTINUED)

c) Loan impairment provisions (continued)

The management uses estimates based on the historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experience and judgment to adjust available data for a group of loans or receivables according to current market conditions.

d) Provisions for legal cases

The Group performs a risk classification of legal cases taking into consideration the legal basis of the claim, prior legal practice, opinions of relevant in-house lawyers, opinions of the outsourced attorneys and the Bank's own experience.

The Group makes provisions for legal cases in proportion with the total amount and estimated likelihood of not winning the case. In estimating provisions, the Bank takes into account the due legal process in the Republic of Croatia, which allows a multiple appeal procedure in certain cases.

Provisions for costs arising from initiated legal proceedings are reversed in the period in which legally valid sentence, arbitration award or settlement in the conciliation proceedings was made, pursuant to the procedures of monitoring legal cases against HBOR.

e) Provisions for retirement and jubilee benefits

In calculating provisions for retirement and jubilee benefits, the Group discounts expected future cash flows in respect of the liabilities, using discount rates that, in the opinion of the Bank's management, best represent the time value of the money.

Provisions for regular retirement and jubilee benefits are calculated and determined by a licensed actuary.

2.3. ADOPTION OF NEW AND AMENDED INTERNATIONAL FINANCIAL REPORTING STANDARDS

The following amendments to IFRSs have been applied in the current year and have affected presentation and disclosures in these financial statements.

- Amendments to IFRS 7 Disclosures – Transfers of Financial Assets
  The Group has applied the amendments to IFRS 7 Disclosures – Transfers of Financial Assets in the current year. The amendments increase the disclosure requirements for transactions involving the transfer of financial assets in order to provide greater transparency around risk exposures when financial assets are transferred.

- Amendments to IAS 1 Presentation of Items of Other Comprehensive Income
  The amendments introduce new terminology for the statement of comprehensive income and income statement. Under the amendments to IAS 1, the 'statement of comprehensive income' is renamed the 'statement of profit or loss and other comprehensive income' and the 'income statement' is renamed the 'statement of profit or loss'. The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section:

2.3. ADOPTION OF NEW AND AMENDED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

(a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis – the amendments do not change the option to present items of other comprehensive income either before tax or net of tax. The amendments have been applied retrospectively, and hence the presentation of items of other comprehensive income has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

The following is a review of adopted standards which are not effective as at the date of publishing the Group's financial statements. The Group will apply the standards relevant to its operations when they become effective.

- Revised IAS 19 Employee Benefits (effective for periods beginning on or after 1 January 2013) which includes numerous changes, of which the most significant ones include abolishing the possibility of deferral of the recognition of actuarial gains and losses in respect of defined benefit plans, introduces the requirements in terms of disclosure of defined benefits which include quantitative information regarding the sensitivity of obligations of certain benefits to a possible change in each significant actuarial assumption and prescribes that the difference between short-term and long-term employee benefits is based more on the expected time of settlement than on the employees' rights to such benefits. This standard does not affect the Group after initial application.

- IFRS 9 Financial Instruments: Classification and measurement (effective for periods beginning on or after 1 January 2015) is the first phase of International Accounting Standards Board (IASB) project to replace IAS 39, applicable for classification and measurement of financial assets as defined by IAS 39. In the following steps, IASB will define impairment, hedge accounting and de-recognition. Taking into account the comprehensiveness of the entire project to replace IAS 39, the envisaged phase and time duration, the Group will quantify the effects upon the completion of all project phases in order to project the full picture.

- IFRS 13 Fair Value Measurement (effective for periods beginning on or after 1 January 2013) provides a description of how an entity measures fair value when its application is required or permitted by the IFRSs. This Standard seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. This Standard does not affect the financial statements of the Group after initial application since the Group presents categorisation of levels in accordance with the IFRS 7 Financial Instruments: Disclosures – Transfers of Financial Assets, but taking into account the business model of the Group.

- Amended IAS 32 Financial Instruments: Presentation – Offsetting of Financial Assets and Liabilities (effective for periods beginning on or after 1 Janu-

2. Summary of significant accounting policies (continued)

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2. Summary of significant accounting policies (continued)

2.3. ADOPTION OF NEW AND AMENDED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

ary 2014) which amends the provisions of the existing Standard with an objective of clarifying inconsistencies in the current practice when applying the offsetting criteria. The amendments clarify the meaning of the expression "currently has a legally enforceable right of set-off'" and the provision that some gross settlement systems may be considered equivalent to net settlement. This Standard will not affect the Group after initial application.

- Amended IFRS 7 Financial Instruments: Disclosures – Transfers of Financial Assets (effective for periods beginning on or after 1 January 2014) which amends the provisions of IAS 32 Financial Instruments: Presentation – Offsetting of Financial Assets and Liabilities by the required related disclosures. This Standard will not affect the Group after initial application.

In 2011, the International Accounting Standards Board (IASB) issued, owing to the financial crisis, three new standards and amended two existing ones: the standards regulating the preparation of consolidated and separate financial statements, the reporting on joint arrangements and the required disclosures of interests in other entities:

- IFRS 10 Consolidated Financial Statements (effective for periods beginning on or after 1 January 2013) which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. As of the date of preparing these statements, this standard does not affect the financial statements of the Group after initial implementation. For any new investment in ownership interest of less than 50%, the Group will, in the period up to the beginning of application and afterwards, carefully consider the substance of the influence, power and significant activities in order to determine the need for consolidation.

  The assessment of control will require a comprehensive understanding of activities and the purposes of the investee in, the rights or exposures to variable returns as well as the returns of other investors. The control assessment may require information from the sources beyond the accounting function, such as operational staff and legal counsellors as well as the information outside the company. In the control assessment, a significant judgement of the information and circumstances will be required.

- The amended IAS 27 Separate Financial Statements (effective for periods beginning on or after 1 January 2013) applies in cases where the entity does not prepare consolidated financial statements but separate financial statements in accordance with the IFRSs. As of the date of preparing the statement, this standard will not affect the Group's financial statements after initial application regarding the requirements relating to the preparation of both separate financial statements of the parent company - the Bank and consolidated financial statements – the Group.

- IFRS 11 Joint Arrangements (effective for periods beginning on or after 1 January 2013) with the core principle that a party to a joint arrangement determines the type of joint arrangement in which it is involved by assessing its rights and obligations and accounts for those rights and obligations in accordance with that type of joint arrangement. As of the date of preparing these financial statements, this standard will not affect the Group's financial statements after initial implementation.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

2.3. ADOPTION OF NEW AND AMENDED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

- The amended IAS 28 Investments in Associates and Joint Ventures (effective for periods beginning on or after 1 January 2013) prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint investment. The basic principle under the equity method, on initial recognition of investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share in the profit or loss on the investee after the acquisition date. As of the date of preparing these financial statements, this standard will not affect the Group's financial statements after initial application since the investments in associates are accounted for under the equity method.

- IFRS 12 Disclosure of Interest in Other Entities (effective for periods beginning on or after 1 January 2013) accompanied IFRSs 10 and 11 and the amended IAS 28 regarding the fact that their provisions do not set out disclosures in financial statements. This standard introduced required disclosures to enable users of financial statements to evaluate the nature of and risks associated with entity's interests in other entities and the impact of these on the financial position, financial performance and cash flows. As of the date of preparing these financial statements, this standard will not affect the Group's financial statements for the reporting year. Upon the beginning of the application of this standard, the Bank and the Group will, if necessary, include the required disclosures in financial statements according to the type of investment.

2. Summary of significant accounting policies (continued)

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3. Interest income

Interest income by borrowers:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Public sector	71,035	59,376	70,908	59,287
State-owned companies	29,947	42,096	29,947	42,096
Foreign companies	5,498	8,855	5,498	8,855
Domestic companies	363,223	331,176	363,223	331,176
Domestic financial institutions	416,021	383,596	414,453	382,136
Foreign financial institutions	242	1,350	242	1,350
Penalty interest	13,840	11,972	13,840	11,972
Other	67,742	59,302	67,742	59,302
	967,548	**897,723**	**965,853**	**896,174**

Interest income by type of facility:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Interest on loans				
- banks	416,005	383,349	416,005	383,349
- other customers	504,280	483,367	504,280	483,367
	920,285	866,716	920,285	866,716
Investments in securities	42,985	27,205	42,859	27,116
Deposits	4,276	3,134	2,709	1,677
Due from domestic banks	2	668	-	665
	967,548	**897,723**	**965,853**	**896,174**

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 25 Other liabilities) and is recognized in the statement of profit or loss on a time basis during the repayment of the loan. Interest income earned on this basis in 2012 amounts to HRK 234,016 thousand (2011: HRK 206,665 thousand).

Further, the difference between interest income and interest collected relates to the amount of loan fees and accrued interest. Loan fees are collected after origination of the loan, but their recognition in the statement of profit or loss is performed using effective interest rate method. Accrued interest is recognized in the statement of profit or loss on a time basis.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

4. Interest expense

Interest expense by type of payee:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Domestic banks	56,375	40,777	56,375	40,777
Foreign banks	499,410	523,083	499,410	523,083
Other	1	1	1	1
	555,786	**563,861**	**555,786**	**563,861**

Interest expense by type of facility:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Borrowings	295,325	230,470	295,325	230,470
Debt securities	260,454	333,390	260,454	333,390
Deposits	7	1	7	1
	555,786	**563,861**	**555,786**	**563,861**

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.

5. Net fee income

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Fee income:				
From issued guarantees	4,044	3,467	4,044	3,467
From managed funds for and on behalf of third parties	6,405	8,354	6,412	8,354
From payment operations	372	189	372	189
Reinsurance commission income	1,478	1,372	-	-
Other	211	232	211	237
	12,510	**13,614**	**11,039**	**12,247**
Fee expense	(927)	(1,236)	(927)	(1,236)
Net fee income	**11,583**	**12,378**	**10,112**	**11,011**

6. Net gains/(losses) on financial operations

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:				
Cash on hand, accounts at banks and due from banks	(2,452)	6,710	(2,452)	6,710
Loans given to banks and other customers	15,491	250,005	15,491	250,005
Assets held to maturity	2	21	-	-
Assets available for sale	1,003	4,950	998	4,926
Other	4	(146)	4	(153)
	14,048	261,540	14,041	261,488
Net foreign exchange gains/(losses) on foreign currency liabilities:				
Deposits	490	(889)	490	(889)
Borrowings and issued long-term securities	(10,825)	(219,981)	(10,825)	(219,980)
Other	331	(398)	332	(392)
	(10,004)	(221,268)	(10,003)	(221,261)
Net foreign exchange gains/(losses) on foreign currency assets and liabilities	4,044	40,272	4,038	40,227
Gains on assets at fair value through profit or loss and realized (losses)/gains on assets available for sale	(4,117)	4,150	(4,156)	4,124
Net gains/(losses) on financial operations	**(73)**	**44,422**	**(118)**	**44,351**

7. Operating expenses

Operating expenses can be shown as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
General and administrative expenses:				
Employee expenses	68,354	59,133	65,550	56,644
Depreciation	7,162	6,515	6,988	6,359
Administration expenses	10,601	9,179	10,425	9,020
Material and services	20,866	19,830	19,224	18,440
	106,983	94,657	102,187	90,463
Other expenses:				
Taxes and contributions	357	281	353	277
Other expenses	9,701	5,210	8,331	4,016
	10,058	5,491	8,684	4,293
	117,041	**100,148**	**110,871**	**94,756**

Other expenses of the Group presented contain changes in technical reserves:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Changes in claims provisions	2,550	3,224	-	-
Changes in claims provisions, share of reinsurance	(1,717)	(2,330)	-	-
Expenses of insurance operations	**833**	**894**	-	-

8. Impairment loss and provisions

The provision for impairment losses on placements may be summarized as follows:

		GROUP		BANK
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Impairment losses on cash on hand and due from banks	25,453	(9,882)	25,453	(9,882)
Impairment losses on deposits with other banks	(34)	(691)	(34)	(691)
Impairment losses on loans to banks	58,158	63,297	58,158	63,297
Impairment losses on loans to other customers and interest	66,900	109,042	66,900	109,042
Impairment losses on non-current assets held for sale	112	1,319	112	1,319
Impairment losses on assets available for sale	(5,428)	1,367	(5,428)	1,367
Impairment losses on property, plant and equipment and intangible assets	-	1,507	-	1,507
Impairment losses on other assets	(34)	(832)	(259)	(874)
Total increase in provision for impairment losses on assets	145,127	165,127	144,902	165,085
Provision for guarantees and commitments	31,370	(25,019)	31,370	(25,057)
Other provisions	990	5,838	1,001	5,838
Total increase/(decrease) in provision for guarantees and commitments and other provisions	32,360	(19,181)	32,371	(19,219)
Total increase of provisions	**177,487**	**145,946**	**177,273**	**145,866**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

9. Income tax

Based on Article 9 of the Act on the Croatian Bank for Reconstruction and Development, the parent company is exempt from income tax. Income tax liabilities arise exclusively from the activities of the other members of the Group.

		GROUP
	2012 HRK '000	2011 HRK '000
Recognised in the Statement of Profit or Loss		
Deferred tax income	95	252
Income tax	**95**	**252**
Income tax reconciliation		
Profit/(loss) before tax	**(704)**	**(1,347)**
Income tax at 20% rate	141	270
Non-deductible expense	(46)	(18)
Income tax recognised in the Statement of Profit or Loss	**95**	**252**
Recognised in the Statement of Profit or Loss and Other Comprehensive Income		
Deferred tax income/(expenditure)	(35)	1
Income tax recognised in the Statement of Profit or Loss and Other Comprehensive Income	**(35)**	**1**
Deffered tax assets throughout the year	**60**	**253**

The Managing Board estimates that the total amount of recognised deferred tax assets can be utilised by using tax losses in the period of 5 years from the reporting period it was originated in.

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10. Cash on hand and due from banks

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Account with the Croatian National Bank	2,783,314	153,613	2,783,314	153,613
Due from domestic banks in foreign currency	112	75	112	75
Due from foreign banks in foreign currency	96,035	116,229	96,035	116,229
Due from domestic banks in HRK	345	504	-	-
	2,879,806	270,421	2,879,461	269,917
Provisions for impairment losses	(28,151)	(2,698)	(28,151)	(2,698)
	2,851,655	**267,723**	**2,851,310**	**267,219**

Funds in the account with the Croatian National Bank are funds drawn from the syndicated loan with domestic commercial banks for the purpose of the realisation of the Programme for the Development of the Economy, which in its mode of implementation is similar to the Models A and A+ that were implemented during 2010 and 2011.

The balance of undisbursed funds in the transaction account with the Croatian National Bank as at 31 December 2012 amounts to HRK 2,718,961 thousand (31 December 2011: HRK 153,480 thousand).

Due from foreign banks in foreign currency represents the amount drawn from a loan tranche approved by the International Bank for Reconstruction and Development (IBRD) under the credit line „Croatia Export Finance Intermediation Loan Project" and amounts to EUR 10,897 thousand (2011: EUR 15,000 thousand).

The movements in the provision for impairment losses on amounts due from banks may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as at 1 January	2,698	12,580	2,698	12,580
Increase of provision for impairment losses on amounts due from banks	25,453	-	25,453	-
Release of provision for impairment losses on amounts due from banks	-	(9,882)	-	(9,882)
Balance as at 31 December	**28,151**	**2,698**	**28,151**	**2,698**

Reconciliation with the Statement of cash flows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Total cash on hands and due from banks, before provisions	2,879,806	270,421	2,879,461	269,917
Balance of cash on hands and due from banks reconciled with statement of cash flows	**2,879,806**	**270,421**	**2,879,461**	**269,917**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

11. Deposits with other banks

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Deposits with foreign banks	5,727	15,132	5,727	15,132
Deposits with domestic banks	56,027	51,640	25,000	20,000
Accrued interest	857	997	50	71
	62,611	67,769	30,777	35,203
Provisions for impairment losses	(358)	(392)	(358)	(392)
	62,253	**67,377**	**30,419**	**34,811**

The movements in the provision for impairment losses on deposits with other banks may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as of 1 January	392	1,083	392	1,083
Increase of provision for impairment losses on deposits with other banks	6,435	-	6,435	-
Release of provision for impairment losses on deposits with other banks	(6,469)	(691)	(6,469)	(691)
Balance as of 31 December	**358**	**392**	**358**	**392**

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12. Loans to banks

Loans to banks, net of provision for impairment losses, may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Loans due within one year	5,570,423	6,543,904	5,570,423	6,543,904
Loans due in over one year	9,944,069	8,561,056	9,944,069	8,561,056
Accrued interest	27,775	52,162	27,775	52,162
Deferred recognition of loan origination fees	(72,854)	(59,014)	(72,854)	(59,014)
	15,469,413	15,098,108	15,469413	15,098,108
Provisions for impairment losses	(720,162)	(798,403)	(720,162)	(798,403)
	14,749,251	**14,299,705**	**14,749,251**	**14,299,705**

The movements in the provision for impairment losses on loans to banks may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as of 1 January	798,403	718,700	798,403	718,700
Increase of provision for impairment losses on loans to banks	204,564	309,509	204,564	309,509
Release of provision for impairment losses on loans to banks	(146,406)	(246,212)	(146,406)	(246,212)
Net foreign exchange gains/(losses) on provision for impairment losses	640	8,538	640	8,538
Provisions transferred from loans to other customers	8,785	7,868	8,785	7,868
Provisions transferred to loans to other customers	(145,824)	-	(145,824)	-
Balance as of 31 December	**720,162**	**798,403**	**720,162**	**798,403**

Transfer of provisions to loans to other customers relates to the transfer of provisions of Credo banka d.d. Split in bankruptcy proceedings, to final borrowers for placements taken over by HBOR into a direct creditor-debtor relationship.

12. Loans to banks

(continued)

Loans to banks, net of provision for impairment losses, by purpose of the loan programme may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Loan programme for reconstruction and development of the economy	4,606,025	4,223,091	4,606,025	4,223,091
Export financing	4,277,450	4,323,563	4,277,450	4,323,563
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	969,842	685,984	969,842	685,984
Loan programme for small and medium-sized enterprises	4,027,329	3,112,384	4,027,329	3,112,384
Loan programme for war-torn and demolished housing and business facilities	16,536	18,552	16,536	18,552
Other	1,617,310	2,741,386	1,617,310	2,741,386
Accrued interest	27,775	52,162	27,775	52,162
Deferred recognition of loan fees	(72,854)	(59,014)	(72,854)	(59,014)
	15,469,413	15,098,108	15,469,413	15,098,108
Provisions for impairment losses	(720,162)	(798,403)	(720,162)	(798,403)
	14,749,251	**14,299,705**	**14,749,251**	**14,299,705**

Average interest rates for total loans to banks are stated at 1.74% (2011: 1.71%) and for loans under HBOR loan programmes excluding the liquidity reserve at 1.62% (2011: 1.59%).

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 1,445,910 thousand (2011: HRK 2,712,136 thousand). The above placements are collateralized by securities in the amount of HRK 1,550,771 thousand (2011: HRK 2,934,272 thousand).

13. Loans to other customers

Loans to other customers, net of provision for impairment losses, may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Domestic companies	6,332,617	5,533,789	6,332,617	5,533,789
State-owned companies	744,274	861,543	744,274	861,543
Public sector	644,901	595,063	644,901	595,063
Foreign companies	164,800	191,819	164,800	191,819
Non-profit institutions	17,674	14,961	17,674	14,961
Other	768,083	736,197	768,083	736,197
Accrued interest	38,016	36,607	38,016	36,607
Deferred recognition of loan origination fees	(72,818)	(62,217)	(72,818)	(62,217)
	8,637,547	7,907,762	8,637,547	7,907,762
Provisions for impairment losses	(1,929,471)	(1,723,045)	(1,929,471)	(1,723,045)
	6,708,076	**6,184,717**	**6,708,076**	**6,184,717**

The movements in the provision for impairment losses on loans to other customers may be summarized as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as of 1 January	1,723,045	1,603,202	1,723,045	1,603,202
Increase of provision for impairment losses on loans to other customers and interest	209,434	230,204	209,434	230,204
Release of provision for impairment losses on loans to other customers and interest	(142,164)	(119,222)	(142,164)	(119,222)
Net foreign exchange gains/(losses) on provision for impairment losses	2,333	22,092	2,333	22,092
Collection of off-balance sheet receivables	(370)	(1,940)	(370)	(1,940)
Provisions transferred from off-balance sheet	370	2,299	370	2,299
Write-offs	(216)	(5,722)	(216)	(5,722)
Provisions transferred to loans to banks	(8,785)	(7,868)	(8,785)	(7,868)
Provisions transferred from loans to banks	145,824	-	145,824	-
Balance as of 31 December	**1,929,471**	**1,723,045**	**1,929,471**	**1,723,045**

Provisions transferred from loans to banks relates to the transfer of provisions of Credo banka d.d. Split in bankruptcy proceedings, to final borrowers for placements taken over by HBOR into a direct creditor-debtor relationship.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

13. Loans to other customers

(continued)

Loans to other customers, net of provision for impairment losses, may be summarized by loan programme as follows:

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Loan programme for reconstruction and development of the economy	3,573,658	3,323,278	3,573,658	3,323,278
Export financing	1,688,769	1,452,075	1,688,769	1,452,075
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	1,533,820	1,601,400	1,533,820	1,601,400
Loan programme for small and medium-sized enterprises	1,733,259	1,395,988	1,733,259	1,395,988
Other	142,843	160,631	142,843	160,631
Accrued interest	38,016	36,607	38,016	36,607
Deferred recognition of loan origination fees	(72,818)	(62,217)	(72,818)	(62,217)
	8,637,547	7,907,762	8,637,547	7,907,762
Provisions for impairment losses	(1,929,471)	(1,723,045)	(1,929,471)	(1,723,045)
	6,708,076	**6,184,717**	**6,708,076**	**6,184,717**

Average interest rates on loans to other customers are stated at 2.11% (2011: 2.15%).

Average interest rates reflect the ratio of interest income from generated the mentioned placements and average assets.

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14. Financial assets at fair value through profit or loss

		GROUP		BANK
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Shares in investments funds recognised at fair value through profit or loss	948	519	-	-
Balance as at 31 December	**948**	**519**	**-**	**-**

15. Assets available for sale

		GROUP		BANK
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Ministry of Finance of the Republic of Croatia	349,487	332,546	347,373	331,563
Treasury bills of the Ministry of Finance of the Republic of Croatia	549,006	728,748	549,006	728,748
Accrued interest	8,246	8,188	8,206	8,167
	906,739	**1,069,482**	**904,585**	**1,068,478**
Equity instruments:				
Unlisted equity instruments:				
Investments in shares of foreign legal entities	25	25	25	25
Investments in financial institutions shares	161	161	161	161
Shares of foreign financial institutions - EIF (Note 28)	12,226	12,721	12,226	12,721
Investments in company's shares	24,969	30,397	24,969	30,397
Provision for impairment losses	(24,969)	(30,397)	(24,969)	(30,397)
	12,412	**12,907**	**12,412**	**12,907**
Investments in investment funds:				
Shares classified as assets available for sale	366,644	1,078	365,531	-
	366,644	**1,078**	**365,531**	**-**
Balance as at 31 December	**1,285,795**	**1,083,467**	**1,282,528**	**1,081,385**

15. Assets available for sale

(continued)

The movements in the provision for impairment losses on assets available for sale may be summarized as follows:

		GROUP		BANK
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 1 January	30,397	29,030	30,397	29,030
Increase of provisions for impairment losses on assets available for sale	547	5,865	547	5,865
Reversal of provisions for impairment losses on assets available for sale	(5,975)	(4,498)	(5,975)	(4,498)
Balance as at 31 December	**24,969**	**30,397**	**24,969**	**30,397**

The text to follow contains investment breakdown:

					GROUP		BANK
	Date of issue	Date of maturity	Interest rate (%)	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Debt instruments:							
Listed debt instruments:							
Bonds of the Republic of Croatia indexed to foreign currency:							
RHMF-O-125A	23.01.2003	23.05.2012.	6.875	-	45,700	-	45,700
RHMF-O-142A	10.02.2004	10.02.2014.	5.5	78,474	75,630	78,474	75,630
RHMF-O-19BA	29.11.2004	29.11.2019.	5.375	11,504	9,860	11,504	9,860
RHMF-O-227E	22.07.2011	22.07.2022.	6.5	163,406	132,453	163,406	132,453
RHMF-O-157A	14.07.2005	14.07.2015.	4.25	2,114	983	-	-
Bonds of the Republic of Croatia in foreign currency:							
XS0645940288	08.07.2011	09.07.2018.	5.875	56,496	4,466	56,496	47,466
Bonds of the Republic of Croatia in HRK:							
RHMF-O-167A	22.07.2011	22.07.2016.	5.75	37,493	20,454	37,493	20,454
Treasury bills in HRK up to 91 days			1.25 – 1.9	134,745	-	134,745	-
Treasury bills in HRK up to 182 days			2.5 –3.2	218,709	216,604	218,709	216,604
Treasury bills in HRK up to 364 days			2.6 – 3.4	195,552	512,144	195,552	512,144
Accrued interest				8,246	8,188	8,206	8,167
				906,739	**1,069,482**	**904,585**	**1,068,478**
Equity instruments:							
Unlisted equity instruments:							
Investments in shares of foreign legal entities in foreign currency				25	25	25	25
Investments in financial institutions shares				161	161	161	161
Investments in shares of foreign financial institutions in foreign currency				12,226	12,721	12,226	12,721
Investments in companies' shares				24,969	30,397	24,969	30,397
Provisions for impairment losses				(24,969)	(30,397)	(24,969)	(30,397)
				12,412	**12,907**	**12,412**	**12,907**
Investments in investments funds in the Republic of Croatia				**366,644**	**1,078**	**365,531**	**-**
Total				**1,285,795**	**1,083,467**	**1,282,528**	**1,081,385**

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15. Assets available for sale

(continued)

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-125A) issued with foreign currency clause on 23 January 2003 repayable over 9 years with an interest rate of 6.875% were redeemed upon maturity on 23 May 2012 (31 December 2011: HRK 45,700 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-142A) issued with foreign currency clause on 10 February 2004 are repayable over 10 years with an interest rate of 5.5%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 78,474 thousand (31 December 2011: HRK 75,630 thousand).

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 2012, the value of these outstanding bonds amounted to HRK 11,504 thousand (31 December 2011: HRK 9,860 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-227E) issued with foreign currency clause on 22 July 2011 are repayable over 11 years with an interest rate of 6.5%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 163,406 thousand (31 December 2011: HRK 132,453 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-157A) issued with foreign currency clause on 14 July 2005 are repayable over 10 years with an interest rate of 4.25%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 2,114 thousand (31 December 2011: HRK 983 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (XS0645940288) issued in foreign currency on 08 July 2011 are repayable over 7 years with an interest rate of 5.875%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 56,496 thousand (31 December 2011: HRK 47,466 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-167A) issued in kuna on 22 July 2011 are repayable over 5 years with an interest rate of 5.75%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 37,493 thousand (31 December 2011: HRK 20,454 thousand).
In February 2007, HBOR made acquisitions of three, and in July 2007 of two more, shares of the European Investment Fund (EIF). The payment made represents 20% of the nominal amount of purchased shares and the other 80% makes a contingent liability towards EIF. On 31 December 2012 this contingent liability was EUR 4 million (Note 28).

The General Meeting, acting on a proposal from the Board of Directors, may require payment of the subscribed but not paid capital to the extent required for the Fund to meet its liabilities towards its creditors. Such payment shall be effected within 90 days from the decision of the General Meeting.

Corporate shares comprise shares in capital of the company for the production of agricultural products, Vinka d.d., and of the shipyard company Brodogradilište Viktor Lenac d.d., Rijeka. The shares were acquired within restructuring measures for those companies in exchange for a portion of receivables.

In March 2010, when all preconditions were met, HBOR's receivables were partly turned into an equity share in the company Vinka d.d., Vinkovci amounting to HRK 16,725 thousand, representing a 5.1823% of the equity share belonging to HBOR in the company's equity.

HBOR effected a 100% impairment of value for the complete amount of the equity share since it was estimated uncollectable.

In 2011, however, owing to an increase in capitalisation, the percentage of HBOR's share in the company's equity was changed to 0.9365%. The shares of the company Vinka d.d., Vinkovci (LPVC-R-B) are not listed.

Upon the commencement of bankruptcy proceedings of the company Brodogradilište Viktor Lenac d.d. in December 2003, HBOR effected a 100% impairment of value for the complete amount of receivables from the company, since they were estimated uncollectable, and the receivables were classified as bad and doubtful receivables.

On the conclusion of the bankruptcy proceedings in April 2008, the equity of the shipyard company was divided into 12,407,813 common shares in the nominal value of HRK 10.00 per share, issued in the procedure of conclusion of the bankruptcy proceedings by registration of rights – receivables in cash. HBOR registered a part of recognized receivables in the amount of HRK 13,673 thousand from the bankruptcy proceedings into the equity of the debtor, by which the Bank acquired 11.0194% of the equity of the company. The conversion of a portion of receivables into the equity in the above mentioned amount has been recorded and stated with a 100% value adjustment, transferred from off-balance sheet.

In 2011, owing to an increase in capitalisation, the percentage of HBOR's share in the company's equity was changed to 8.1321%. The shares of the company (VLEN-R-B) were listed in 2008 at the Zagreb Stock Exchange, and trade started in May 2009. Quoted price per share as of 31 December 2012 amounted to HRK 6.03 (31 December 2011: HRK 10.00 per share).

Pursuant to the decision of the subsidiary's management dated 10 April 2012, shares in investment funds were classified as assets available for sale.

15. Assets available for sale (continued)

16. Assets held to maturity

	GROUP		BANK	
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Ministry of finance of the Republic of Croatia	1,064	1,069	-	-
Accrued interest	23	23	-	-
Balance as at 31 December	**1,087**	**1,092**	**-**	**-**

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-142A) issued with foreign currency clause on 10 February 2004 are repayable over 10 years with an interest rate of 5.5%. As of 31 December 2012, the value of these outstanding bonds amounted to HRK 1,064 thousand (31 December 2011: HRK 1,069 thousand).

17. Investments in subsidiaries

As at 31 December 2012, the Bank's subsidiaries are as follows:

Consolidated company	Activity	Ownership 2012	Ownership 2011	Investment 2012	Investment 2011
Direct share					
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%	51%	36,124	19,125
TOTAL				**36,124**	**19,125**

On 25 September 2012, HBOR acquired the remaining 49% share in the equity of the subsidiary Hrvatsko kreditno osiguranje d.d. through a purchase transaction and thus became the 100% owner of the company. The cash consideration paid for the purchase of the 49% share in the company's equity amounted to EUR 2,300 thousand.

Since this is a subsequent acquisition of non-controlling interest, this transaction is not considered a business merger.

The consideration paid for the purchase of the remaining share is lower than the fair value of net assets of the subsidiary company and a positive movements was recognised in the equity of the parent company in other reserves.

18. Investments in associates

	GROUP		BANK	
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Investments in associates	23,687	23,687	23,687	23,687
Value adjustments	(23,687)	(23,687)	(23,687)	(23,687)
	-	-	-	-

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. HBOR has a significant influence in the associated companies through its representative in the Supervisory Board.

	Line of business	% ownership in 2012	% ownership in 2011
Bila boja d.o.o., Grohote	Production of plastic products	17.96%	17.96%
THC d.d., 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%	26.00%
Pounje d.d., Hrvatska Kostajnica	Textile industry - clothes production	18.36%	18.36%
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.

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19. Property, plant and equipment and intangible assets

GROUP 2012	Buildings HRK '000	Computers HRK '000	Furniture, equipment and vehicles HRK '000	Property, plant and equipment and intangible assets not ready for use HRK '000	Total property, plant and equipment HRK '000	Intangible assets HRK '000	Total HRK '000
Cost							
At 31 December 2011	**77,102**	**13,667**	**12,541**	**1,398**	**104,708**	**16,555**	**121,263**
Additions	-	-	-	7,106	7,106	-	7,106
Transfer from assets not yet ready for use	-	2,742	814	(7,096)	(3,540)	3,540	-
Disposals and write-offs	-	(1,185)	(173)	(20)	(1,378)	-	(1,378)
At 31 December 2012	**77,102**	**15,224**	**13,182**	**1,388**	**106,896**	**20,095**	**126,991**
Accumulated depreciation							
At 31 December 2011	**16,465**	**11,531**	**10,042**	**-**	**38,038**	**14,824**	**52,862**
Depreciation for 2012	2,336	1,960	843	-	5,139	2,023	7,162
Disposals and write-offs	-	(1,185)	(171)	-	(1,356)	-	(1,356)
At 31 December 2012	**18,801**	**12,306**	**10,714**	**-**	**41,821**	**16,847**	**58,668**
Net book value at 31 December 2012	**58,301**	**2,918**	**2,468**	**1,388**	**65,075**	**3,248**	**68,323**
Net book value at 31 December 2011	**60,637**	**2,136**	**2,499**	**1,398**	**66,670**	**1,731**	**68,401**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

19. Property, plant and equipment and intangible assets

(continued)

GROUP 2011	Buildings HRK '000	Computers HRK '000	Furniture, equipment and vehicles HRK '000	Property, plant and equipment and intangible assets not ready for use HRK '000	Total property, plant and equipment HRK '000	Intangible assets HRK '000	Total HRK '000
Cost							
At 31 December 2010	**76,178**	**12,071**	**12,600**	**2,905**	**103,754**	**15,985**	**119,739**
Additions	-	-	-	4,595	4,595	-	4,595
Transfer from assets not yet ready for use	924	1,674	1,387	(4,595)	(610)	610	-
Disposals and write-offs	-	(78)	(1,446)	(1,507)	(3,031)	(40)	(3,071)
At 31 December 2011	**77,102**	**13,667**	**12,541**	**1,398**	**104,708**	**16,555**	**121,263**
Accumulated depreciation							
At 31 December 2010	**14,155**	**9,945**	**10,667**	**-**	**34,767**	**13,133**	**47,900**
Depreciation for 2011	2,310	1,664	810	-	4,784	1,731	6,515
Impairment	-	-	-	1,507	1,507	-	1,507
Disposals and write-offs	-	(78)	(1,435)	(1,507)	(3,020)	(40)	(3,060)
At 31 December 2011	**16,465**	**11,531**	**10,042**	**-**	**38,038**	**14,824**	**52,862**
Net book value at 31 December 2011	**60,637**	**2,136**	**2,499**	**1,398**	**66,670**	**1,731**	**68,401**
Net book value at 31 December 2010	**62,023**	**2,126**	**1,933**	**2,905**	**68,987**	**2,852**	**71,839**

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19. Property, plant and equipment and intangible assets

(continued)

BANK 2012	Buildings HRK '000	Computers HRK '000	Furniture, equipment and vehicles HRK '000	Property, plant and equipment and intangible assets not ready for use HRK'000	Total property, plant and equipment HRK '000	Intangible assets HRK '000	Total HRK '000
Cost							
At 31 December 2011	**77,102**	**13,652**	**12,425**	**1,398**	**104,577**	**16,131**	**120,708**
Additions	-	-	-	6,962	6,962	-	6,962
Transfer from assets not ready for use	-	2,658	785	(6,952)	(3,509)	3,509	-
Disposals and write-offs	-	(1,185)	(173)	(20)	(1,378)	-	(1,378)
At 31 December 2012	**77,102**	**15,125**	**13,037**	**1,388**	**106,652**	**19,640**	**126,292**
Accumulated depreciation							
At 31 December 2011	**16,465**	**11,524**	**9,972**	**-**	**37,961**	**14,641**	**52,602**
Depreciation for 2012	2,336	1,948	828	-	5,112	1,876	6,988
Disposals and write-offs	-	(1,185)	(171)	-	(1,356)	-	(1,356)
At 31 December 2012	**18,801**	**12,287**	**10,629**	**-**	**41,717**	**16,517**	**58,234**
Net book value at 31 December 2012	**58,301**	**2,838**	**2,408**	**1,388**	**64,935**	**3,123**	**68,058**
Net book value at 31 December 2011	**60,637**	**2,128**	**2,453**	**1,398**	**66,616**	**1,490**	**68,106**

19. Property, plant and equipment and intangible assets

(continued)

BANK 2011	Buildings HRK '000	Computers HRK '000	Furniture, equipment and vehicles HRK '000	Property, plant and equipment and intangible assets not ready for use HRK '000	Total property, plant and equipment HRK '000	Intangible assets HRK '000	Total HRK '000
Cost							
At 31 December 2010	**76,178**	**12,071**	**12,484**	**2,905**	**103,638**	**15,576**	**119,214**
Additions	-	-	-	4,565	4,565	-	4,565
Transfer from assets not ready for use	924	1,659	1,387	(4,565)	(595)	595	-
Disposals and write-offs	-	(78)	(1,446)	(1,507)	(3,031)	(40)	(3,071)
At 31 December 2011	**77,102**	**13,652**	**12,425**	**1,398**	**104,577**	**16,131**	**120,708**
Accumulated depreciation							
At 31 December 2010	**14,155**	**9,945**	**10,609**	**-**	**34,709**	**13,087**	**47,796**
Depreciation for 2011	2,310	1,657	798	-	4,765	1,594	6,359
Impairment	-	-	-	1,507	1,507	-	1,507
Disposals and write-offs	-	(78)	(1,435)	(1,507)	(3,020)	(40)	(3,060)
At 31 December 2011	**16,465**	**11,524**	**9,972**	**-**	**37,961**	**14,641**	**52,602**
Net book value at 31 December 2011	**60,637**	**2,128**	**2,453**	**1,398**	**66,616**	**1,490**	**68,106**
Net book value at 31 December 2010	**62,023**	**2,126**	**1,875**	**2,905**	**68,929**	**2,489**	**71,418**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

20. Non-current assets held for sale

	GROUP 2012 HRK '000	GROUP 2011 HRK '000	BANK 2012 HRK '000	BANK 2011 HRK '000
Non-current assets held for sale	42,547	43,907	42,547	43,907
Provisions for impairment losses	(8,417)	(9,475)	(8,417)	(9,475)
	34,130	**34,432**	**34,130**	**34,432**

In 2012, there was no increase in non-current assets held for sale, whereas in 2011 the increase totalling HRK 1,195 thousand occurred and it comprised of buildings. Fair value of taken over non–current assets held for sale amounted to HRK 2,379 thousand.

In 2012, HBOR sold non-current assets held for sale of HRK 204 thousand (2011: HRK 804 thousand) comprised of: land of HRK 204 thousand (2011: HRK 444 thousand), buildings of HRK 0 thousand (2011: HRK 47 thousand) and apartments of HRK 0 thousand (2011: HRK 313 thousand).

The movements in the provision for impairment losses on non-current assets held for sale may be summarized as follows:

	GROUP 2012 HRK '000	GROUP 2011 HRK '000	BANK 2012 HRK '000	BANK 2011 HRK '000
Balance as of 1 January	9,475	6,499	9,475	6,499
Increase of provisions for impairment losses on non-current assets held for sale	368	1,319	368	1,319
Decrease of provisions for impairment losses on non-current assets held for sale	(256)	-	(256)	-
Derecognition of impairment due to the sale of non-current assets held for sale	(1,170)	(84)	(1,170)	(84)
Transfer from loans	-	1,741	-	1,741
Balance as of 31 December	**8,417**	**9,475**	**8,417**	**9,475**

21. Other assets

	GROUP 2012 HRK '000	GROUP 2011 HRK '000	BANK 2012 HRK '000	BANK 2011 HRK '000
Fees receivable	1,002	1,490	1,002	1,490
Premium receivables	1,865	1,681	-	-
Receivables for reinsurance commissions	309	235	-	-
Receivables for risk assessment fees	53	183	-	-
Deferred tax assets	525	439	-	-
Other assets	5,723	5,542	5,691	5,534
	9,477	**9,570**	**6,693**	**7,024**
Provisions for impairment losses	(3,774)	(4,140)	(3,358)	(3,600)
	5,703	**5,430**	**3,335**	**3,424**

The movements in the provision for impairment losses on other assets may be summarized as follows:

	GROUP 2012 HRK '000	GROUP 2011 HRK '000	BANK 2012 HRK '000	BANK 2011 HRK '000
Balance as at 1 January	4,140	4,496	3,600	4,496
Increase of provision for impairment losses on other assets	1,772	1,272	922	726
Release of provision for impairment losses on other assets	(1,789)	(1,601)	(1,164)	(1,595)
Collection of off-balance sheet receivable items	(17)	(5)	(17)	(5)
Provisions transferred from off-balance sheet	17	5	17	5
Write-offs	(349)	(27)	-	(27)
Balance as of 31 December	**3,774**	**4,140**	**3,358**	**3,600**

22. Deposits

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Bank deposits	721	1,252	721	1,252
Foreign currency accounts of the companies	7	85	7	85
Foreign currency account of the Ministry of Finance of the Republic of Croatia	30,132	20,059	30,132	20,059
Foreign currency special purpose accounts of the companies	23,446	2,027	23,446	2,027
Deposits by local authorities and state funds	50,244	54,855	50,244	54,855
Deposits by state institutions	62,724	73,967	62,724	73,967
Other deposits	136	1,998	136	1,998
	167,410	**154,243**	**167,410**	**154,243**

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 18,128 thousand (2011: HRK 6,860 thousand), grant funds provided by the Global Environment Facility (GEF) aimed at the Renewable Energy Resources Project of HRK 6,850 thousand (2011: HRK 7,961 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 5,154 thousand (2011: HRK 5,238 thousand), all managed by HBOR for and on behalf of the Republic of Croatia.

Demand deposits by State institutions relate to the Bank's operations carried out for and on behalf of the Ministry of Finance, the Ministry of the Economy, the Ministry for Entrepreneurship and Crafts, the Ministry for Maritime Affairs, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the Environmental Protection and Energy Efficiency Fund, the company Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs and Investment ('HAMAG INVEST').

HBOR does not pay interest on the above deposits.

23. Borrowings

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as of 1 January	8,155,455	7,015,834	8,155,455	7,015,834
New borrowings	5,810,058	1,547,066	5,810,058	1,547,066
Repayments	(499,936)	(516,386)	(499,936)	(516,386)
Net foreign exchange gains/(losses)	23,278	108,941	23,278	108,941
	13,488,855	8,155,455	13,488,855	8,155,455
Accrued interest	57,503	41,908	57,503	41,908
Balance as of 31 December	**13,546,358**	**8,197,363**	**13,546,358**	**8,197,363**

Interest rates on borrowings ranged from 1.4% fixed per annum to variable interest rates on the International money market (LIBOR EUR; EURIBOR) increased by 0.5 – 3.25 percentage points annually.

The Bank is subject to different financial covenants arising from contracts. During 2012 and as at 31 December 2012, the Bank was in compliance with all the required contractual financial covenants.

24. Bonds payable

The book value of bonds includes interest.

GROUP AND BANK	Effective interest rate %	Fair value 2012 HRK '000	Net book value 2012 HRK '000	Fair value 2011 HRK '000	Net book value 2011 HRK '000
Bonds EUR 100 million	5.899	-	-	150,593	150,609
Bonds EUR 150 million	4.836	904,234	905,081	1,074,565	1,128,962
Bonds EUR 250 million	5.076	1,894,876	1,880,899	1,684,611	1,876,029
Bonds EUR 250 million	8.58	-	-	1,898,871	1,867,005
Accrued interest		-	72,313	-	122,119
		2,799,110	**2,858,293**	**4,808,640**	**5,144,724**

24. Bonds payable

(continued)

According to the Agreement dated 28 November 2002 between HBOR and J.P. Morgan Europe Limited (as lead manager), HBOR issued Amortizing Notes due in 2008 - 2012 under the EMTN program on 4 December 2002, with a guarantee of the Republic of Croatia, of EUR 100,000 thousand (HRK 150,609 thousand as at 31 December 2011) and with a maturity period of 10 years and a fixed interest rate of 5.75% and amortized repayment in the period from 2008 to 2012. The first instalment was due and paid in December 2008 and the last payment of principal was paid together with interest in December 2012, and the bonds were entirely redeemed.

According to the Agreement between HBOR and Deutsche Bank AG London (as lead manager), HBOR issued bonds on 11 July 2006 of EUR 150,000 thousand (HRK 905,081 thousand as of 31 December 2012 and HRK 1,128,962 thousand as at 31 December 2011) with a maturity period of 10 years and a fixed interest rate of 4.807% and amortized repayment in the period from 2012 to 2016. Interest is paid annually, in arrears. Bonds are listed in London Stock Exchange quotation.

According to the Agreement between HBOR and UBS Investment Bank and Deutsche Bank AG London (as joint lead managers), HBOR issued bonds on 14 June 2007 of EUR 250,000 thousand (HRK 1,880,899 thousand as at 31 December 2012 and HRK 1,876,029 thousand as at 31 December 2011) with maturity period of 10 years and fixed interest rate of 5.0%. Interest is paid annually, in arrears. Bonds are listed in Luxembourg Stock Exchange quotation.

In the reporting period, on 3 September 2012, HBOR redeemed long-term securities in the amount of HRK 1,867,010 thousand, together with interest of HRK 135,358 thousand, on its regular maturity date. Bonds were issued on 3 September 2009 pursuant to the Agreement between HBOR and Deutsche Bank AG London in the amount of EUR 250,000 thousand (HRK 1,867,005 thousand as at 31 December 2011) with the maturity of 3 years and fixed interest rate of 7.25%.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

25. Other liabilities

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Deferred recognition of interest income	930,152	941,090	930,152	941,090
Liabilities in respect of subsidized interest	22,128	137,898	22,128	137,898
Provisions for guarantees and commitments	60,190	28,940	60,190	28,940
Provisions for other liabilities	52,879	51,889	52,751	51,750
Accrued salaries	6,809	4,626	6,711	4,540
Deferred recognition of income from fees on issued guarantees	-	1,745	-	1,745
Liabilities to suppliers	1,039	1,262	899	1,184
Liabilities for prepaid receivables	3,187	1,809	3,187	1,809
Deferrable premium	665	375	-	-
Provisions for claims	1,740	923	-	-
Provisions for return premiums	84	80	-	-
Liabilities to re-insurers	1,541	1,349	-	-
Deferred tax liabilities	30	5	-	-
Other liabilities	3,994	3,620	3,744	3,397
	1,084,438	**1,175,611**	**1,079,762**	**1,172,353**

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 (see Note 29). These liabilities include:

- HRK 8,455 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (2011: HRK 122,608 thousand),
- HRK 9,114 thousand in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet (2011: HRK 11,080 thousand),
- HRK 0 thousand in respect of the Environmental protection and energy efficiency fund and Energy efficiency project (2011: HRK 1,850 thousand),
- HRK 219 thousand (2011: HRK 219 thousand) in respect of loans granted to the borrowers investing into entrepreneurial zones.
- HRK 4,340 thousand (2011: HRK 2,141 thousand) in respect of the Loan Programme for the Financing of Female Entrepreneurship

25. Other liabilities

(continued)

Deferred recognition of interest income of HRK 930,152 thousand (2011: HRK 941,090 thousand) consists of state subsidies for interest in respect of loans which are provided and drawn down by final borrowers at lower interest rates (see Note 2) but are not yet in repayment stage, amounting to HRK 66,545 thousand (2011: HRK 210,990 thousand), and in respect of those already in repayment stage amounting to HRK 863,607 thousand (2011: HRK 730,100 thousand) (see Note 2).

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.

Out of the total provisions for guarantees and commitments, HRK 22,485 thousand relates to banks (2011: HRK 15,099 thousand), HRK 32,551 thousand relates to domestic companies (2011: HRK 9,842 thousand), HRK 307 thousand relates to state-owned companies (2011: HRK 2,511 thousand), HRK 4,706 thousand relates to the public sector (2011: HRK 56 thousand) and HRK 141 thousand relates to others (2011: HRK 1,432 thousand).

Movements in the provision for guarantees, commitments and other liabilities may be summarized as follows:

		GROUP		BANK
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
Balance as at 1 January	28,940	53,856	28,940	53,856
Increase in provision for guarantees and commitments	62,593	65,992	62,593	65,992
Release in provision for guarantees and commitments	(31,223)	(91,049)	(31,223)	(91,049)
Net foreign exchange gains/(losses) on provisions for impairment losses	(120)	141	(120)	141
Provision for guarantees and commitments	**60,190**	**28,940**	**60,190**	**28,940**
Balance as at 1 January	51,889	46,012	51,750	45,912
Increase in provision for other liabilities	6,027	10,390	5,899	10,252
Release in provision for other liabilities	(5,037)	(4,513)	(4,898)	(4,414)
Provisions for other liabilities	**52,879**	**51,889**	**52,751**	**51,750**
Balance as at 31 December	**113,069**	**80,829**	**112,941**	**80,690**

26. Founder's capital and reserves

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 is not set in advance, but is 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, as well as measuring and assessing the policies for capital management. Capital management is described and presented in Note 34.

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 2,000 thousand and is 100% owned by Hrvatsko kreditno osiguranje d.d. The capital of both companies is subscribed and paid in full.

27. Guarantee fund

GROUP AND BANK	HRK '000
Balance as of 1 January 2011	**12,092**
Write-off	-
Net foreign exchange	238
Balance as of 31 December 2011	**12,330**
Write-off	-
Net foreign exchange	25
Balance as of 31 December 2012	**12,355**

The Guarantee fund, of HRK 12,355 thousand and HRK 12,330 thousand as of 31 December 2012 and 2011 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."

Recognised increase compared to the previous year is due to foreign exchange gains amounting to HRK 25 thousand.

28. Guarantees and commitments

In its regular activities, the Bank 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 2012 HRK '000	GROUP 2011 HRK '000	BANK 2012 HRK '000	BANK 2011 HRK '000
Guarantees issued in HRK	-	518	-	518
Guarantees issued in foreign currency	441,329	325,112	441,329	325,112
Issued bills of exchange	18,934	22,782	18,934	22,782
Undrawn loans	2,208,498	1,151,477	2,208,498	1,151,477
EIF - subscribed, not called up capital (note 15)	30,182	30,122	30,182	30,122
Open letters of credit in foreign currency	19,490	1,912	19,490	1,912
	2,718,433	1,531,923	2,718,433	1,531,923
Provisions for guarantees and commitments	(60,190)	(28,940)	(60,190)	(28,940)
	2,658,243	**1,502,983**	**2,658,243**	**1,502,983**

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.

Bank guarantees are, to the extent of 84%, collateralized by the guarantees issued by the Republic of Croatia or the liability was taken over by the Republic of Croatia. Letters of credit are entirely covered by deposits (Note 22).

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.

29. 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, the Ministry for Entrepreneurship and Crafts, the Ministry for Maritime Affairs, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the Environmental Protection and Energy Efficiency Fund, the company Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs and Investment ("HAMAG INVEST"), 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 beneficiary, 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 **Programme**	2012 HRK '000	2011 HRK '000
Development and Reconstruction of Rural Housing	57,258	61,988
Employment of Former Soldiers	476,299	478,451
Emergency Reconstruction Project (loan IBRD 3760 - HR)	154	191
Loans to companies having difficulties - Ministry of Finance funds	7,641	14,518
Municipal Environmental Infrastructure Investment Program - MEIP	793,298	773,298
Collection of receivables under HAMAG INVEST guarantees	256	262
Insurance of export transactions	184,362	218,956
Programme of Preferential Financing through HBOR's Loan Programmes	8,455	122,608
Programme for Development and Employment - loans*	-	87,550
Programme for Regional Development of the Republic of Croatia - loans	20,811	23,385
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy	22,539	22,738
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry for Maritime Affairs, Transport and Infrastructure	24,771	24,771
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture	36,225	36,225
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy - interest subsidy	208	384
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry for Maritime Affairs, Transport and Infrastructure - interest subsidy	769	1,561
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture - interest subsidy	8,345	9,135
Renewable Energy Resources Project	22,536	22,642
VIK – EKO account A - dedicated water charge	525,383	484,922
VIK – EKO account B - VAT	142,600	134,685
The Environment and Energy Efficiency Fund - interest subsidy	-	850
Programme of Issuing Bank Guarantees for Energy Efficiency Projects - IBRD	5,154	5,238
HBOR Loan Programme for the Energy Efficiency Projects - interest subsidy	-	1,000
Interest subsidies for the loans to the entrepreneurs who invest in entrepreneurial zones	219	219
Operational Programme for the development of cattle-breeding production	50,632	50,631
Operational Programme for the development of pig-breeding production	32,913	32,913
Financing the Establishment of Fishing Infrastructure-Ministry for Maritime Affairs, Transport and Infrastructure	46,665	46,665
Loan Programme for the Financing of Female Entrepreneurship - Ministry for Entrepreneurship and Crafts - interest subsidy	4,340	2,141
Transactions related to investments in the Funds for Economic Co-operation**	196,320	152,191
	2,668,153	**2,810,118**

*Pursuant to the Decree on Internal Organisation of the Ministry of Finance (Official Gazette of the Republic of Croatia, No. 32/2012), on 15 March 2012, the Ministry of Finance and the Ministry of Entrepreneurship and Crafts entered into an Agreement on the Takeover of Transactions, by means of which the Ministry of Finance took over transactions that used to be administered by the former Development and Employment Fund.

**The fair value of net assets value of the Funds for Economic Co-operation in 2012 is recognised on the basis of the latest available data and does not represent the final fair value, whereas, in 2011, the amount was recognised in accordance with the audited financial statements.

29. Managed funds for and on behalf of third parties

(continued)

Beside the mentioned transactions for and on behalf of its principals, the Bank manages assets for the coverage of technical provisions of its subsidiary company, Hrvatsko kreditno osiguranje d.d. These funds are managed separately from the Bank's assets. Revenues and expenses relating to these transactions are charged to the principal, and the Bank does not have other liabilities. For the services provided, the Bank charges a fee.

Agency business funds per individual programmes amount to:

BANK		
Programme	2012 HRK '000	2011 HRK '000
Development and Reconstruction of Rural Housing	57,258	61,988
Employment of Former Soldiers	476,299	478,451
Emergency Reconstruction Project (loan IBRD 3760 - HR)	154	191
Loans to companies having difficulties - Ministry of Finance funds	7,641	14,518
Municipal Environmental Infrastructure Investment Program - MEIP	793,298	773,298
Collection of receivables under HAMAG INVEST guarantees	256	262
Insurance of export transactions	184,362	218,956
Programme of Preferential Financing through HBOR's Loan Programmes	8,455	122,608
Programme for Development and Employment - loans*	-	87,550
Programme for Regional Development of the Republic of Croatia - loans	20,811	23,385
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy	22,539	22,738
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry for Maritime Affairs, Transport and Infrastructure	24,771	24,771
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture	36,225	36,225
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of the Economy - interest subsidy	208	384
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry for Maritime Affairs, Transport and Infrastructure - interest subsidy	769	1,561
Financing Model for the Reconstruction and Modernisation of the Fishing Fleet - Ministry of Agriculture - interest subsidy	8,345	9,135
Renewable Energy Resources Project	22,536	22,642
VIK – EKO account A - dedicated water charge	525,383	484,922
VIK – EKO account B - VAT	142,600	134,685
The Environment and Energy Efficiency Fund - interest subsidy	-	850
Programme of Issuing Bank Guarantees for Energy Efficiency Projects - IBRD	5,154	5,238
HBOR Loan Programme for the Energy Efficiency Projects - interest subsidy	-	1,000
Interest subsidies for the loans to the entrepreneurs who invest in entrepreneurial zones	219	219
Operational Programme for the development of cattle-breeding production	50,632	50,631
Operational Programme for the development of pig-breeding production	32,913	32,913
Financing the Establishment of Fishing Infrastructure-Ministry for Maritime Affairs, Transport and Infrastructure	46,665	46,665
Loan Programme for the Financing of Female Entrepreneurship - Ministry for Entrepreneurship and Crafts - interest subsidy	4,340	2,141
Transactions related to investments in the Funds for Economic Co-operation**	196,320	152,191
HKO – Funds for the coverage of technical provisions	3,213	2,069
	2,671,366	**2,812,187**

*Pursuant to the Decree on Internal Organisation of the Ministry of Finance (Official Gazette of the Republic of Croatia, No. 32/2012), on 15 March 2012, the Ministry of Finance and the Ministry of Entrepreneurship and Crafts entered into an Agreement on the Takeover of Transactions, by means of which the Ministry of Finance took over transactions that used to be administered by the former Development and Employment Fund.

**The fair value of net assets of the Funds for Economic Co-operation in 2012 is recognised on the basis of the latest available data and does not represent the final fair value, whereas, in 2011, the amount was recognised in accordance with the audited financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

30. 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 (in which the Republic of Croatia holds 51% or more of the ownership).

All transactions stated were carried out under usual/regular conditions of the Bank.

As of 31 December 2012 and 31 December 2011, balances arising from transactions with related parties, including the Bank's key management personnel, include the following:

a) Related-party transactions

GROUP	Exposure	Liabilities	Income	Expense	Exposure	Liabilities	Income	Expense
	2012	2012	2012	2012	2011	2011	2011	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Owner	1,407,075	61,203	66,106	5,741	1,424,260	163,195	52,914	2,434
Government funds, executive authorities and agencies	363,467	21,276	5,724	2,731	96,817	23,460	9,231	6
State-owned companies	763,540	808	33,680	-	849,267	898	45,881	637
Non-controlling interests	-	-	-	-	711	733	1,109	3,207
Associates	97	-	171	-	24	-	363	-
Key management personnel	5,092	-	110	17	3,443	-	117	9
Total	**2,539,271**	**83,287**	**105,791**	**8,489**	**2,374,522**	**188,286**	**109,615**	**6,293**

BANK	Exposure	Liabilities	Income	Expense	Exposure	Liabilities	Income	Exposure
	2012	2012	2012	2012	2011	2011	2011	2011
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Owner	1,407,075	61,203	66,106	5,741	1,424,260	163,195	52,914	2,434
Government funds, executive authorities and agencies	363,467	21,276	5,724	2,731	96,817	23,460	9,231	6
State-owned companies	763,540	808	33,680	-	849,267	898	45,881	637
Subsidiary companies	36,125	-	12	-	19,127	-	17	-
Associates	97	-	171	-	24	-	363	-
Key management personnel	4,729	-	99	17	3,050	-	102	9
Total	**2,575,033**	**83,287**	**105,792**	**8,489**	**2,392,545**	**187,553**	**108,508**	**3,086**

Exposures include loans to other customers, available-for-sale assets, assets held to maturity, other assets and off-balance sheet exposure relating to guarantees, letters of credit and commitments.

Liabilities include deposits and other liabilities.

Income includes interest income, fee income and reversal of impairment losses and provisions.

Expense includes impairment losses and provisions.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

30. Related-party trasnactions (continued)

b) Collateral received

	GROUP		BANK	
	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
The Republic of Croatia	659,412	975,688	480,391	750,139
State agencies	480,239	422,608	480,239	422,608
Total	**1,139,651**	**1,398,296**	**960,630**	**1,172,747**

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising the Republic of Croatia guarantees, HAMAG INVEST 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 of 70% of an insured amount.

A decrease in the collateral received from the Republic of Croatia relates for the most part to the guarantee of Government of the Republic of Croatia issued as a collateral for guarantee issued in the amount of HRK 194,247 thousand for which the liability was taken over by the Republic of Croatia in 2012.

c) Salaries of key management personnel

Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, jubilee awards. In 2012, salaries for the Group amounted to HRK 9,315 thousand (2011: HRK 7,748 thousand), and for the Bank HRK 7,949 thousand (2011: HRK 6,753 thousand).

Remuneration for the work of the members of the Supervisory Board in 2012 amounted to HRK 414 thousand for the Group and the Bank (2011: HRK 434 thousand) and it relates to the HBOR Supervisory Board member eligible for remuneration and members of supervisory boards at associates who were appointed by HBOR.

31. Risk management

31.1. INTRODUCTION

Based on the Act on the Croatian Bank for Reconstruction and Development, the Bank is obliged to mitigate business risks directed by the principles of banking operations.

In the process of risk management, the Bank identifies the sources of risks, continuously measures, estimates, manages and controls all risks to which it is or might be exposed in the course of business. The mode, methods and frequency of measurement and evaluation of risk are prescribed by the general acts of the Bank. The most significant types of risk the Bank is exposed to: credit risk, liquidity risk, interest rate risk and foreign exchange risk as well as operational risk. These risks are managed daily in accordance with the policies, procedures, methodologies and limit systems that regulate this area as well as through the operations of the bodies of the Bank in charge.

Risk management structure

The Supervisory Board is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Bank. The Supervisory Board adopts the Risk Management Strategies that lay out the main principles and standards of risk management and define the tendency towards risk-taking.

The Managing Board of the Bank is responsible for implementing risk management strategies and establishing an effective and reliable risk management system. In order to accomplish its task, the Managing Board delegated their risk management authority to three committees.

Risk management boards

- **Assets and Liabilities Management Committee (ALCO)** – manages liquidity risk, interest rate risk and currency risk within the framework of the Liquidity Risk Management Procedures, the Currency Risk Management Procedures and the Interest Rate Risk Management Procedures 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 Procedures, methodologies 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.

Risk Management Unit

The Bank formed the Risk Management unit as a functionally and organizationally separate and independent organizational unit for the control of business risks, which is directly responsible to the Managing Board. The Risk Management unit is responsible for defining, measuring, monitoring and controlling all risks to which the Bank is exposed or might be exposed in the course of its business. The Risk Management unit carries out its role by performing analyses, evaluations, measurements, controls, by giving suggestions and recommendations, by developing risk management-related procedures and methodologies, recommending and monitoring accepted exposure limits, as well as reporting on risks to the bodies in charge, etc.

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 and Basel Committee recommendations.

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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.1. INTRODUCTION (CONTINUED)

Organizational Unit for Control and Audit

Control and audit is organized as a separate organizational unit, functionally and organizationally independent from the activities subject to its audit and other organizational units of HBOR. The Control and Audit unit is responsible to the Managing Board, Supervisory Board and Audit committee. The Control and Audit unit verifies the application and efficiency of the procedures and methodologies for risk management. Their role is achieved through testing of the risk management system according to the principles of operational stability, including managing IT resources and other associated technologies.

Organizational Unit for EU Co-operation

The Bank established separate organizational unit EU Co-operation. Within this unit, an independent function of compliance with laws, regulations and professional standards as well as of defining and assessing compliance risk was set up in 2009. Its role is to support the managing bodies of the Bank with compliance risk management and controls and report periodically to the Managing Board and Supervisory Board. Within this function following risks are monitored and controlled: legal and regulatory risks (risk of disobedience of the laws, legislation and professional practice), sanction risk (risk of court, administrative or disciplinary sanctions and/or measures resulted from breaches of law, legislation, rules or contractual provision) and the reputation risk.

Risk measurement and reporting systems

When assessing and measuring risk, the Bank takes into account historical data, business plans, market conditions and the specific characteristics of the Bank as a special financial institution. The results of risk measurements, assessments and analyses carried out are presented at the meetings of the Risk Management Committee, the Managing Board and the Supervisory Board. For risk monitoring and control, systems of limits are introduced for the management of credit risk, liquidity risk, interest rate risk and currency risk. These limits are regularly reviewed by the Risk Management Unit and the Assets and Liabilities Management Committee. They are adopted by the Managing Board and are communicated to those organizational units that participate in risk management and that are obliged to comply with them.

The Bank monitors risks also through scenario analyses and sensitivity analyses in regular and "operating-under-stress" conditions. Systems of pro-active risk management are continuously developed for the purpose of minimizing potential future risks.

Bodies in charge are systematically reported on the quality of the loan portfolio, high exposure and the highest permissible exposure, capital adequacy, collection of risk placements, measures taken and receivables collected, changes in internal ratings and measures taken in case of rating deterioration, open foreign currency positions, possible losses by significant currencies, interest rate gap, average weighted rates for Bank sources and placements as well as a number of liquidity status indicators and projections, etc. The reporting dynamics and the risk measurement/assessment methodologies are prescribed within the framework of the procedures for the management of the aforementioned risks.

31.2. CREDIT RISK

Credit risk encompasses losses derived from full or partial default, i.e. an untimely discharge of a financial obligation by the client.

The Bank controls credit risk by way of credit policies and prescribed procedures which determine internal control systems aiming to act preventively.

The credit risk management system is a crucial part of the Bank'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 procedures, that are applied in all phases of the credit process (from the development of new bank products or from the credit application until its final repayment).

Credit risk management procedures are included in a comprehensive document comprised of separate methodologies aimed at the evaluation of different targeted groups of clients:

- Credit risk evaluation methodology which encompasses collateral valuation methodology,
- Credit scoring methodology,
- Methodology for evaluation and selection of banks,
- Methodology for evaluation and selection of foreign banks.

In the case of direct clients, the Bank uses the Credit risk evaluation methodology (for loans over HRK 700 thousand) or the Credit scoring methodology (for loans below HRK 700 thousand) to determine creditworthiness. The Credit scoring methodology is used to determine creditworthiness of clients that belong to the "small portfolio" is advanced, containing three scoring models: placements up to HRK 200 thousand, placements from HRK 200 thousand to HRK 700 thousand to companies and placements from HRK 200 thousand to HRK 700 thousand to all other entrepreneurs.

Pursuant to the HBOR Act, the Bank on-lends part of its placements via commercial banks the assessment of which is based on the Methodology for the Assessment and Selection of Banks and the Methodology for the Assessment and Selection of Foreign Banks.

The Bank controls related party risk on the occasion of credit approval and for the duration of a business relationship when it is requested from the clients to state their related parties. The information thereby gathered is verified and the type and nature of intra-relationship is determined as well as the existence of a group of related parties and the occurrence of the influence of the improvement or worsening of economic and financial conditions of one related party to the economic or financial position of the other related party

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

The Bank, as a developmental financial institution, supports growth and development of the Croatian economy through investment construction. For this reason, the clients mainly approach the Bank 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 Bank is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

Due to the impact of the economic and financial crisis, HBOR introduced new loan programmes with the objective of improving liquidity and maintaining and expanding the existing scope of the economic entities operations. One of the programmes is the Programme for the Development of the Economy launched for the purpose of financing economic entities with development potential that is implemented with HBOR's sharing of risk with commercial banks in proportion 50% : 50%.

By continuous monitoring and evaluation of the clients' businesses, the Bank makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Bank 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 Bank.

Also, large exposure limits as well as highest amount of credit risk exposure toward single client and his related parties and concentration (aggregate of large exposures) risk limits were determined.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure

The table below shows the highest gross credit risk exposures existing in the Statement of Financial Position and in Guarantees and commitments as of the reporting date, before the effect of mitigation through collateral received:

		GROUP		BANK
	Gross highest exposure 2012	Gross highest exposure 2011	Gross highest exposure 2012	Gross highest exposure 2011
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and due from banks	2,851,652	267,719	2,851,307	267,215
Deposits with other banks	62,253	67,377	30,419	34,811
Loans to banks	14,749,251	14,299,705	14,749,251	14,299,705
Loans to other customers	6,708,076	6,184,717	6,708,076	6,184,717
Financial assets at fair value through profit or loss	948	519	-	-
Assets available for sale	1,285,795	1,083,467	1,282,528	1,081,385
Assets held to maturity	1,087	1,092	-	-
Other assets	4,231	3,941	2,388	2,374
Total	**25,663,293**	**21,908,537**	**25,623,969**	**21,870,207**
Guarantees and commitments				
Issued guarantees in domestic currency	-	513	-	513
Issued guarantees in foreign currency	416,696	317,723	416,696	317,723
Issued bills of exchange	18,744	22,554	18,744	22,554
Open letters of credit in foreign currency	19,295	1,893	19,295	1,893
Undrawn loans	2,173,326	1,130,178	2,173,326	1,130,178
EIF - subscribed, not called up capital	30,182	30,122	30,182	30,122
Total	**2,658,243**	**1,502,983**	**2,658,243**	**1,502,983**
Total credit risk exposure	**28,321,536**	**23,411,520**	**28,282,212**	**23,373,190**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

The Bank, with its developmental loan programmes, covers the entire Republic of Croatia with a special emphasis on special concern areas. Credit risk is diversified across geographical areas and developmental credit programmes. Through development of new loan programmes (products), the Bank takes into account concentration of credit risk with a view to evenly develop all areas of the Republic of Croatia.

Through financing of different sectors by stimulating production and development with the purpose of developing the Croatian economy, the Bank is creating a better base for repayment of loans and minimization of risk.

As of 31 December 2012, the highest credit exposure of the Group to one debtor equalled HRK 2,079,122 thousand (31 December 2011: HRK 1,505,175 thousand), and of the Bank HRK 2,055,145 thousand (31 December 2011: HRK 1,472,105 thousand) after the effect of mitigation through collateral received, as the client is included in the risk group "A", i.e. the client is a first class debtor. The collateral policy is disclosed further in note 31.2.

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. In its operations, the Bank abides by the HBOR Act. The regulations of the Croatian National Bank that apply to the Bank have been incorporated into the internal documents of the Bank. Since the exposure towards some of the banks has reached the maximum permitted level, the Bank obtained, at the end of 2011, in order to be able to continue performing its development role and make the loans accessible to as many final borrowers as possible, 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 approved by the Supervisory Board will be 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 – with exposure increase coverage provided through a contract on the assignment of receivables.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows:

GROUP 2012	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	2,756,578	93,256	1,818	2,851,652
Deposits with other banks	56,584	-	5,669	62,253
Loans to banks	14,748,400	-	851	14,749,251
Loans to other customers	6,546,170	-	161,906	6,708,076
Financial assets at fair value through profit or loss	948	-	-	948
Assets available for sale	1,273,544	12,251	-	1,285,795
Assets held to maturity	1,087	-	-	1,087
Other assets	3,762	469	-	4,231
Total	**25,387,073**	**105,976**	**170,244**	**25,663,293**
Guarantees and commitments				
Issued guarantees in domestic currency	-	-	-	-
Issued guarantees in foreign currency	416,696	-	-	416,696
Issued bills of exchange	-	18,744	-	18,744
Open letters of credit in foreign currency	19,295	-	-	19,295
Undrawn loans	2,173,326	-	-	2,173,326
EIF - subscribed, not called up capital	-	30,182	-	30,182
Total	**2,609,317**	**48,926**	**-**	**2,658,243**
Total credit risk exposure	**27,996,390**	**154,902**	**170,244**	**28,321,536**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

GROUP 2011	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	152,652	113,180	1,887	267,719
Deposits with other banks	52,396	-	14,981	67,377
Loans to banks	14,298,613	-	1,092	14,299,705
Loans to other customers	6,000,323	-	184,394	6,184,717
Financial assets at fair value through profit or loss	519		-	519
Assets available for sale	1,070,721	12,746	-	1,083,467
Assets held to maturity	1,092	-	-	1,092
Other assets	3,941	-	-	3,941
Total	**21,580,257**	**125,926**	**202,354**	**21,908,537**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	317,723	-	-	317,723
Issued bills of exchange	-	22,554	-	22,554
Open letters of credit in foreign currency	1,893	-	-	1,893
Undrawn loans	1,130,178	-	-	1,130,178
EIF - subscribed, not called up capital	-	30,122	-	30,122
Total	**1,450,307**	**52,676**	**-**	**1,502,983**
Total credit risk exposure	**23,030,564**	**178,602**	**202,354**	**23,411,520**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

BANK 2012	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	2,756,233	93,256	1,818	2,851,307
Deposits with other banks	24,750	-	5,669	30,419
Loans to banks	14,748,400	-	851	14,749,251
Loans to other customers	6,546,170	-	161,906	6,708,076
Assets available for sale	1,270,277	12,251	-	1,282,528
Other assets	1,919	469	-	2,388
Total	**25,347,749**	**105,976**	**170,244**	**25,623,969**
Guarantees and commitments				
Issued guarantees in domestic currency	-	-	-	-
Issued guarantees in foreign currency	416,696	-	-	416,696
Issued bills of exchange	-	18,744	-	18,744
Open letters of credit in foreign currency	19,295	-	-	19,295
Undrawn loans	2,173,326	-	-	2,173,326
EIF - subscribed, not called up capital	-	30,182	-	30,182
Total	**2,609,317**	**48,926**	**-**	**2,658,243**
Total credit risk exposure	**27,957,066**	**154,902**	**170,244**	**28,282,212**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

BANK 2011	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	152,148	113,180	1,887	267,215
Deposits with other banks	19,830	-	14,981	34,811
Loans to banks	14,298,613	-	1,092	14,299,705
Loans to other customers	6,000,323	-	184,394	6.184,717
Assets available for sale	1,068,639	12,746	-	1,081,385
Other assets	2,374	-	-	2,374
Total	**21,541,927**	**125,926**	**202,354**	**21,870,207**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	317,723	-	-	317,723
Issued bills of exchange	-	22,554	-	22,554
Open letters of credit in foreign currency	1,893	-	-	1,893
Undrawn loans	1,130,178	-	-	1,130,178
EIF - subscribed, not called up capital	-	30,122	-	30,122
Total	**1,450,307**	**52,676**	**-**	**1,502,983**
Total credit risk exposure	**22,992,234**	**178,602**	**202,354**	**23,373,190**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

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31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

GROUP	Gross highest exposure 2012 HRK '000	Net highest exposure 2012 HRK '000	Gross highest exposure 2011 HRK '000	Net highest exposure 2011 HRK '000
Financial intermediation and insurance	19,106,278	-	15,579,394	-
Water and electric supply and other infrastructure	1,447,254	1,165,053	1,190,430	856,125
Tourism	1,134,513	289,755	721,195	9,110
Transport, warehousing and connections	558,047	145,213	681,200	218,409
Shipbuilding	520,280	389,059	499,900	170,015
Agriculture and fishery	545,306	67,508	495,771	75,187
Food industry	716,582	317,435	494,068	184,596
Construction industry	480,156	51,890	413,023	91,129
Other industry	666,229	185,657	417,795	62,821
Public administration	897,773	897,773	1,060,399	1,060,399
Education	94,074	90,390	115,304	112,747
Manufacture of basic metals and fabricated metal products, except machinery and equipment	267,038	57,365	163,833	3,810
Manufacture of chemicals and chemical products	110,249	30,150	85,153	25,966
Manufacture of other non-metallic mineral products	259,483	47,416	201,465	53,467
Other	1,518,274	412,251	1,292,590	285,208
Total credit risk exposure	**28,321,536**	**4,146,915**	**23,411,520**	**3,208,989**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

BANK	Gross highest exposure	Net highest exposure	Gross highest exposure	Net highest exposure
	2012	2012	2011	2011
	HRK ´000	HRK ´000	HRK ´000	HRK ´000
Financial intermediation and insurance	19,072,039	-	15,544,730	1
Water and electric supply and other infrastructure	1,447,254	1,165,053	1,190,430	856,125
Tourism	1,134,513	289,755	721,195	9,110
Transport, warehousing and connections	558,047	145,213	681,200	218,409
Shipbuilding	520,280	389,059	499,900	170,015
Agriculture and fishery	545,306	67,508	495,771	75,187
Food industry	716,582	317,435	494,068	184,596
Construction industry	480,156	51,890	413,023	91,129
Other industry	666,229	185,657	417,795	62,821
Public administration	897,773	897,773	1,060,399	1,060,399
Education	94,074	90,390	115,304	112,747
Manufacture of basic metals and fabricated metal products, except machinery and equipment	267,038	57,365	163,833	3,810
Manufacture of chemicals and chemical products	110,249	30,150	85,153	25,966
Manufacture of other non-metallic mineral products	259,483	47,416	201,465	53,467
Other	1,513,189	407,165	1,288,924	281,542
Total credit risk exposure	**28,282,212**	**4,141,829**	**23,373,190**	**3,205,324**

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 (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

The fair value of collateral for the Group in 2012 amounted to HRK 24,174,621 thousand (2011: HRK 20,202,531 thousand) and for the Bank HRK 24,140,383 thousand (2011: HRK 20,167,866 thousand).

In the total net highest exposure of the Bank in 2012, the credit risk of HRK 2,641,035 thousand (2011: HRK 2,392,924 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 607,107 thousand (2011: HRK 485,927 thousand), from local (regional) authorities of HRK 231,452 thousand (2011: HRK 132,108 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 354,745 thousand (2011: HRK 86,464 thousand), government funds of HRK 7,629 thousand (2011: HRK 9,161 thousand), government bonds and Treasury bills of the Ministry of Finance of HRK 904,585 thousand (2011: HRK 1,068,478 thousand). In addition, an amount of HRK 535,517 thousand (2011: HRK 610,786 thousand) relates to receivables from a majority state-owned company (51%).

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 banks; the operation and collateral quality for placements with commercial banks is described further in note 31.2 under Collateral for placements with commercial banks.

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Credit risk exposure by internal credit rating:

Internal credit rating	Historical default rate (%)	Historical default rate (%)		GROUP		BANK
	2012	2011	2012 HRK '000	2011 HRK '000	2012 HRK '000	2011 HRK '000
A	1.75%	1.12%	26,051,188	21,763,832	26,011,864	21,725,502
B	19.70%	16.61%	2,270,348	1,647,688	2,270,348	1,647,688
C	87.85%	82.74%	-	-	-	-
	Total		28,321,536	23,411,520	28,282,212	23,373,190

Credit risk assessment internal methodology
For the evaluation of various target groups of clients, the Bank has prescribed internal methodologies. They represent the basis for decisions on approval of loans, guarantees and letters of credit and one of criteria for determination of the placement risk category.

The methodology for evaluation of credit ratings is applied for the evaluation of credit risk for direct placements to companies over HRK 700 thousand. It comprises two main evaluation areas: client evaluation and project/investment evaluation and the combination of these two evaluations. All evaluation areas consist of three basic parts: financial, non-financial analysis and correction of evaluation based on currency-induced credit risk (VIKR). Clients are classified in 10 ratings depending on total points given through the criteria of the client's creditworthiness, evaluation of project criteria and exposure to VIKR criteria. Methodologies of credit scoring are used during credit risk evaluation for all direct placements below HRK 700 thousand where the Bank is exposed to credit risk. The final result of scoring determines whether the client is acceptable for credit placement. The quality and value of collateral for the placement are a part of the credit scoring procedure.

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 methodologies include the estimation of the financial risk (quantitative evaluation), the estimation of business risks for banks analysed (qualitative evaluation) and the estimation of reputation risk. The result of application of the methodologies for the evaluation of banks is the internal rating of the bank.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

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31.2. CREDIT RISK (CONTINUED)

Concentration of risk and highest credit risk exposure (continued)

Impairment loss and provisions
The Bank forms provisions for identified losses in accordance with International Financial Reporting Standards and internal procedures. 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 and the debtors' regularity of repayment upon maturity and the quality of placement collateral. 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 credit worthiness, industry risk factor, type and the debtor's foreign currency alignment.

Investments which are at least 80% covered by first class collateral are allocated in risk group "A".

The Managing Board of HBOR believes that the policies and procedures of forming provisions are adequate and that they ensure sufficient provisions for losses.

Loan restructuring
Under restructuring of placements, the Managing Board means the creation of a new HBOR placement to a borrower instead of an already existing placement, but with significant changes in the agreed terms and conditions of the placement. Without such changes, the level of credit risk in the portfolio would increase as a result of an increase in liabilities due and/or a decrease in placement value. Changes in the terms and conditions are primarily caused by deterioration of the debtor's financial standing, with the purpose of such changes being the reduction of the debtor's liabilities arising from the repayment of loans and/or payment of interest and other fees. Restructuring of a placement means a prolongation of the principal repayment period by simultaneous undertaking of at least one of the following activities: capitalisation of interest, reduction of interest rate due to a weak financial standing of the debtor, decrease of debt level, takeover of other assets for a partial or complete settlement of debt, and other similar activities for the purpose of reducing a possible occurrence of increased credit risk.

In 2012 gross loans, before provision for impairment losses, that were restructured amounted to HRK 1,916,289 thousand (2011: HRK 1,257,767 thousand), and the net value of the restructured loans after provision for impairment losses amounted to HRK 1,582,728 thousand (2011: HRK 649,322 thousand).

Restructured loans to banks, before provision for impairment losses, account for 42% (2011: 37%) of total restructured loans or 48% after provision for impairment losses (2011: 65%). In this case, commercial banks bear the default risk of the ultimate borrower.

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial assets

Credit risk analysis, 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:

GROUP 2012	Gross exposure of portfolio of risk group A HRK '000	Gross exposure of portfolio of risk group B HRK '000	Gross exposure of portfolio of risk group C HRK '000	Gross exposure of total portfolio HRK '000	Net exposure of portfolio of risk group A HRK '000	Net exposure of portfolio of risk group B HRK '000	Net exposure of portfolio of risk group C HRK '000	Net exposure of total portfolio HRK '000
Assets								
Cash on hand and due from banks	2,851,652	-	-	2,851,652	-	-	-	-
Deposits with other banks	62,253	-	-	62,253	-	-	-	-
Loans to banks	13,851,689	897,562	-	14,749,251	-	-	-	-
Loans to other customers	5,427,005	1,281,071	-	6,708,076	2,126,177	52,478	-	2,178,655
Financial assets at fair value through profit or loss	948	-	-	948	-	-	-	-
Assets available for sale	1,285,795	-	-	1,285,795	906,739	-	-	906,739
Assets held to maturity	1,087	-	-	1,087	1,087	-	-	1,087
Other assets	4,207	24	-	4,231	3,622	24	-	3,646
Total	**23,484,636**	**2,178,657**	**-**	**25,663,293**	**3,037,625**	**52,502**	**-**	**3,090,127**
Guarantees and commitments								
Issued guarantees in domestic currency	-	-	-	-	-	-	-	-
Issued guarantees in foreign currency	331,563	85,133	-	416,696	222,481	9,052	-	231,533
Issued bills of exchange	18,744	-	-	18,744	-	-	-	-
Open letters of credit in foreign currency	19,295	-	-	19,295	-	-	-	-
Undrawn loans	2,166,768	6,558	-	2,173,326	825,255	-	-	825,255
EIF - subscribed, not called up capital	30,182	-	-	30,182	-	-	-	-
Total	**2,566,552**	**91,691**	**-**	**2,658,243**	**1,047,736**	**9,052**	**-**	**1,056,788**
Total credit risk exposure	**26,051,188**	**2,270,348**	**-**	**28,321,536**	**4,085,361**	**61,554**	**-**	**4,146,915**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial assets (continued)

Credit risk analysis, 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 2011	Gross exposure of portfolio of risk group A HRK '000	Gross exposure of portfolio of risk group B HRK '000	Gross exposure of portfolio of risk group C HRK '000	Gross exposure of total portfolio HRK '000	Net exposure of portfolio of risk group A HRK '000	Net exposure of portfolio of risk group B HRK '000	Net exposure of portfolio of risk group C HRK '000	Net exposure of total portfolio HRK '000
Assets								
Cash on hand and due from banks	267,719	-	-	267,719	-	-	-	-
Deposits with other banks	67,377	-	-	67,377	-	-	-	-
Loans to banks	13,779,530	520,175	-	14,299,705	-	-	-	-
Loans to other customers	5,102,374	1,082,343	-	6,184,717	1,868,112	101,594	-	1,969,706
Financial assets at fair value through profit or loss	519	-	-	519	-	-	-	-
Assets available for sale	1,083,467	-	-	1,083,467	1,069,482	-	-	1,069,482
Assets held to maturity	1,092	-	-	1,092	1,092	-	-	1,092
Other assets	3,924	17	-	3,941	3,904	17	-	3,921
Total	**20,306,002**	**1,602,535**	**-**	**21,908,537**	**2,942,590**	**101,611**	**-**	**3,044,201**
Guarantees and commitments								
Issued guarantees in domestic currency	513	-	-	513	-	-	-	-
Issued guarantees in foreign currency	289,108	28,615	-	317,723	6,951	28,615	-	35,566
Issued bills of exchange	22,554	-	-	22,554	-	-	-	-
Open letters of credit in foreign currency	1,893	-	-	1,893	-	-	-	-
Undrawn loans	1,113,640	16,538	-	1,130,178	126,391	2,831	-	129,222
EIF - subscribed, not called up capital	30,122	-	-	30,122	-	-	-	-
Total	**1,457,830**	**45,153**	**-**	**1,502,983**	**133,342**	**31,446**	**-**	**164,788**
Total credit risk exposure	**21,763,832**	**1,647,688**	**-**	**23,411,520**	**3,075,933**	**133,057**	**-**	**3,208,989**

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31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial assets (continued)

Credit risk analysis, 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 2012	Gross exposure of portfolio of risk group A HRK '000	Gross exposure of portfolio of risk group B HRK '000	Gross exposure of portfolio of risk group C HRK '000	Gross exposure of total portfolio HRK '000	Net exposure of portfolio of risk group A HRK '000	Net exposure of portfolio of risk group B HRK '000	Net exposure of portfolio of risk group C HRK '000	Net exposure of total portfolio HRK '000
Assets								
Cash on hand and due from banks	2,851,307	-	-	2,851,307	-	-	-	-
Deposits with other banks	30,419	-	-	30,419	-	-	-	-
Loans to banks	13,851,689	897,562	-	14,749,251	-	-	-	-
Loans to other customers	5,427,005	1,281,071	-	6,708,076	2,126,177	52,478	-	2,178,655
Assets available for sale	1,282,528	-	-	1,282,528	904,585	-	-	904,585
Other assets	2,364	24	-	2,388	1,777	24	-	1,801
Total	**23,445,312**	**2,178,657**	**-**	**25,623,969**	**3,032,539**	**52,502**	**-**	**3,085,041**
Guarantees and commitments								
Issued guarantees in domestic currency	-	-	-	-	-	-	-	-
Issued guarantees in foreign currency	331,563	85,133	-	416,696	222,481	9,052	-	231,533
Issued bills of exchange	18,744	-	-	18,744	-	-	-	-
Open letters of credit in foreign currency	19,295	-	-	19,295	-	-	-	-
Undrawn loans	2,566,768	6,558	-	2,173,326	825,255	-	-	825,255
EIF - subscribed, not called up capital	30,182	-	-	30,182	-	-	-	
Total	**2,566,552**	**91,691**	**-**	**2,658,243**	**1,047,736**	**9,052**	**-**	**1.056,788**
Total credit risk exposure	**26,011,864**	**2,270,348**	**-**	**28,282,212**	**4,080,275**	**61,554**	**-**	**4,141,829**

In the total net highest exposure of the Group and the Bank, the amount of loans to other customers of HRK 1,542,994 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 13,706 thousand, local (regional) authorities of HRK 231,452 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 354,745 thousand and the government funds of HRK 7,574 thousand. An additional amount of HRK 535,517 thousand relates to receivables from majority (51%) state-owned companies.

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 907,826 thousand for the Group and HRK 904,585 thousand for the Bank.

Other assets of HRK 1,151 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

The amount of HRK 192,305 thousand relates to a guarantee issued in foreign currency, for which the liability was assumed by the Republic of Croatia.

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31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Credit risk analysis, 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 2011	Gross exposure of portfolio of risk group A HRK '000	Gross exposure of portfolio of risk group B HRK '000	Gross exposure of portfolio of risk group C HRK '000	Gross exposure of total portfolio HRK '000	Net exposure of portfolio of risk group A HRK '000	Net exposure of portfolio of risk group B HRK '000	Net exposure of portfolio of risk group C HRK '000	Net exposure of total portfolio HRK '000
Assets								
Cash on hand and due from banks	267,215	-	-	267,215	-	-	-	-
Deposits with other banks	34,811	-	-	34,811	-	-	-	-
Loans to banks	13,779,530	520,175	-	14,299,705	-	-	-	-
Loans to other customers	5,102,374	1,082,343	-	6,184,717	1,868,111	101,594	-	1,969,705
Assets available for sale	1,081,385	-	-	1,081,385	1,068,478	-	-	1,068,478
Other assets	2,357	17	-	2,374	2,336	17	-	2,353
Total	**20,267,672**	**1,602,535**	**-**	**21,870,207**	**2,938,925**	**101,611**	**-**	**3,040,536**
Guarantees and commitments								
Issued guarantees in domestic currency	513	-	-	513	-	-	-	-
Issued guarantees in foreign currency	289,108	28,615	-	317,723	6,951	28,615	-	35,566
Issued bills of exchange	22,554	-	-	22,554	-	-	-	-
Open letters of credit in foreign currency	1,893		-	1,893	-	-	-	-
Undrawn loans	1,113,640	16,538	-	1,130,178	126,391	2,831	-	129,222
EIF - subscribed, not called up capital	30,122	-	-	30,122	-	-	-	-
Total	**1,457,830**	**45,153**	**-**	**1,502,983**	**133,342**	**31,446**	**-**	**164,788**
Total credit risk exposure	**21,725,502**	**1,647,688**	**-**	**23,373,190**	**3,072,267**	**133,057**	**-**	**3,205,324**

In the total net highest exposure of the Group and the Bank, the amount of loans to other customers of HRK 1,323,234 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 484,725 thousand, local (regional) authorities of HRK 132,108 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 186,464 thousand and the government funds of HRK 9,151 thousand. An additional amount of HRK 610,786 thousand relates to receivables from majority (51%) state-owned companies.

The amount of assets available for sale is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 1,070,574 thousand for the Group and HRK 1,068,478 thousand for the Bank.

Other assets of HRK 1,213 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category:

GROUP 2012	Gross exposure neither past due nor impaired HRK '000	Gross exposure past due not impaired HRK '000	Gross exposure individually impaired HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	2,851,652	-	-	2,851,652
Deposits with other banks	62,253	-	-	62,253
Loans to banks	13,740,371	111,318	897,562	14,749,251
Loans to other customers	5,303,173	123,832	1,281,071	6,708,076
Financial assets at fair value through profit or loss	948	-	-	948
Assets available for sale	1,285,795	-	-	1,285,795
Assets held to maturity	1,087	-	-	1,087
Other assets	3,654	553	24	4,231
Total	**23,248,933**	**235,703**	**2,178,657**	**25,663,293**
Guarantees and commitments				
Issued guarantees in domestic currency	-	-	-	-
Issued guarantees in foreign currency	331,563	-	85,133	416,696
Issued bills of exchange	18,744	-	-	18,744
Open letters of credit in foreign currency	19,295	-	-	19,295
Undrawn loans	2,166,768	-	6,558	2,173,326
EIF - subscribed, not called up capital	30,182	-	-	30,182
Total	**2,566,552**	**-**	**91,691**	**2,658,243**
Total credit risk exposure	**25,815,485**	**235,703**	**2,270,348**	**28,321,536**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

GROUP 2011	Gross exposure neither past due nor impaired HRK '000	Gross exposure past due not impaired HRK '000	Gross exposure individually impaired HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	267,719	-	-	267,719
Deposits with other banks	67,377	-	-	67,377
Loans to banks	13,580,769	198,761	520,175	14,299,705
Loans to other customers	4,956,084	146,290	1,082,343	6,184,717
Financial assets at fair value through profit or loss	519	-	-	519
Assets available for sale	1,083,467	-	-	1,083,467
Assets held to maturity	1,092	-	-	1,092
Other assets	3,661	263	17	3,941
Total	**19,960,688**	**345,314**	**1,602,535**	**21,908,537**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	289,108	-	28,615	317,723
Issued bills of exchange	22,554	-	-	22,554
Open letters of credit in foreign currency	1,893	-	-	1,893
Undrawn loans	1,113,640	-	16,538	1,130,178
EIF - subscribed, not called up capital	30,122	-	-	30,122
Total	**1,457,830**	**-**	**45,153**	**1,502,983**
Total credit risk exposure	**21,418,518**	**345,314**	**1,647,688**	**23,411,520**

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

BANK 2012	Gross exposure neither past due nor impaired HRK '000	Gross exposure past due not impaired HRK '000	Gross exposure individually impaired HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	2,851,307	-	-	2,851,307
Deposits with other banks	30,419	-	-	30,419
Loans to banks	13,740,371	111,318	897,562	14,749,251
Loans to other customers	5,303,173	123.,832	1,281,071	6,708,076
Assets available for sale	1,282,528	-	-	1,282,528
Other assets	1,811	553	24	2,388
Total	**23,209,609**	**235,703**	**2,178,657**	**25,623,969**
Guarantees and commitments				
Issued guarantees in domestic currency	-	-	-	-
Issued guarantees in foreign currency	331,563	-	85,133	416,696
Issued bills of exchange	18,744	-	-	18,744
Open letters of credit in foreign currency	19,295	-	-	19,295
Undrawn loans	2,166,768	-	6,558	2,173,326
EIF - subscribed, not called up capital	30,182	-	-	30,182
Total	**2,566,552**	**-**	**91,691**	**2,658,243**
Total credit risk exposure	**25,776,161**	**235,703**	**2,270,348**	**28,282,212**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

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31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Credit risk quality due to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

BANK 2011	Gross exposure neither past due nor impaired HRK '000	Gross exposure past due not impaired HRK '000	Gross exposure individually impaired HRK '000	Total HRK '000
Assets				
Cash on hand and due from banks	267,215	-	-	267,215
Deposits with other banks	34,811	-	-	34,811
Loans to banks	13,580,769	198,761	520,175	14,299,705
Loans to other customers	4,956,084	146,290	1,082,343	6,184,717
Assets available for sale	1,081,385	-	-	1,081,385
Other assets	2,094	263	17	2,374
Total	**19,922,358**	**345,314**	**1,602,535**	**21,870,207**
Guarantees and commitments				
Issued guarantees in domestic currency	513	-	-	513
Issued guarantees in foreign currency	289,108	-	28,615	317,723
Issued bills of exchange	22,554	-	-	22,554
Open letters of credit in foreign currency	1,893	-	-	1,893
Undrawn loans	1,113,640	-	16,538	1,130,178
EIF - subscribed, not called up capital	30,122	-	-	30,122
Total	**1,457,830**	**-**	**45,153**	**1,502,983**
Total credit risk exposure	**21,380,188**	**345,314**	**1,647,688**	**23,373,190**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Credit risk quality according to type of financial asset (continued)

Aging analysis of past due but not impaired loans per class of financial asset:

	Up to 2 days 2012 HRK '000	3 to 45 days 2012 HRK '000	46 to 90 days 2012 HRK '000	Over 90 days 2012 HRK '000	Total 2012 HRK '000	Up to 2 days 2011 HRK '000	3 to 45 days 2011 HRK '000	46 to 90 days 2011 HRK '000	Over 90 days 2011 HRK '000	Total 2011 HRK '000
Assets										
Loans to banks	67,448	33,250	10,319	301	111,318	175,563	13,321	2,372	7,505	198,761
Loans to other customers	81,645	7,428	7,813	26,946	123,832	120,722	1,008	1,529	23,031	146,290
Other assets	11	4	206	332	553	4	105	115	39	263
Total	**149,104**	**40,682**	**18,338**	**27,579**	**235,703**	**296,289**	**14,434**	**4,016**	**30,575**	**345,314**

From total due and not impaired loans to banks in 2012, an amount of HRK 77,000 thousand or 69% relates to not executed extensions of revolving loans under framework contracts within the export credit financing programme.

If the total amount of due and not impaired loans to banks is reduced by the debt of banks under the export credit finance programme, the remaining debt equals HRK 34,318 thousand.

From total due and not impaired loans to other customers in 2012, an amount of HRK 81,645 thousand or 66% relates to delays of up to 2 days, of which the amount of HRK 6,728 thousand, i.e. 8%, was guaranteed by the Republic of Croatia.

From total due and not impaired loans to banks in 2011, an amount of HRK 14,781, i.e. 7%, relates to not executed extensions of revolving loans under framework contracts within the export credit financing programme.

If the total amount of due and not impaired loans to banks is reduced by the debt of banks under the export credit finance programme, the remaining debt equals HRK 183,980 thousand.

From total due and not impaired loans to other customers in 2011, an amount of HRK 120,722 thousand or 83% relates to delays of up to two days, of which the amount of HRK 6,166 thousand, i.e. 5%, was guaranteed by the Republic of Croatia.

31.2. CREDIT RISK (CONTINUED)

Collateral and other instruments
Collateral for the Bank's placements are:

1. obligatory (bills of exchange and promissory notes),
2. ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local (regional) authorities, guarantees from HAMAG INVEST (Croatian Agency for SMSs and Investment), insurance policy from political and/or commercial risks), and
3. other collateral (movable property, bills of exchange or guarantees form 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 Bank placements have to be secured with obligatory collateral. The Bank secures placements by property transfer or mortgage (super-mortgage) on real estate/movables.

Acceptable standard 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. Only the acceptable collateral is evaluated while the sixth group of collateral is unacceptable.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the insurance instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLS), guarantees from HAMAG INVEST, insurance policy against political and/or commercial risks and when the Republic of Croatia, JLS or other government bodies guarantee for clients implicitly (through legal acts).

Collateral for placements with commercial banks
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 Bank approves part of its placements with commercial banks. As collateral for placements approved to final customers through commercial banks, the Bank uses mandatory collateral from commercial banks. The commercial bank 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 commercial bank takes on the risk of default by the final customer, it is given the option to contract sufficient collateral with the final customer.

Where the loan approved through a commercial bank is higher than HRK 700 thousand, depending on the commercial bank's internal rating, the Bank contracts a super-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 super-mortgage on the same collateral.

31. Risk management

(continued)

31.2. CREDIT RISK (CONTINUED)

Collateral and other instruments (continued)

Collateral for placements with commercial banks (continued)

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 fulfillment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR to transfer ownership over all collateral that the bank had agreed with the final customer on the particular placement, without having to obtain any additional approvals or permissions from the bank.

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.

Collateral for direct placements
All direct placements are mainly secured with a mortgage over real estate and, if that is possible, the Bank obtains as security against credit risk a guarantee from HAMAG INVEST, a guarantee from the local (regional) authority, a guarantee from the Republic of Croatia, etc.

The Bank has the right to review 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 insurance or the decision of an authorised body, the Bank has determined the necessary ratio of placements and collateral.

For real estate, the necessary ratio between the amount of placement and the appraised value of the real estate is 1:1.5 except for investments on islands, in areas of special concern and hill or mountain areas, where the ratio is 1:1.3. For movable property, the necessary ratio between the amount of placement and the appraised value of the movable is 1:2.

The insured amount for insurance policies against political and/or commercial risks should cover at least 80% of the principal of the placement.

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31. Risk management

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31.2. CREDIT RISK (CONTINUED)

Collateral and other instruments (continued)

The Bank continuously monitors the value of the collateral by verification/statistical evaluation. 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
- supervision over the withdrawal of loan funds for the purpose of the construction 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, 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.

For monitoring and dealing with problem loans, the Bank has loan workout organizational unit that is independent from loan granting activities. Loan workout unit finds appropriate ways of placement collection for the clients who are facing problems of existential, financial and business nature, taking into consideration possibilities of new repayment terms and conditions in order to alleviate the maintenance of production process, employment increase or recovery.

31. Risk management

(continued)

31.3. LIQUIDITY RISK

Liquidity risk is a risk of financial loss which arises from the Bank's present or expected inability to fund its financial liabilities when due.

The basic principles for managing the Bank's liquidity risk are defined by the Liquidity Risk Management Procedures and decisions/conclusions made by the Supervisory Board, the Managing Board and the ALCO.

In order to manage liquidity risk, the Bank maintains the sufficient 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. The current surplus of available funds is placed in instruments for maintaining liquidity managed by the prescribed limits for investments in each of these instruments.

The Bank's liquidity reserve is set in the amount of at least 10% of net assets.

The Bank manages liquidity risk based on weekly, monthly, quarterly, annual and multi-annual plans of inflow and outflow.

Managing short term liquidity encompasses monitoring and managing daily liquidity, planning liquidity for the next 5 weeks and for 1-year period. Within the framework of short-term liquidity risk management, incompatibility of cash flows in the mentioned periods is monitored as well as the compliance with short-term liquidity risk management.

By long term liquidity risk management, the Bank monitors and aims to achieve maturity compatibility of existing and planned placements and sources in the period over one year.

The Bank monitors liquidity risk through scenario analysis and sensitivity analysis in regular and "operating-under-stress" conditions. Early warnings signals, proceedings in indication cases and in crisis conditions are determined.

Liquidity risk management is ensured by the established system of limits and a regular review of their sufficiency, reporting to the competent authorities on the projected size of available resources and liquidity reserves in the short and long term, which also represent the basis for making conclusions by the Asset and Liability Management Committee/decisions by the Managing Board about activities ensuring business continuity within the prescribed limits.

The Bank does not hold deposits of citizens and is therefore not exposed to wide daily fluctuations in liquidity.

As a special financial institution the Bank is not profit driven and is in that sense not using derivative instruments. The use of derivatives is allowed for the purpose of position hedging only.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

The table below provides an analysis of the Bank's assets and liabilities as of 31 December 2012 and 31 December 2011 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 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	308,384	471,735	1,158,300	913,236	-	2,851,655
Deposits with other banks	30,419	-	31,834	-	-	62,253
Loans to banks*	1,473,208	1,332,220	2,507,743	3,725,644	5,710,436	14,749,251
Loans to other customers	598,685	232,140	1.004,459	2,045,141	2,827,651	6,708,076
Financial assets at fair value through profit or loss	948	-	-	-	-	948
Assets available for sale	1,277,589	8,206	-	-	-	1,285,795
Assets held to maturity	-	23	-	1,064	-	1,087
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,323	68,323
Non-current assets held for sale	-	1	3,654	30,245	230	34,130
Other assets	4,043	1,012	123	-	525	5,703
Total assets (1)	**3,693,276**	**2,045,337**	**4,706,113**	**6,715,330**	**8,607,165**	**25,767,221**
Liabilities						
Deposits	144,584	13	19,523	1,939	1,351	167,410
Borrowings	11,790	156,931	250,964	3,254,476	9,872,197	13,546,358
Bonds payable	-	72,313	226,270	452,541	2,107,169	2,858,293
Other liabilities	53,376	57,933	191,114	363,196	418,819	1,084,438
Total liabilities	**209,750**	**287,190**	**687,871**	**4,072,152**	**12,399,536**	**17,656,499**
Equity						
Founder's capital	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	1,983,293	1,983,293
Other reserves	-	-	-	-	37,256	37,256
Net profit for the year	-	-	-	-	134,079	134,079
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Non-controlling interests	-	-	-	-	-	-
Capital	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Guarantee fund	-	-	-	-	12,355	12,355
Total equity	**-**	**-**	**-**	**-**	**8,110,722**	**8,110,722**
Total liabilities and total equity (2)	**209,750**	**287,190**	**687,871**	**4,072,152**	**20,510,258**	**25,767,221**
Net assets/liabilities (1) - (2)	**3,483,526**	**1,758,147**	**4,018,242**	**2,643,178**	**(11,903,093)**	**-**
Net cumulative assets/liabilities	**3,483,526**	**5,241,673**	**9,259,915**	**11,903,093**	**-**	**-**

The items with undefined maturity are included in terms over 3 years.

** Receivables of HRK 1,445,910 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 405,000 thousand was placed in the 1 up to 3 months maturity category.*

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31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

GROUP 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	179,029	39,600	49,094	-	-	267,723
Deposits with other banks	29,863	4,948	32,566	-	-	67,377
Loans to banks*	1,159,624	2,823,018	2,241,496	3,258,832	4,816,735	14,299,705
Loans to other customers	445,574	189,990	895,933	2,072,874	2,580,346	6,184,717
Financial assets at fair value through profit or loss	519	-	-	-	-	519
Assets available for sale	1,075,300	8,167	-	-	-	1,083,467
Assets held to maturity	-	23	-	-	1,069	1,092
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,401	68,401
Non-current assets held for sale	-	-	23,918	10,514	-	34,432
Other assets	3,224	1,486	281	-	439	5,430
Total assets (1)	**2,893,133**	**3,067,232**	**3,243,288**	**5,342,220**	**7,466,990**	**22,012,863**
Liabilities						
Deposits	154,012	13	63	69	86	154,243
Borrowings	55,656	91,025	372,197	1,823,733	5,854,752	8,197,363
Bonds payable	-	122,119	2,243,406	451,585	2,327,614	5,144,724
Other liabilities	171,266	49,369	170,434	375,262	409,280	1,175,611
Total liabilities	**380,934**	**262,526**	**2,786,100**	**2,650,649**	**8,591,732**	**14,671,941**
Equity						
Founder's capital	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	1,836,565	1,836,565
Other reserves	-	-	-	-	(16,813)	(16,813)
Net profit for the year	-	-	-	-	147,626	147,626
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**7,311,117**	**7,311,117**
Non-controllig interests	-	-	-	-	17,475	17,475
Capital	**-**	**-**	**-**	**-**	**7,328,592**	**7,328,592**
Guarantee fund	-	-	-	-	12,330	12,330
Total equity	**-**			**-**	**7,340,922**	**7,340,922**
Total liabilities and total equity (2)	**380,934**	**262,526**	**2,786,100**	**2,650,649**	**15,932,654**	**22,012,863**
Net assets/liabilities (1) - (2)	**2,512,199**	**2,804,706**	**457,188**	**2,691,571**	**(8,465,664)**	**-**
Net cumulative assets/liabilities	**2,512,199**	**5,316,905**	**5,774,093**	**8,465,664**	**-**	**-**

The items with undefined maturity are included in terms over 3 years.

** Receivables of HRK 2,712,136 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 2,050,684 thousand was placed in the 1 up to 3 months maturity category.*

Receivables from Credo banka d.d. in bankruptcy proceedings, are reported in the period of up to 1 month because all amounts became due on the date of opening the bankruptcy proceedings, on 16th January 2012 .

31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

The table below provides an analysis of the Bank's assets and liabilities as of 31 December 2012 and 31 December 2011 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:

BANK 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	308,039	471,735	1,158,300	913,236	-	2,851,310
Deposits with other banks	30,419	-	-	-	-	30,419
Loans to banks*	1,473,208	1,332,220	2,507,743	3,725,644	5,710,436	14,749,251
Loans to other customers	598,685	232,140	1,004,459	2,045,141	2,827,651	6,708,076
Assets available for sale	1,274,322	8,206	-	-	-	1,282,528
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,058	68,058
Non-current assets held for sale	-	1	3,654	30,245	230	34,130
Other assets	3,071	141	123	-	-	3,335
Total assets (1)	**3,687,744**	**2,044,443**	**4,674,279**	**6,714,266**	**8,642,499**	**25,763,231**
Liabilities						
Deposits	144,584	13	19,523	1,939	1,351	167,410
Borrowings	11,790	156,931	250,964	3,254,476	9,872,197	13,546,358
Bonds payable	-	72,313	226,270	452,541	2,107,169	2,858,293
Other liabilities	52,914	56,391	188,887	362,462	419,108	1,079,762
Total liabilities	**209,288**	**285,648**	**685,644**	**4,071,418**	**12,399,825**	**17,651,823**
Equity						
Founder's capital	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	1,984,984	1,984,984
Other reserves	-	-	-	-	35,912	35,912
Net profit for the year	-	-	-	-	134,418	134,418
Capital	**-**	**-**	**-**	**-**	**8,099,053**	**8,099,053**
Guarantee fund	-	-	-	-	12,355	12,355
Total equity	**-**	**-**	**-**	**-**	**8,111,408**	**8,111,408**
Total liabilities and total equity (2)	**209,288**	**285,648**	**685,644**	**4,071,418**	**20,511,233**	**25,763,231**
Net assets/liabilities (1) - (2)	**3,478,456**	**1,758,795**	**3,988,635**	**2,642,848**	**(11,868,734)**	**-**
Net cumulative assets/liabilities	**3,478,456**	**5,237,251**	**9,225,886**	**11,868,734**	**-**	**-**

The items with undefined maturity are included in terms over 3 years.

** Receivables of HRK 1,445,910 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 405,000 thousand was placed in the 1 up to 3 months maturity category.*

31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

BANK 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	178,525	39,600	49,094	-	-	267,219
Deposits with other banks	29,863	4,948	-	-	-	34,811
Loans to banks*	1,159,624	2,823,018	2,241,496	3,258,832	4,816,735	14,299,705
Loans to other customers	445,574	189,990	895,933	2,072,874	2,580,346	6,184,717
Assets available for sale	1,073,218	8,167	-	-	-	1,081,385
Investments in subsidiaries	-	-	-	-	19,125	19,125
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,106	68,106
Non-current assets held for sale	-	-	23,918	10,514	-	34,432
Other assets	2,511	632	281	-	-	3,424
Total assets (1)	**2,889,315**	**3,066,355**	**3,210,722**	**5,342,220**	**7,484,312**	**21,992,924**
Liabilities						
Deposits	154,012	13	63	69	86	154,243
Borrowings	55,656	91,025	372,197	1,823,733	5,854,752	8,197,363
Bonds payable	-	122,119	2,243,406	451,585	2,327,614	5,144,724
Other liabilities	171,013	47,902	169,160	374,861	409,417	1,172,353
Total liabilities	**380,681**	**261,059**	**2,784,826**	**2,650,248**	**8,591,869**	**14,668,683**
Equity						
Founder's capital	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	1,836,924	1,836,924
Other reserves	-	-	-	-	(16,812)	(16,812)
Net profit for the year	-	-	-	-	148,060	148,060
Capital	**-**	**-**	**-**	**-**	**7,311,911**	**7,311,911**
Guarantee fund	-	-	-	-	12,330	12,330
Total equity	**-**	**-**	**-**	**-**	**7,324,241**	**7,324,241**
Total liabilities and total equity (2)	**380,681**	**261,059**	**2,784,826**	**2,650,248**	**15,916,110**	**21,992,924**
Net assets/liabilities (1) - (2)	**2,508,634**	**2,805,296**	**425,896**	**2,691,972**	**(8,431,798)**	**-**
Net cumulative assets/liabilities	**2,508,634**	**5,313,930**	**5,739,826**	**8,431,798**	**-**	

The items with undefined maturity are included in terms over 3 years.

** Receivables of HRK 2,712,136 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 2,050,684 thousand was placed in the 1 up to 3 months maturity category.*

Receivables from Credo banka d.d. in bankruptcy proceedings, are reported in the period of up to 1 month because all amounts became due on the date of opening the bankruptcy proceedings, on 16th January 2012 .

31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

The table below provides an analysis of the Group's undiscounted financial liabilities placed into the relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date:

GROUP 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Financial liabilities						
Deposits	144,584	13	19,523	1,939	1,351	167,410
Borrowings	24,633	175,668	497,468	3,861,796	11,091,325	15,650,890
Bonds payable	-	-	364,117	695,589	2,306,691	3,366,397
Other liabilities	53,376	57,933	191,114	363,196	418,819	1,084,438
Total	**222,593**	**233,614**	**1,072,222**	**4,922,520**	**13,818,186**	**20,269,135**

GROUP 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Financial liabilities						
Deposits	154,012	13	63	69	86	154,243
Borrowings	58,454	111,002	598,778	2,389,914	6,957,955	10,116,103
Bonds payable	-	-	2,536,983	715,863	2,642,584	5,895,430
Other liabilities	171,266	49,369	170,434	375,262	409,280	1,175,611
Total	**383,732**	**160,384**	**3,306,258**	**3,481,108**	**10,009,905**	**17,341,387**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31. Risk management

(continued)

31.3. LIQUIDITY RISK (CONTINUED)

The table below provides an analysis of the Bank's undiscounted financial liabilities placed into the relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date:

BANK 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Financial liabilities						
Deposits	144,584	13	19,523	1,939	1,351	167,410
Borrowings	24,633	175,668	497,468	3,861,796	11,091,325	15,650,890
Bonds payable	-	-	364,117	695,589	2,306,691	3,366,397
Other liabilities	52,914	56,391	188,887	362,462	419,108	1,079,762
Total	**222,131**	**232,072**	**1,069,995**	**4,921,786**	**13,818,475**	**20,264,459**

BANK 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Financial liabilities						
Deposits	154,012	13	63	69	86	154,243
Borrowings	58,454	111,002	598,778	2,389,914	6,957,955	10,116,103
Bonds payable	-	-	2,536,983	715,863	2,642,584	5,895,430
Other liabilities	171,013	47,902	169,160	374,861	409,417	1,172,353
Total	**383,479**	**158,917**	**3,304,984**	**3,480,707**	**10,010,042**	**17,338,129**

31.4. MARKET RISK

Management of market risks at the Bank implies the reduction of interest rate risk and the currency risk to a minimal level.

31.4.1. Interest rate risk

Interest rate risk is the financial risk that occurs due to interest rate mismatching of the value and maturity of interest-sensitive assets, liabilities and off balance sheet positions.

The basic principles for managing the Bank's interest rate risk are defined by the Interest Rate Risk Management Procedures and decisions/conclusions made by the Managing Board and the ALCO.

For the purpose of measurement and monitoring of interest rate risk, the Bank carries out interest rate gap analysis. Interest rate gap is calculated for certain periods according to the possibilities of interest rate changes (fixed or floating rates) and presents the sensitivity of the Bank to the changes in interest rates. Interest rates are structured per currency, type and value, and projections of average weighted interest rates for Bank's funds and placements are made.

Based on the mentioned reports, the sensitivity of Bank's statement of profit or loss to possible interest rate fluctuations is monitored simultaneously with the endeavours to match the interest bearing assets and liabilities. In this way, the Bank reduces its market movement sensitivity as well as its sensitivity to reference interest rates fluctuations. Furthermore, current market conditions and movements in forecasted market indicators are also monitored.

The Bank continuously analyses net interest rate margins by preparing projections on the basis of selected scenarios and among other things, assesses the impact of the change in interest rates by Bank's loan programmes, change in interest reference rates and change in prices of fund sources. The Risk Management unit reports to the ALCO and the Managing Board on the results of the analyses performed with the aim to act proactively and insure further operations in accordance with the set of limits established for the purpose of risk management.

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

The following tables demonstrate the sensitivity of Group to a reasonable possible change in interest rates as of 31 December 2012 and 2011 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 2012 and 2011 which may not be indicative for the positions in other periods.

GROUP 2012	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non-interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets							
Cash on hand and due from banks	345	-	-	-	-	2,851,310	2,851,655
Deposits with other banks	30,369	-	31,028	-	-	856	62,253
Loans to banks	1,461,138	2,045,055	3,059,635	3,145,812	5,010,170	27,441	14,749,251
Loans to other customers	549,586	373,770	1,793,840	1,636,858	2,324,651	29,371	6,708,076
Financial assets at fair value through profit or loss	-	-	-	-	-	948	948
Assets available for sale	910,905	-	-	-	-	374,890	1,285,795
Assets held to maturity	-	-	-	1,064	-	23	1,087
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	68,323	68,323
Non-current assets held for sale	-	-	-	-	-	34,130	34,130
Other assets	-	-	-	-	-	5,703	5,703
Total assets (1)	**2,952,343**	**2,418,825**	**4,884,503**	**4,783,734**	**7,334,821**	**3,392,995**	**25,767,221**

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

GROUP 2012	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non-interest bearing	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Liabilities							
Deposits	6	13	33	-	-	167,358	167,410
Borrowings	11,790	325,797	1,161,183	2,954,537	9,035,548	57,503	13,546,358
Bonds payable	-	-	226,270	452,541	2,107,169	72,313	2,858,293
Other liabilities	-	-	-	-	-	1,084,438	1,084,438
Total liabilities	**11,796**	**325,810**	**1,387,486**	**3,407,078**	**11,142,717**	**1,381,612**	**17,656,499**
Equity							
Founder's capital	-	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	-	1,983,293	1,983,293
Other reserves	-	-	-	-	-	37,256	37,256
Net profit for the year	-	-	-	-	-	134,079	134,079
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Non-controlling interests	-	-	-	-	-	-	-
Capital	**-**	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Guarantee fund	-	-	-	-	-	12,355	12,355
Total equity	**-**	**-**	**-**	**-**	**-**	**8,110,722**	**8,110,722**
Total liabilities and total equity (2)	**11,796**	**325,810**	**1,387,486**	**3,407,078**	**11,142,717**	**9,492,334**	**25,767,221**
Net assets/liabilities (1) - (2)	**2,940,547**	**2,093,015**	**3,497,017**	**1,376,656**	**(3,807,896)**	**(6,099,339)**	**-**

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

GROUP 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Non-interest bearing HRK '000	Total HRK '000
Assets							
Cash on hand and due from banks	504	-	-	-	-	267,219	267,723
Deposits with other banks	29,801	4,940	31,640	-	-	996	67,377
Loans to banks	1,111,199	3,541,833	2,780,935	2,744,984	4,069,218	51,536	14,299,705
Loans to other customers	400,864	343,419	1,808,113	1,650,167	1,948,968	33,186	6,184,717
Financial assets at fair value through profit or loss	-	-	-	-	-	519	519
Assets available for sale	1,074,200	-	-	-	-	9,267	1,083,467
Assets held to maturity	-	-	-	-	1,069	23	1,092
Investments in associates	-	-	-	-	-	-	-
Property, plant and intangible assets	-	-	-	-	-	68,401	68,401
Non-current assets held for sale	-	-	-	-	-	34,432	34,432
Other assets	-	-	-	-	-	5,430	5,430
Total assets (1)	**2,616,568**	**3,890,192**	**4,620,688**	**4,395,151**	**6,019,255**	**471,009**	**22,012,863**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

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31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

GROUP 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Non-interest bearing HRK '000	Total HRK '000
Liabilities							
Deposits	6	13	63	69	-	154,092	154,243
Borrowings	55,656	440,699	1,089,816	1,737,799	4,831,485	41,908	8,197,363
Bonds payable	-	-	2,243,406	451,585	2,327,614	122,119	5,144,724
Other liabilities	-	-	-	-	-	1,175,611	1,175,611
Total liabilities	**55,662**	**440,712**	**3,333,285**	**2,189,453**	**7,159,099**	**1,493,730**	**14,671,941**
Equity							
Founder's capital	-	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	-	1,836,565	1,836,565
Other reserves	-	-	-	-	-	(16,813)	(16,813)
Net profit for the year	-	-	-	-	-	147,626	147,626
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**-**	**7,311,117**	**7,311,117**
Non-controlling interests	-	-	-	-	-	17,475	17,475
Capital	**-**	**-**	**-**	**-**	**-**	**7,328,592**	**7,328,592**
Guarantee fund	-	-	-	-	-	12,330	12,330
Total equity	**-**	**-**	**-**	**-**	**-**	**7,340,922**	**7,340,922**
Total liabilities and total equity (2)	**55,662**	**440,712**	**3,333,285**	**2,189,453**	**7,159,099**	**8,834,652**	**22,012,863**
Net assets/liabilities (1) - (2)	**2,560,906**	**3,449,480**	**1,287,403**	**2,205,698**	**(1,139,844)**	**(8,363,643)**	**-**

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

The following tables demonstrate the sensitivity of HBOR to a reasonable possible change in interest rates as of 31 December 2012 and 2011 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 2012 and 2011 which may not be indicative for the positions in other periods.

BANK 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3-12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Non-interest bearing HRK '000	Total HRK '000
Assets							
Cash on hand and due from banks	-	-	-	-	-	2,851,310	2,851,310
Deposits with other banks	30,369	-	-	-	-	50	30,419
Loans to banks	1,461,138	2,045,055	3,059,635	3,145,812	5,010,170	27,441	14,749,251
Loans to other customers	549,586	373,770	1,793,840	1,636,858	2,324,651	29,371	6,708,076
Assets available for sale	908,792	-	-	-	-	373,736	1,282,528
Investments in subsidiaries	-	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	68,058	68,058
Non-current assets held for sale	-	-	-	-	-	34,130	34,130
Other assets	-	-	-	-	-	3,335	3,335
Total assets (1)	**2,949,885**	**2,418,825**	**4,853,475**	**4,782,670**	**7,334,821**	**3,423,555**	**25,763,231**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

BANK 2012	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Non-interest bearing HRK '000	Total HRK '000
Liabilities							
Deposits	6	13	33	-	-	167,358	167,410
Borrowings	11,790	325,797	1,161,183	2,954,537	9,035,548	57,503	13,546,358
Bonds payable	-	-	226,270	452,541	2,107,169	72,313	2,858,293
Other liabilities	-	-	-	-	-	1,079,762	1,079,762
Total liabilities	**11,796**	**325,810**	**1,387,486**	**3,407,078**	**11,142,717**	**1,376,936**	**17,651,823**
Equity							
Founder's capital	-	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	-	1,984,984	1,984,984
Other reserves	-	-	-	-	-	35,912	35,912
Net profit for the year	-	-	-	-	-	134,418	134,418
Capital	-	-	-	-	-	**8,099,053**	**8,099,053**
Guarantee fund	-	-	-	-	-	12,355	12,355
Total equity	**-**	**-**	**-**	**-**	**-**	**8,111,408**	**8,111,408**
Total liabilities and total equity (2)	**11,796**	**325,810**	**1,387,486**	**3,407,078**	**11,142,717**	**9,488,344**	**25,763,231**
Net assets/liabilities (1) - (2)	**2,938,089**	**2,093,015**	**3,465,989**	**1,375,592**	**(3,807,896)**	**(6,064,789)**	**-**

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31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

BANK 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Non-interest bearing HRK '000	Total HRK '000
Assets							
Cash on hand and due from banks	-	-	-	-	-	267,219	267,219
Deposits with other banks	29,801	4,940	-	-	-	70	34,811
Loans to banks	1,111,199	3,541,833	2,780,935	2,744,984	4,069,218	51,536	14,299,705
Loans to other customers	400,864	343,419	1,808,113	1,650,167	1,948,968	33,186	6,184,717
Assets available for sale	1,073,218	-	-	-	-	8,167	1,081,385
Investments in subsidiaries	-	-	-	-	-	19,125	19,125
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	68,106	68,106
Non-current assets held for sale	-	-	-	-	-	34,432	34,432
Other assets	-	-	-	-	-	3,424	3,424
Total assets (1)	**2,615,082**	**3,890,192**	**4,589,048**	**4,395,151**	**6,018,186**	**485,265**	**21,992,924**

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. Interest rate risk (continued)

BANK 2011	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 -3 years HRK '000	Over 3 years HRK' 000	Non-interest bearing HRK '000	Total HRK '000
Liabilities							
Deposits	6	13	63	69	-	154,092	154,243
Borrowings	55,656	440,699	1,089,816	1,737,799	4,831,485	41,908	8,197,363
Bonds payable	-	-	2,243,406	451,585	2,327,614	122,119	5,144,724
Other liabilities	-	-	-	-	-	1,172,353	1,172,353
Total liabilities	**55,662**	**440,712**	**3,333,285**	**2,189,453**	**7,159,099**	**1,490,472**	**14,668,683**
Equity							
Founder's capital	-	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	-	1,836,924	1,836,924
Other reserves	-	-	-	-	-	(16,812)	(16,812)
Net profit for the year	-	-	-	-	-	148,060	148,060
Capital	**-**	**-**	**-**	**-**	**-**	**7,311,911**	**7,311,911**
Guarantee fund	-	-	-	-	-	12,330	12,330
Total equity	**-**	**-**	**-**	**-**	**-**	**7,324,241**	**7,324,241**
Total liabilities and total equity (2)	**55,662**	**440,712**	**3,333,285**	**2,189,453**	**7,159,099**	**8,814,713**	**21,992,924**
Net assets/liabilities (1) - (2)	**2,559,420**	**3,449,480**	**1,255,763**	**2,205,698**	**(1,140,913)**	**(8,329,448)**	**-**

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.1. 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 2012 has been determined using the standard deviation method on the daily changes of the reference interest rates linked to EUR. On the basis of the above volatility, possible changes in reference interest rates linked to EUR have been established and used in the sensitivity analysis.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points. 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 2012	Effect on profit in 2012 HRK '000	Increase in b.p. in 2011	Effect on profit in 2011 HRK '000
EUR	+27	2,500	+50	7,526
USD	-	-	-	-
Currency	Decrease in b.p. in 2012	Effect on profit in 2012 HRK '000	Decrease in b.p. in 2011	Effect on profit in 2011 HRK '000
EUR	-27	(2,500)	-50	(7,526)
USD	-	-	-	-

** Sensitivity analysis has not been performed for the items with reference interest rates linked to USD since such items are not a constituent element of the Bank's assets and liabilities as of 31 December 2012 and 31 December 2011.*

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk

Currency risk represents the exposure of the Bank to changes in foreign exchange rates and arises, above all, out of asset and liability currency mismatch that could result in higher expenses and/or not realized projected income.

Basic rules and principles in currency risk management of the Bank are determined in Currency risk management procedures and the decisions/conclusions of the Managing Board and the Asset and liabilities management committee.

Currency risk management procedures determine: methods for the measurement/assessment, monitoring, management and control of this risk, limits and proceedings both in cases indicating to a crisis and in crisis conditions as well as reports necessary for comprehensive perception of currency risk.

The Bank monitors open foreign currency positions when assessing currency risk exposure. A report on open foreign currency positions is generated on a daily basis and, in addition to the daily monitoring; the projections of their developments are also prepared. For the measurement/assessment of currency risk, the Bank uses VaR model and the bodies in charge report on maximum possible losses on significant currencies regularly. The currency risk is monitored through prescribed limits of currency risk exposure.

The Bank performs stress tests on profits under the assumption of extensive appreciation/depreciation of HRK against significant currencies and reports on test results to the ALCO and the Managing Board.

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31. Risk management
(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk (continued)

Total assets and liabilities as of 31 December 2012 and 31 December 2011 in HRK and foreign currencies can be shown as follows:

GROUP 2012	USD HRK '000	EUR HRK '000	Other foreign currencies HRK '000	Total foreign currencies HRK '000	HRK HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	399	93,348	1,439	95,186	2,756,469	2,851,655
Deposits with other banks	5,669	228	-	5,897	56,356	62,253
Loans to banks	-	8,553,030	-	8.,553,030	6,196,221	14,749,251
Loans to other customers	24,068	2,958,374	-	2,982,442	3,725,634	6,708,076
Financial assets at fair value through profit or loss	-	175	-	175	773	948
Assets available for sale	-	331,804	-	331,804	953,991	1,285,795
Assets held to maturity	-	1,087	-	1,087	-	1,087
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,323	68,323
Non-current assets held for sale	-	-	-	-	34,130	34,130
Other assets	-	120	-	120	5,583	5,703
Total assets (1)	**30,136**	**11,938,166**	**1,439**	**11,969,741**	**13,797,480***	**25,767,221**
Liabilities						
Deposits	19,682	34,586	38	54,306	113,104	167,410
Borrowings	-	8,238,841	-	8,238,841	5,307,517	13,546,358
Bonds payable	-	2,858,293	-	2,858,293	-	2,858,293
Other liabilities	-	7,374	19,032	26,406	1,058,032	1,084,438
Total liabilities	**19,682**	**11,139,094**	**19,070**	**11,177,846**	**6,478,653**	**17,656,499**
Equity						
Founder's capital	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	1,983,293	1,983,293
Other reserves	-	-	-	-	37,256	37,256
Net profit for the year	-	-	-	-	134,079	134,079
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Non-controlling interests	-	-	-	-	-	-
Capital	**-**	**-**	**-**	**-**	**8,098,367**	**8,098,367**
Guarantee fund	-	12,355	-	12,355	-	12,355
Total equity	**-**	**12,355**	**-**	**12,355**	**8,098,367**	**8,110,722**
Total liabilities and total equity (2)	**19,682**	**11,151,449**	**19,070**	**11,190,201**	**14,577,020**	**25,767,221**
Net assets/liabilities (1) - (2)	**10,454**	**786,717**	**(17,631)****	**779,540**	**(779,540)**	**-**

** Amounts linked to a one-way currency clause represent HRK 894,431 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 (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

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31. Risk management
(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk (continued)

GROUP 2011	USD HRK '000	EUR HRK '000	Other foreign currencies HRK '000	Total foreign currencies HRK '000	HRK HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	375	113,383	1,382	115,140	152,583	267,723
Deposits with other banks	14,981	221	-	15,202	52,175	67,377
Loans to banks	-	9,243,340	-	9,243,340	5,056,365	14,299,705
Loans to other customers	34,349	3,137,532	-	3,171,881	3,012,836	6,184,717
Financial assets at fair value through profit or loss	-	93	-	93	426	519
Assets available for sale	-	333,027	-	333,027	750,440	1,083,467
Assets held to maturity	-	1,069	-	1,069	23	1,092
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,401	68,401
Non-current assets held for sale	-	-	-	-	34,432	34,432
Other assets	-	235	-	235	5,195	5,430
Total assets (1)	**49,705**	**12,828,900**	**1,382**	**12,879,987**	**9,132,876***	**22,012,863**
Liabilities						
Deposits	21,407	3,890	37	25,334	128,909	154,243
Borrowings	-	6,237,961	-	6,237,961	1,959,402	8,197,363
Bonds payable	-	5,144,724	-	5,144,724	-	5,144,724
Other liabilities	2,293	5,194	5	7,492	1,168,119	1,175,611
Total liabilities	**23,700**	**11,391,769**	**42**	**11,415,511**	**3,256,430**	**14,671,941**
Equity						
Founder's capital	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	1,836,565	1,836,565
Other reserves	-	-	-	-	(16,813)	(16,813)
Net profit for the year	-	-	-	-	147,626	147,626
Total equity attributable to equity holders of the parent	**-**	**-**	**-**	**-**	**7,311,117**	**7,311,117**
Non-controlling interests	-	-	-	-	17,475	17,475
Capital	**-**	**-**	**-**	**-**	**7,328,592**	**7,328,592**
Guarantee fund	-	12,330	-	12,330	-	12,330
Total equity	**-**	**12,330**	**-**	**12,330**	**7,328,592**	**7,340,922**
Total liabilities and total equity (2)	**23,700**	**11,404,099**	**42**	**11,427,841**	**10,585,022**	**22,012,863**
Net assets/liabilities (1) - (2)	**26,005**	**1,424,801**	**1,340**	**1,452,146**	**(1,452,146)**	**-**

** Amounts linked to a one-way currency clause represent HRK 1,243,189 thousand.*

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk (continued)

Total assets and liabilities as of 31 December 2012 and 31 December 2011 in HRK and foreign currencies can be shown as follows:

BANK 2012	USD HRK '000	EUR HRK '000	Other foreign currencies HRK '000	Total foreign currencies HRK '000	HRK HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	399	93,348	1,439	95,186	2,756,124	2,851,310
Deposits with other banks	5,669	-	-	5,669	24,750	30,419
Loans to banks	-	8,553,030	-	8,553,030	6,196,221	14,749,251
Loans to other customers	24,068	2,958,374	-	2,982,442	3,725,634	6,708,076
Assets available for sale	-	329,433	-	329,433	953,095	1,282,528
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,058	68,058
Non-current assets held for sale	-	-	-	-	34,130	34,130
Other assets	-	-	-	-	3,335	3,335
Total assets (1)	**30,136**	**11,934,185**	**1,439**	**11,965,760**	**13,797,471***	**25,763,231**
Liabilities						
Deposits	19,682	34,586	38	54,306	113,104	167,410
Borrowings	-	8,238,841	-	8,238,841	5,307,517	13,546,358
Bonds payable	-	2,858,293	-	2,858,293	-	2,858,293
Other liabilities	-	4,509	19,020	23,529	1,056,233	1,079,762
Total liabilities	**19,682**	**11,136,229**	**19,058**	**11,174,969**	**6,476,854**	**17,651,823**
Equity						
Founder's capital	-	-	-	-	5,943,739	5,943,739
Retained earnings and reserves	-	-	-	-	1,984,984	1,984,984
Other reserves	-	-	-	-	35,912	35,912
Net profit for the year	-	-	-	-	134,418	134,418
Capital	**-**	**-**	**-**	**-**	**8,099,053**	**8,099,053**
Guarantee fund	-	12,355	-	12,355	-	12,355
Total equity	**-**	**12,355**	**-**	**12,355**	**8,099,053**	**8,111,408**
Total liabilities and total equity (2)	**19,682**	**11,148,584**	**19,058**	**11,187,324**	**14,575,907**	**25,763,231**
Net assets/liabilities (1) - (2)	**10,454**	**785,601**	**(17,619)****	**778,436**	**(778,436)**	**-**

** Amounts linked to a one-way currency clause represent HRK 894,431 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 (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

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31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk (continued)

BANK 2011	USD HRK '000	EUR HRK '000	Other foreign currencies HRK '000	Total foreign currencies HRK '000	HRK HRK '000	Total HRK '000
Assets						
Cash on hand and due from banks	375	113,383	1,382	115,140	152,079	267,219
Deposits with other banks	14,981	-	-	14,981	19,830	34,811
Loans to banks	-	9,243,340	-	9,243,340	5,056,365	14,299,705
Loans to other customers	34,349	3,137,532	-	3,171,881	3,012,836	6,184,717
Assets available for sale	-	331,475	-	331,475	749,910	1,081,385
Investments in subsidiaries	-	-	-	-	19,125	19,125
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	68,106	68,106
Non-current assets held for sale	-	-	-	-	34,432	34,432
Other assets	-	192	-	192	3,232	3,424
Total assets (1)	**49,705**	**12,825,922**	**1,382**	**12,877,009**	**9,115,915***	**21,992,924**
Liabilities						
Deposits	21,407	3,890	37	25,334	128,909	154,243
Borrowings	-	6,237,961	-	6,237,961	1,959,402	8,197,363
Bonds payable	-	5,144,724	-	5,144,724	-	5,144,724
Other liabilities	2,293	3,882	-	6,175	1,166,178	1,172,353
Total liabilities	**23,700**	**11,390,457**	**37**	**11,414,194**	**3,254,489**	**14,668,683**
Equity						
Founder's capital	-	-	-	-	5,343,739	5,343,739
Retained earnings and reserves	-	-	-	-	1,836,924	1,836,924
Other reserves	-	-	-	-	(16,812)	(16,812)
Net profit for the year	-	-	-	-	148,060	148,060
Capital	**-**	**-**	**-**	**-**	**7,311,911**	**7,311,911**
Guarantee fund	-	12,330	-	12,330	-	12,330
Total equity	**-**	**12,330**	**-**	**12,330**	**7,311,911**	**7,324,241**
Total liabilities and total equity (2)	**23,700**	**11,402,787**	**37**	**11,426,524**	**10,566,400**	**21,992,924**
Net assets/liabilities (1) - (2)	**26,005**	**1,423,135**	**1,345**	**1,450,485**	**(1,450,485)**	**-**

** Amounts linked to a one-way currency clause represent HRK 1,243,189 thousand.*

31. Risk management

(continued)

31.4. MARKET RISK (CONTINUED)

31.4.2. Currency risk (continued)

Sensitivity analysis

Sensitivity analysis was performed for the foreign currency risk which HBOR was exposed to on 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 2012.

Volatility of the exchange rate EUR/HRK, determined using the standard deviation method on the monthly changes of the foreign exchange rate EUR/HRK, equalled 1.8% in 2012 (2011: 1.6%).

The effect of the assumed changes in the foreign exchange rate EUR/HRK by asset and liability items denominated or indexed to EUR on HBOR's profits is stated below.

	Change in currency rate in %	Effect on profit in 2012	Change in currency rate in %	Effect on profit in 2012
	2012	HRK '000	2011	HRK '000
EUR	+1.8%	34,350	+1.6%	44,339
USD	-	-	-	-
EUR	-1.8%	(18,375)	-1.6%	(26,137)
USD	-	-	-	-

**Sensitivity analysis has not been performed for the asset and liability items denominated or indexed to USD since USD is no longer considered to be a significant currency of the Bank as of 31 December 2012 and 31 December 2011.*

31.5. OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequate or failed internal processes, people, systems or external events. Operational risk includes legal risk while it excludes strategic and reputational risk.

Particularity of operational risk when compared to other types of risk is reflected in its presence throughout the organisation and its implementation in all organisational units of the Bank.

In order to manage its operational risk in a complete and comprehensive manner, in 2012, the Bank established a framework for operational risk management. The introduction of the framework was carried out from the EU grant for technical assistance in cooperation with the KfW. With this frame, the Bank is 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.

The basic principles of operational risk management were identified in the umbrella act, Operational Risk Management Policy which prescribes the elements of the system for management of these risks, which include identifying, measuring, assessing, controlling and monitoring operational risk. Furthermore, a structure of management and accountability in the system has been set up, an approach for the calculation of capital requirements for operational risk has been determined and a reporting system has been established.

Monitoring of operational risks is supported by a software solution that enables recording of operational risk events.

Evaluation of operational risk is performed through the Operational Risk Map, which identifies and evaluates operational risk the Bank is exposed to, in order to identify further risk elimination measures.

The Bank is trying to minimise the operational risk by active monitoring, management and control of operational risk exposures.

31. Risk management
(continued)

31. Risk management
(continued)

31.5. OPERATIONAL RISK (CONTINUED)

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. Considering the significant level of operational risk arising from IT utilisation, the Bank has established a function for analysis and control of IT system security.

32. Fair value of financial instruments

Fair value represents the amount at which an asset may be exchanged or a liability settled in an arm's-length transaction. If there is no active market for the financial assets and liabilities, or if due to any other reason, the fair value cannot be reliably measured by the market price, the Managing Board uses an evaluation technique for fair value estimation. Such techniques include prices achieved in recent transactions agreements between informed and willing sides, reference to similar financial instruments, and discounted cash flow analysis, making maximum use of market inputs and relying on entity-specific inputs.

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 to 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 interest subsidies that are recognized as deferred income in discounted amounts and presented within other liabilities are taken into account in estimating fair value. The fair value of HRK loans with one-way foreign currency clause is assessed as described under the "Foreign currency transactions and foreign currency clause" paragraph.

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 Statement of Financial Position date for new borrowings of a similar nature and with a similar remaining maturity. As the Bank's long-term borrowings mostly bear variable interest, the Bank estimates that its carrying amount is a reasonable approximation of fair value.

The fair value of bonds issued by HBOR on 31 December 2012 is stated in Note 24.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

32. Fair value of financial instruments
(continued)

32.1. FAIR VALUE OF FINANCIAL INSTRUMENTS INITIALLY RECOGNIZED AND MEASURED AT FAIR VALUE

In the table below, financial instruments initially recognized and measured at fair value are analysed and classified in three groups depending on whether used input data about fair value are observable or not:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities,

Level 2: inputs about fair value other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices), and

Level 3: inputs for the asset or liability that are derived by valuation methods for assets and liabilities based on observable market data (unobservable inputs).

Out of financial instruments in the Bank's portfolio, only assets available for sale that were initially carried at fair value are classified in Level 1 and Level 2 but the value impairment test is also applied.

The evaluation of fair value of quoted instruments in the active market is based on the recent prices provided directly from the regulated capital market (Zagreb Stock Exchange or other regulated capital market).

In case of direct acceptance of instruments' value from the regulated capital market, and if the latest price is not available, the concluding price will be taken for evaluation.

The evaluation of fair value of financial instruments is performed as follows:

- For equity instruments, the Zagreb Stock Exchange (ZSE) closing market price for the last working day of the month, and if the above has not been published, the last realized price before the last working day of the month for which the revaluation is done.
- For bonds of the Ministry of Finance of the Republic of Croatia issued in the domestic market, bid price of instruments quoted on the ZG-Fixing on the last working day of the month will be used. If the above is not available, the concluding price of instruments realized at ZSE on the last working day of the month will be used, and if neither of the above are available, the closing price per institutional transaction will be used. If both the final and the concluding price are available for an individual security per institutional transaction, the latest price in the regular business will be used for the purpose of evaluation.
- For Croatian Securities issued abroad (i.e. Eurobonds) and for all other foreign issuers' securities, or securities issued outside of the Republic of Croatia, bid price for a security quoted at the adequate Bloomberg site on the last working day of the month will be used for evaluation purposes.

32. Fair value of financial instruments

(continued)

32.1. FAIR VALUE OF FINANCIAL INSTRUMENTS INITIALLY RECOGNIZED AND MEASURED AT FAIR VALUE (CONTINUED)

- Fair value of treasury bills of the Ministry of Finance of the Republic of Croatia and of the Croatian National Bank with the remaining maturity period over 90 days is calculated based on the yield achieved at the last auction of treasury bills of the Ministry of Finance of the Republic of Croatia held before the last working day of the month for which the revaluation is made. Yields are calculated by linear interpolation for the time period of the remaining maturity of instruments. Fair value of treasury bills of the Ministry of Finance of the Republic of Croatia and of the Croatian National Bank with the remaining maturity under 91 days is calculated based on the linear interpolation of ZIBOR interest rate set on the last business day of each month.

The same approach in the evaluation of fair value is also applied in case when the trust over the securities investment portfolio is given to a trustee.

If there is no active market for a financial instrument, or if due to any other reason, the fair value cannot be reliably measured by the market price, the Bank uses an evaluation technique for fair value estimation. Such technique includes prices achieved in recent transactions by reference to similar financial instruments, and discounted cash flow analysis, making maximum use of market inputs. When the discounted cash flow technique is used, the estimated future cash flows are based on the best evaluation of the Managing Board, and the discounted rate is market rate for similar instruments.

In case of evaluation of fair value for shares in investment funds (cash funds), the price of shares in the fund on a particular day is acquired from the investment fund management company.

The Bank has chosen to present comparative information for both reporting and prior period.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

32. Fair value of financial instruments

(continued)

32.1. FAIR VALUE OF FINANCIAL INSTRUMENTS INITIALLY RECOGNIZED AND MEASURED AT FAIR VALUE (CONTINUED)

GROUP			2012			2011
			HRK '000			HRK '000
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Financial assets at fair value through profit or loss						
Shares in investments funds recognised at fair value through profit or loss	948	-	-	519	-	-
Total financial assets at fair value through profit or loss	**948**	**-**	**-**	**519**	**-**	**-**
Assets available for sale:						
Debt instruments:						
Listed debt instruments:						
Bonds of the Ministry of Finance of the Republic of Croatia	349,487	-	-	332,546	-	-
Treasury bills of the Ministry of Finance of the Republic of Croatia	549,006	-	-	728,748	-	-
Accrued interest	8,246	-	-	8,188	-	-
Total debt instruments	**906,739**	**-**	**-**	**1,069,482**	**-**	**-**
Equity instruments:						
Investment in shares of foreign companies	-	25	-	-	25	-
Investment in financial institutions shares	-	161	-	-	161	-
Shares of foreign financial institutions - EIF	-	12,226	-	-	12,721	-
Corporate shares	-	-	-	-	-	-
Total equity instruments	**-**	**12,412**	**-**	**-**	**12,907**	**-**
Investments in investment funds:						
Shares classified as assets available for sale	366,644	-	-	1,078	-	-
Total investments in investment funds	**366,644**	**-**	**-**	**1,078**	**-**	**-**
Total assets available for sale	**1,273,383**	**12,412**	**-**	**1,070,560**	**12,907**	**-**
Assets held to maturity:						
Debt instruments:						
Bonds of the Ministry of Finance of the Republic of Croatia	1,064	-	-	1,069	-	-
Accrued interest	23	-	-	23	-	-
Total assets held to maturity	**1,087**	**-**	**-**	**1,092**	**-**	**-**

32. Fair value of financial instruments

(continued)

32.1. FAIR VALUE OF FINANCIAL INSTRUMENTS INITIALLY RECOGNIZED AND MEASURED AT FAIR VALUE (CONTINUED)

BANK			2012			2011
			HRK '000			HRK '000
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets available for sale						
Debt instruments:						
Listed debt instruments:						
Bonds of the Ministry of Finance of the Republic of Croatia	347,373	-	-	331,563	-	-
Treasury bills of the Ministry of Finance of The Republic of Croatia	549,006	-	-	728,748	-	-
Accrued interest	8,206	-	-	8,167	-	-
Total debt instruments	**904,585**	**-**	**-**	**1,068,478**	**-**	**-**
Equity instruments:						
Investment in shares of foreign companies	-	25	-	-	25	-
Investment in financial institutions shares	-	161	-	-	161	-
Shares of foreign financial institutions - EIF	-	12,226	-	-	12,721	-
Corporate shares	-	-	-	-	-	-
Total equity instruments	**-**	**12,412**	**-**	**-**	**12,907**	**-**
Investments in investment funds:						
Shares classified as assets available for sale	365,531	-	-	-	-	-
Total investments in investment funds	**365,531**	**-**	**-**	**-**	**-**	**-**
Total assets available for sale	**1,270,116**	**12,412**	**-**	**1,068,478**	**12,907**	**-**

32.2. FAIR VALUE OF FINANCIAL INSTRUMENTS CARRIED AT AMORTIZED COST

The Managing Board estimates that their carrying amounts of financial assets and liabilities carried at amortized cost are a reasonable approximation of fair value, except for the fair value of bonds payable (Note 24). Fair value of liabilities upon bonds payable is determined according to adjusted quoted prices.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

33. 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

33. Reporting by segments

(continued)

2012	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	410,067	1,684	11	-	411,762
Net fee income	10,112	998	508	(35)	11,583
Net income/(expenses) from financial operations	(118)	25	20	-	(73)
Net premiums earned	-	1,950	-	-	1,950
Other income	2,501	710	31	(74)	3,168
Income from operating activities	**422,562**	**5,367**	**570**	**(109)**	**428,390**
Operating costs	(110,871)	(4,463)	(704)	110	(115,928)
Impairment loss and provisions	(177,273)	(195)	(19)	-	(177,487)
Expenses for insured cases	-	(228)	-	-	(228)
Net change in provisions	-	(833)	-	-	(833)
Other expenses	-	(52)	-	-	(52)
Operating expenses	**(288,144)**	**(5,771)**	**(723)**	**110**	**(294,528)**
Profit/(loss) before income tax	**134,418**	**(404)**	**(153)**	**1**	**133,862**
Income tax	-	66	29	-	95
Profit/(loss) for the year	**134,418**	**(338)**	**(124)**	**1**	**133,957**
Assets of segment	25,763,231	40,293	1,869	(38,172)	25,767,221
Total assets	**25,763,231**	**40,293**	**1,869**	**(38,172)**	**25,767,221**
Liabilities of segment	17,651,823	4,593	125	(42)	17,656,499
Total equity and guarantee fund	8,111,408	(1,800)	(256)	1,370	8,110,722
Total liabilities and total equity	**25,763,231**	**2,793**	**(131)**	**1,328**	**25,767,221**

Intra-group transactions are presented under "Unallocated".

For the purposes of this note, net income/(expense) from financial activities is reported as an income item, regardless the actual realization, to enable comparison of the amounts stated in the Statement of profit or loss.

33. Reporting by segments

(continued)

2011	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	332,313	1,538	11	-	333,862
Net fee income	11,011	858	514	(5)	12,378
Net income from financial operations	44,351	52	19	-	44,422
Net premiums earned	-	1,248	-	-	1,248
Other income	1,007	76	-	(61)	1,022
Income from operating activities	**388,682**	**3,772**	**544**	**(66)**	**392,932**
Operating costs	(94,756)	(3,658)	(641)	66	(98,989)
Impairment loss and provisions	(145,866)	(38)	(42)	-	(145,946)
Expenses for insured cases	-	(230)	-	-	(230)
Net change in provisions	-	(894)	-	-	(894)
Other expenses	-	(35)	-	-	(35)
Operating expenses	**(240,622)**	**(4,855)**	**(683)**	**66**	**(246,094)**
Profit/(loss) before income tax	**148,060**	**(1,083)**	**(139)**	**-**	**146,838**
Income tax	-	227	25	-	252
Profit/(loss) for the year	**148,060**	**(856)**	**(114)**	**-**	**147,090**
Assets of segment	21,992,924	39,172	1,922	(21,155)	22,012,863
Total assets	**21,992,924**	**39,172**	**1,922**	**(21,155)**	**22,012,863**
Liabilities of segment	14,668,683	3,214	67	(23)	14,671,941
Total equity and guarantee fund	7,324,241	(1,542)	(145)	18,368	7,340,922
Total liabilities and total equity	**21,992,924**	**1,672**	**(78)**	**18,345**	**22,012,863**

Intra-group transactions are presented under "Unallocated".

34. Capital management

The primary objectives of the Bank'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 Bank has identified liable capital as a manageable capital category.

Liable 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.

Liable capital consists of core capital (Tier 1) and supplementary capital (Tier 2), and is calculated in accordance with bank regulations in the Republic of Croatia.

The Bank has determined measures for the implementation and monitoring of the capital management policy as follows:

- At the reporting date, liable capital has 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.

The calculation of the capital adequacy ratio is performed in line with the regulations prescribed for the banks in the Republic of Croatia and does not differ from international banking practice.

		GROUP		BANK
	2012	2011	2012	2011
	HRK '000	HRK '000	HRK '000	HRK '000
Core capital - Tier 1	8,062,679	7,327,752	8,063,140	7,328,722
Supplementary capital - Tier 2	298,177	255,504	298,177	255,504
Total liable capital	**8,360,856**	**7,583,256**	**8,361,317**	**7,584,226**
Risk weighted assets	10,066,849	9,123,408	10,093,939	9,133,539
Capital requirements for currency risk	1,864,902	2,822,529	1,860,921	2,819,899
Total capital requirements	**11,931,751**	**11,945,937**	**11,954,860**	**11,953,438**
	%	%	%	%
Capital ratio (Tier 1)	**67.57**	**61.34**	**67.45**	**61.31**
Capital adequacy ratio	**70.07**	**63.48**	**69.94**	**63.45**
	HRK '000	HRK '000	HRK '000	HRK '000
Liable capital needed for ensuring capital adequacy according to regulatory requirements	**1,431,810**	**1,433,512**	**1,434,583**	**1,434,413**

Minimum capital adequacy ratio at the end of 2012 was 12% as well as in 2011. From the second quarter of 2010 and onwards, the regulatory minimum for the liable capital adequacy ratio is increased to 12%. Apart from the increase of the minimum ratio percentage, the new regulations require a change of method for the calculation of capital adequacy. Pursuant to the new requirement for liable capital adequacy ratio maintenance capital management requirement are being amended as follows:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2012 (ALL AMOUNTS ARE EXPRESSED IN HRK THOUSAND)

34. Capital management

(continued)

liable capital has to be at least at the level of founder's capital for the reporting period and liable capital adequacy ratio at the reporting date has to be at least at the level of 12% and level sufficient for coverage of capital risk requirements.

Due to the extensive changes in the support application for the Bank's operations, the Managing Board has prolonged a transitional period for the implementation and testing of new applications until the end of 2012. In this period, the capital adequacy and exposure calculations will be made in the existing manner.

The Managing Board of the Group does not expect any adverse effects on the level of capital adequacy as a result of application of the new regulations for credit institutions, taking into account that the bank's capital adequacy ratio at the end of 2012 was 5.8 higher than the prescribed one. This was primarily due to the model of operation and its orientation to the lending operations.

35. 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.

36. Events after the reporting period date

36.1. FUNDRAISING

In December 2012, the European Investment Bank approved to HBOR a loan for EUR 500,000 thousand. After the year end, on 25th January 2013, HBOR and the EIB signed the contract on the first tranche of the loan in the amount of EUR 250,000 thousand.

The purpose of the loan is financing small and medium-sized enterprises and mid-cap companies, small and medium-scale infrastructure projects in the public sector as well as limited size investments in the industry sector in the areas of knowledge, energy, environmental protection, health and education in the Republic of Croatia

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