



**ANNUAL REPORT
OF THE CROATIAN BANK FOR RECONSTRUCTION AND
DEVELOPMENT GROUP
FOR 2019**

Zagreb, March 2020

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

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STATEMENT OF PERSONS RESPONSIBLE FOR THE PREPARATION OF THE ANNUAL REPORT

To the best of our knowledge the 2019 Annual Report contains a truthful development of events and business results as well as the position of the Croatian Bank for Reconstruction and Development and the Group and the description of the most significant risks and contingencies the Croatian Bank for Reconstruction and Development and the Group are exposed to.

President of the Management Board

Tamara Perko, MSc



Member of the Management Board

Hrvoje Čuvalo, MSc

Zagreb, 23 March 2020

MANAGEMENT REPORT FOR 2019

The Annual Report includes the summary of financial information, description of operations and audited Annual Financial Statements with the Independent auditor's report for the year ended 31 December 2019. Audited Financial Statements are shown for the Croatian Bank for Reconstruction and Development Group and the Croatian Bank for Reconstruction and Development.

Legal status

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

Establishment

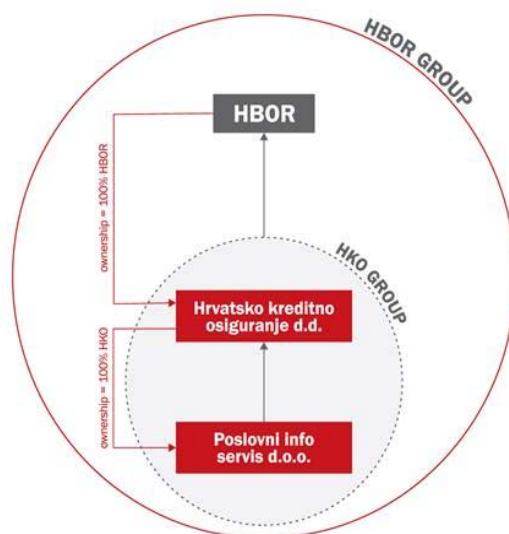
Croatian Bank for Reconstruction and Development was established on 12 June 1992 by the Act on Hrvatska kreditna banka za obnovu (HKBO). The Bank was renamed Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development) by changes and amendments to the above Act in December 1995.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

HBOR Group

Croatian Bank for Reconstruction and Development (HBOR or the Bank) is the parent company of the HBOR group that was formed in 2010. The HBOR Group consists of the parent company, Hrvatsko kreditno osiguranje d.d. (HKO) and Poslovni info servis d.o.o. (PIS).

NAME	ROLE WITHIN THE GROUP	% OF PARTICIPATION	HEADQUARTERS	BUSINESS ACTIVITIES
<u>Hrvatsko kreditno osiguranje d.d.</u>	Subsidiary company, direct equity participation	100% HBOR	Republic of Croatia	Insurance for company's foreign and domestic short-term receivables, regarding shipments of goods and services
Poslovni info servis d.o.o.	Subsidiary company, indirect equity participation	100% HKO	Republic of Croatia	Providing analysis, credit risk assessment and information on creditworthiness

Illustration of the HBOR Group structure



Strategic goals

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

Breakdown of the most significant financial information for HBOR, in HRK million

	2015	2016	2017	2018	2019
Total assets	25,540.78	27,374.92	28,055.80	27,198.93	26,446.49
Gross loans	24,722.82	26,343.12	26,332.99	26,243.12	26,571.11
Total equity	9,662.45	10,037.98	10,268.83	10,054.01	10,267.10
Total income	917.11	924.00	919.36	791.25	702.69
Total expense	(711.88)	(610.47)	(758.58)	(586.92)	(547.64)
Profit	205.23	313.53	160.78	204.33	155.05
Interest income	872.61	870.34	866.20	731.71	664.59
Interest expense	(474.53)	(452.67)	(390.46)	(356.07)	(311.56)
Net interest income	398.08	417.67	475.74	375.64	353.03

Credit rating as at 31 December 2019

Ba2 by Moody's¹

BBB- by Standard & Poor's

¹ By the expiry of the contractual relation, on 19 February 2020, the rating agency Moody's withdrew the credit rating awarded to HBOR.

Regional offices

Regional office for Dalmatia

Regional office for Istria

Regional office for Lika

Regional office for Primorje and Gorski kotar

Regional office for northwestern Croatia

Regional office for Slavonia and Baranja

Number of employees

On 31 December 2019, there were 372 employees in HBOR.

On 31 December 2019, there were 392 employees in HBOR Group.

Exchange rate

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

31 December 2019	EUR 1 = HRK 7.442580	USD 1 = HRK 6.649911
31 December 2018	EUR 1 = HRK 7.417575	USD 1 = HRK 6.469192

Subsequent events

Impact of COVID-19 on HBOR's business and implementation of proposed measures to assist the economy in the coronavirus outbreak

The emergence of COVID-19 (coronavirus) and the global spread since February 2020 have created significant immediate challenges and risks and it is undoubtedly like to affect economic activity in the Republic of Croatia, including the HBOR Group. The long-term level of impact on the Group's operations is currently difficult to quantify, but since the HBOR Group has high capitalisation and liquidity as well as the appropriate level of provisions for exposure to business continuity is beyond doubt.

In order to make the crisis caused by the epidemic in the Republic of Croatia easier to overcome, the Government of the Republic of Croatia adopted a Proposal of measures to assist the economy in the wake of the coronavirus epidemic. The aim of the measures is to preserve the level of economic activity, the liquidity of economic operators and, most importantly, to preserve the jobs. HBOR, as a development bank, will have an extremely important role and will be very active in implementing the following measures in these changed conditions:

- Introduction of moratorium on clients' loan obligations under existing placements,
- Rescheduling of existing loans to HBOR's clients with introduction of a grace period in the loan principal repayment,
- Approval of new liquidity loans to economic entities for financing salaries, overhead expenses and other basic operating expenses, the so-called idle mode (excluding loan obligations to commercial banks and other financial institutions) in cooperation with commercial banks,
- Approval of guarantees (insurance policies) to commercial banks of exporters and to HBOR under the Export Insurance Guarantee Fund with the aim of granting new loans for working capital – liquidity,
- Expanding the scope of the Export Insurance Guarantee Fund by including the tourism sector with the aim of enabling the issuance of guarantees (insurance policies) for loans to banks and to HBOR, for additional liquidity funds to exporters and tourism sector,
- Expanding the scope of the Export Insurance Guarantee Fund by further extending the circle of eligible beneficiaries of insurance policies from exports and tourism to economic entities that are indirect exporters or are suppliers of direct exporters.

STATEMENT ON THE CODE OF CORPORATE GOVERNANCE APPLICATION

Croatian Bank for Reconstruction and Development (HBOR)

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

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

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

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

The Code of Corporate Governance establishes the standards of corporate governance and the transparency and upgrading of HBOR's operations for effective and responsible management of public capital, as well as the activities of special social significance for the development of the Croatian economy. In order to achieve the standard of corporate governance, HBOR's Code describes the relationships with governing bodies and stakeholders, as well as the adopted business principles aimed at mitigating the risks of operating in adverse market conditions.

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

On its session held on 17 October 2019, the Government of the Republic of Croatia made the Decision on the Obligation to Introduce the Function of Monitoring the Compliance of Business Operations in Legal Entities Majority-Owned by the State (hereinafter: the Decision).

The stated Decision was made based on activity 1.3.1.3. of the National Reform Programme for 2019 and is in line with the OECD Guidelines as generally recognised standards of good corporate governance and the Anti-Corruption Programme for Companies Predominantly Owned by the State 2019-2020 („Narodne novine“, the Official Gazette of the Republic of Croatia No. 48/19). HBOR introduced the compliance function in accordance with the regulations governing the work of credit institutions in 2009, and the existing organisation and description of the compliance function is fully complied with the Decision.

In accordance with the principles of public business, in the reporting period, the financial statements of the Bank and the Group were published on the websites of HBOR and 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. The assessment of HBOR's rating was implemented by international independent rating agencies (Standard & Poor's, Moody's). Pursuant to the Freedom of Information Act, HBOR submits a report on the implementation of this act to the Public Relations Commissioner.

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

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

In 2019, the members of the Supervisory Board were as follows:

- Zdravko Marić, DSc, Minister of Finance, President of the Supervisory Board (Deputy Prime Minister of the Republic of Croatia since 24 July 2019),
- Darko Horvat, Minister of the Economy, Entrepreneurship and Trade, Vice President of the Supervisory Board,
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning,
- Gabrijela Žalac, Minister of Regional Development and EU Funds (until 24 July 2019),
- Marko Pavić, MSc, Minister of Regional Development and EU Funds (since 24 July 2019),
- Gari Cappelli, Minister of Tourism,
- Tomislav Tolušić, Deputy Prime Minister of the Republic of Croatia and Minister of Agriculture (until 24 July 2019),
- Marija Vučković, MSc, Minister of Agriculture (since 24 July 2019),
- Luka Burilović, President of the Croatian Chamber of the Economy,
- Božica Makar, Member of the Croatian Parliament,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament,
- Boris Lalovac, MSc, Member of the Croatian Parliament (until 23 March 2019),
- Saša Đujić, Member of the Croatian Parliament (since 23 March 2019).

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

Members of the Management Board of HBOR in 2019:

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

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

Members of the **Audit Committee** of HBOR are:

- Prof.DSc. Lajoš Žager, Full Professor, Department of Accounting, Faculty of Economics and Business of the University of Zagreb, Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, Vice Chairman of the Audit Committee,
- Aurora Volarević, Auditor General in Infobip Ltd, member of the Audit Committee.

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

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

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

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

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

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

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

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

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

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

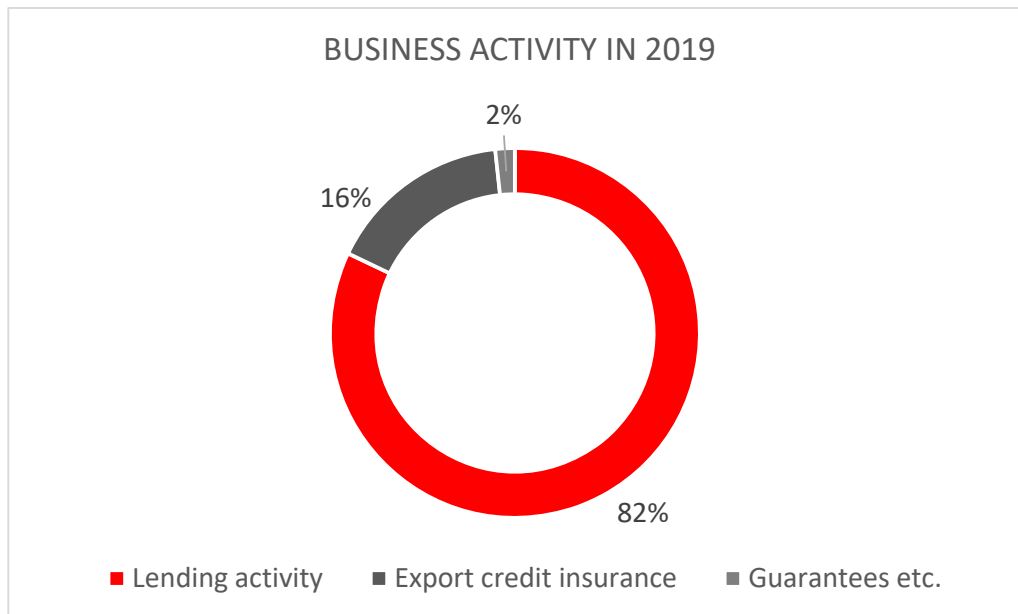
This Statement is considered to be part of the Annual Report of the HBOR Group for the period 1 January to 31 December 2019.

DESCRIPTION OF OPERATIONS OF HBOR GROUP IN 2019

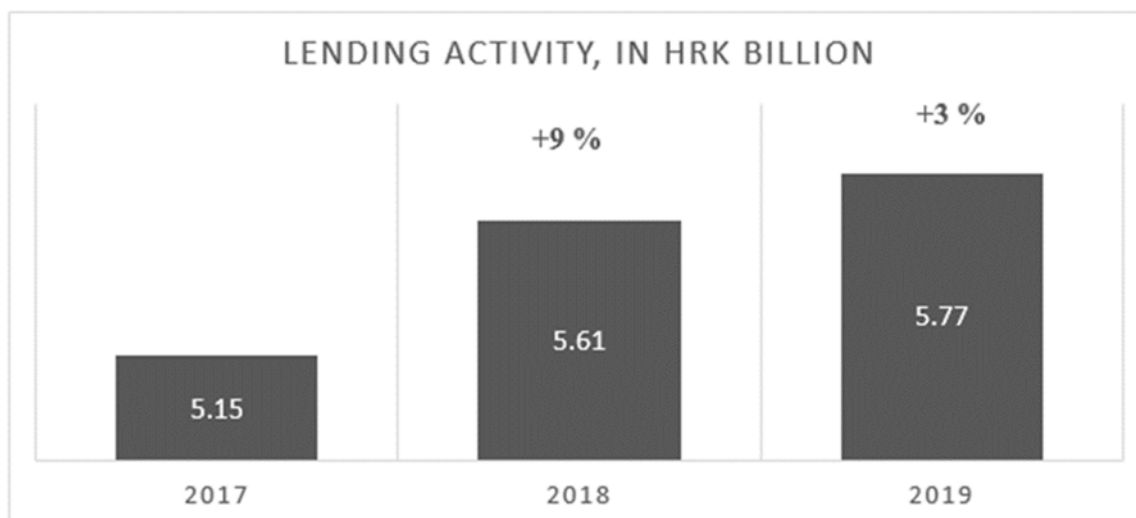
OPERATIONS OF CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

2019 was another successful year for HBOR, in which it was made possible for private sector and public sector to use new financial products, interest rates were reduced for individual groups of borrowers and purposes, and improvements were implemented that had been prepared in previous years.

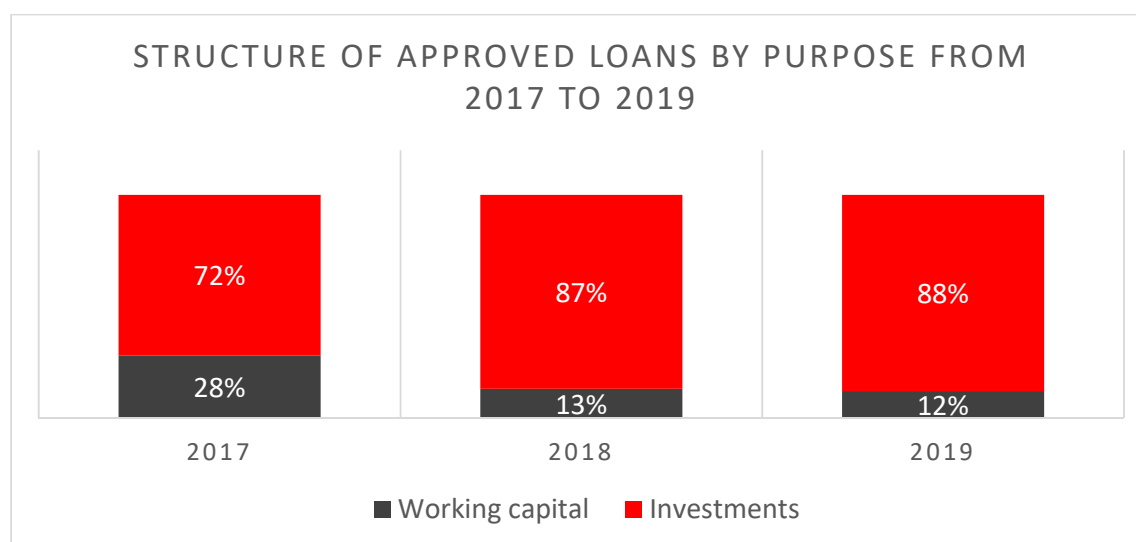
In 2019, HBOR supported 2,413 projects through with the total amount exceeding HRK 7 billion.



The major part of approvals related to lending activity: in the reporting year, 1,848 projects were supported with an amount of HRK 5.77 billion, i.e. an increase of 3 percent in comparison with the previous year.

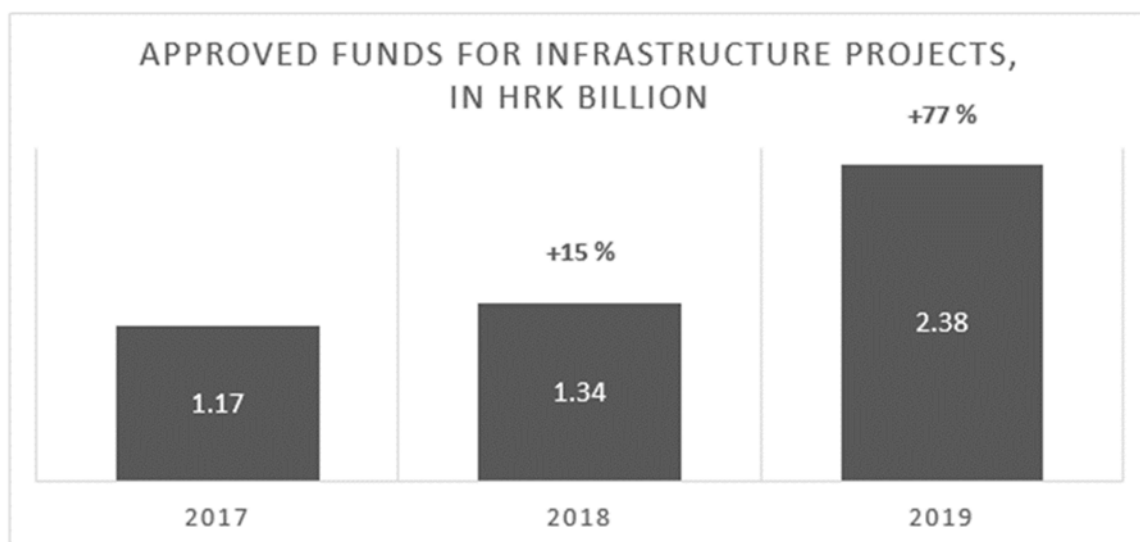


Of the total number of loans approved in 2019, 88 percent were intended for investments, and 12 percent for working capital. The share of approved investments for loans is important, because such investments are focused on the development of a particular area, increase in entrepreneurs' competitiveness, investments in new technologies and production, as well as new employment.



Most of HBOR's borrowers in 2019 were small and medium-sized companies, to which 1,640 loans were approved, i.e. 89 percent of the total number of approved loans in the amount of HRK 1.44 billion.

In 2019, the interest of investors in HBOR's funds for infrastructure projects rose significantly. In 2019, the amount of HRK 2.38 billion was approved via HBOR loans and financial instruments for investments in infrastructure, which is almost 80 percent higher amount than the one approved for the same purpose in 2018. Investments in infrastructure are extremely important, because they are a precondition for better development of individual areas, investments in entrepreneurial activities and creation of new jobs. Environmental protection and energy efficiency projects also represent a significant share in investments.



In 2019, Croatian exporters were backed by HBOR in 839 projects with the total amount of HRK 2.75 billion: under all loan programmes, exporters were approved 292 loans totalling HRK 1.56 billion kuna, through export credit insurance policies 536 export transactions were insured totalling HRK 1.14 billion and 11 bank guarantees at the request of exporters in the total amount of HRK 48.74 million were issued. Further facilitating of financing conditions for Croatian exporters was one of the key focuses in the development of new financial products and programmes.

NEW PROGRAMMES AND FINANCIAL PRODUCTS

In accordance with its role, during 2019, HBOR continued to implement financial instruments and introduced a number of new programmes and financial products to address market failures and more adequate financing for entrepreneurs.

SIMPLIFICATION OF LOAN PROGRAMMES – REDUCTION OF THEIR NUMBER BY RETAINING ALL BENEFITS AND INTRODUCING THE NEW ONES

In order to additionally facilitate access to finance for Croatian entrepreneurs, from 1 May 2019, HBOR condensed its former 25 loan programmes into 9 loan programmes: Youth, Female and Start-Up Entrepreneurship, Pre-Export Finance, Private Sector Investment, Public Sector Investment, EU Projects, Working Capital, Buyer Credit, Supplier Credit and Financial Restructuring. This change made it easier for entrepreneurs to select the most adequate of HBOR's programmes for financing their projects or necessary working capital. When reducing the number of loan programmes, special care was taken not to impede loan terms and conditions for any of the existing groups of entrepreneurs, and for some groups, more favourable terms and conditions were introduced in terms of reduced interest rates.

INTEREST RATES AND FEES REDUCTION

By reducing the number of loan programmes, interest rates and fees were reduced for a large number of entrepreneurs and beneficiaries from the public sector:

- for market-competitive entrepreneurs engaged in activities of special interest: agriculture and fisheries, processing industry or computer programming, an interest rate of 1.5 percent was introduced (previous interest rate from 2 to 4 percent),
- under the Pre-Export Finance loan programme, the interest rate, which depends on the credit rating of entrepreneur and collateralisation, can be as low as 1.75 percent instead of the previous rate of 2 or 3 percent, respectively,
- interest rate charged on working capital loans was reduced from 4 percent to 3.5 percent for long-term loans and 2 percent for short-term loans,
- the public sector can borrow funds for investment finance at interest rates of 1.75 percent or 2 percent, depending on the area of investment without a commitment fee charged,
- the temporary measure of reducing the commitment fee to 0.5% became a permanent one, and interest rate for small and medium companies as well as mid-cap companies employing or training young people (Youth Employment Initiative of the European Investment Bank (EIB)) was reduced by 0.20 percentage points.

Co-operation with counties and cities – interest rate subsidy

In addition to HBOR programmes, as a result of cooperation with individual counties and cities, entrepreneurs investing in certain areas can count on subsidised interest rates on HBOR loans from county or city funds. Thus, in 2019, entrepreneurs investing in the area of Osijek-Baranja County and the City of Prelog were granted interest-free loans, while entrepreneurs in the Istria County were provided an interest rate of one percent.

During 2020 (until March), subsidised lending has been provided to entrepreneurs investing in the area of Virovitica-Podravina County, Zagreb County and Koprivnica-Križevci County, and negotiations on cooperation with several counties, cities and municipalities have been continued.

FINANCIAL INSTRUMENTS

During 2019, HBOR implemented four financial instruments.

Intended for private sector:

- **ESIF Growth and Expansion Loans** – provides favourable funds for long-term investment loans to micro, small and medium-sized enterprises. Loans are granted in such a way that 50 percent of loan (from ESIF source) is financed at an interest rate of 0 percent, and the other 50 percent of loans (from commercial bank's source) at the market interest rate determined by the commercial bank.
- **Investment Loans for Rural Development** – intended for micro, small and medium entrepreneurs from agricultural, processing and forestry sectors. Loans are granted via commercial banks in the manner that 50 percent of the loan is financed at an interest rate of 0 percent, and 50 percent of the loan from commercial banks' sources, at the market interest rate determined by the commercial bank. The financial instrument has been available to potential beneficiaries since September 2019.

Intended for public sector:

- **ESIF Loans for Energy Efficiency in Public Sector Buildings** – enables very favourable financing of investments in energy efficiency and promoting the use of renewable energy sources in public sector buildings in order to achieve energy savings that will result in decreased consumption of energy for heating/cooling at year level of at least 50 percent. Due to the exceptionally successful implementation of this financial instrument and the utilised allocation originally granted in the amount of HRK 190 million, HBOR and the Ministry of Regional Development and the EU Funds signed an addendum to the Financing Agreement, by which the initial allocation was increased to HRK 402.80 million.
- **ESIF Loans for Public Lighting** – implemented for the purpose of financing investments in energy efficiency of public lighting system through the implementation of energy renovation of the existing systems. Investments resulting in energy savings of at least 50 percent in comparison with the existing situation are eligible for financing.

During 2019, 108 projects were supported through financial instruments, amounting to almost HRK 300 million.

During 2019, arrangements for the implementation of **ESIF Loans for Energy Efficiency for Entrepreneurs** were completed. The aim of this financial instrument is to support the reduction in energy consumption in the manufacturing industry and in the service sector through the implementation of measures of energy efficiency and/or measures for the use of renewable energy sources. This financial instrument is intended for micro, small, medium and large entrepreneurs engaged in activities in the manufacturing and service sectors (trade and tourism). The loans will be available in the market in the second quarter of 2020, and will be implemented through commercial banks, with which HBOR will sign financing agreements and authorise them for the implementation of this financial instrument.

ELENA PROGRAMME

In order to optimise the preparation of projects and to reduce costs for investors, in October 2019 HBOR and the European Investment Bank signed a contract on the implementation of ELENA programme (*European Local Energy Assistance*). This is a European Commission programme implemented by the European Investment Bank, funded by the HORIZON 2020 programme. By the proceeds of ELENA programme, advisory services and the preparation of project documentation can be financed for the beneficiaries of: financial instruments (*ESIF Loans for Public Lighting, ESIF Loans for Energy Efficiency in Public Sector Buildings, ESIF Loans for Energy Efficiency for Entrepreneurs*), HBOR loan programmes, for beneficiaries that finance their projects with their own funds or with other sources of funding. The consultants whose services will be paid from the ELENA programme funds will be selected through a public procurement procedure. It is expected that these funds will be available to entrepreneurs in the first half of 2020.

DEVELOPMENT OF VENTURE CAPITAL AND PRIVATE EQUITY MARKET

The venture capital and private equity market in Croatia is poorly developed. The financial market of the Republic of Croatia is dominated by traditional sources of finance. Although in the past few years, financial conditions of the traditional sources of finance have improved significantly (significant decrease in interest rates), their availability still depends largely on available collateral.

A number of analysis show that Croatian micro, small, medium and mid-cap companies, particularly the innovative ones and those with a higher degree of risk (start-ups, fast-growing companies or companies in propulsive ICT industries) or those operating in sectors with lower rates of return, are faced with the challenge of finding adequate sources of finance.

Some analyses indicate that a market failure of more than EUR 120 million has been identified per year for the next five years, that would be required for investment in equity or quasi-equity capital. Therefore, HBOR has launched a number of initiatives for the development of this market in order to provide adequate sources for the growth of entrepreneurial activities.

FRC2 Croatia Partners SCSp (ESIF Venture Capital Fund)

FRC2 Croatia Partners SCSp is a venture capital fund financed partially from the proceeds of ESIF Financial instruments through cooperation with the European Investment Fund (hereinafter: the EIF), and partially from the proceeds of private investors.

By the Financing Agreement signed between the Ministry of Regional Development and EU Funds (hereinafter: the Ministry) and the EIF, the Ministry delegated to the EIF the implementation of the financial instrument called „ESIF Venture Capital Fund“ as well as the selection and supervision of work of the „ESIF Venture Capital Fund“ manager. Pursuant to the Agreement, the representatives of HBOR were appointed observers of the entire process for the purpose of gaining knowledge and competences in the implementation of financial instruments.

The company FRC2 GP S.à r.l. has been selected by the EIF as the fund management company.

After having conducted internal analyses and approvals, in June 2019, HBOR became one of the investors in the fund, but it does not participate in the selection of business entities of the company in which the fund will invest.

The Fund consists of two components:

- acceleration component intended to innovative start-ups that have only business ideas (Start-up school) or prototype (Accelerator) and
- venture capital component intended to companies that already operate, have initial buyers and that have already passed the initial phase of development.

The Fund invests in companies in the Republic of Croatia in the earliest stages of development that have necessary innovation and desire to succeed.

From its establishment in June 2019 until the end of 2019, the fund reviewed more than 700 investment opportunities, the first accelerator programme has been completed and an amount of almost EUR 6.5 million has been put in 33 investments.

EIF-NPI Equity platform

The European Commission, in co-operation with EIF and national promotional institutions (NPI) launched the NPI equity platform for the purpose of developing the market of investments in private equity funds. As one of the founding institutions, in September 2016, HBOR joined the creation of this platform and has been participating in the work of two platform bodies since then – the General Forum and Consultative Forum, the work of which is focused on exchange of experience and knowledge aimed at strengthening the private equity industry.

CROGIP

Within the framework of the EIF-NPI Equity Platform, in January 2019, the EIF and HBOR signed the agreement, by which the Croatian Growth Investment Programme (hereinafter: CROGIP) was launched. CROGIP is an initiative that will stimulate capital investments in small and medium-sized companies as well as mid-cap companies in the total amount of at least EUR 70 million.

The EIF and HBOR will jointly invest (each committing EUR 35 million) into:

- private equity funds to be managed by companies selected by the EIF pursuant to its methodologies, and
- co-investments with funds that already have an established cooperation with the EIF and positive references.

In addition to the overall objective of providing support to Croatian companies and creating of new jobs through ensuring the availability of private equity/venture capital, the aim of CROGIP is to develop the market and institutional capacities for the financing through private equity /venture capital in the Republic of Croatia by supporting fund management companies that direct a significant portion of their investments to Croatian companies.

EIF will manage and deploy the CROGIP programme through fund investments and co-investments with funds and private investors at market conditions. The programme is not restricted to any particular sector.

EIF will enable investments in funds and co-investments to selected fund management companies with positive references in accordance with the criteria defined by HBOR in advance through CROGIP. In addition to the EIF's selection criteria, the funds must meet the following criterion in their investment strategy: at least 70 percent of total investments of a fund will be invested in companies that are established in Croatia and perform the majority of their business operations in Croatia and/or companies that will start their long-term operations in Croatia and employ a significant number of workers from Croatia.

HBOR does not participate in the selection of funds and opportunities for co-investments and as the EIF's local partner, it is available to provide local support to management companies wishing to increase their presence in the Republic of Croatia.

As part of activities under CROGIP, with a view to market development and strengthening of capacities, in March 2019, the EIF issued a Call for Expression of Interest for the selection of management companies eligible for CROGIP funds. The process of selecting fund management companies started in 2019 and is planned to be completed in the first half of 2020.

OTHER ACTIVITIES

Lending to private renters

In 2019, the Agreement on Business Cooperation on the Implementation of Lending to Private Renters was signed. The participants in the implementation of this Agreement are the Ministry of Tourism, commercial banks and HBOR.

The aim of this programme is to equalise standards of accommodation facilities in which hospitality services are provided in households, to raise the quality level and offer additional private accommodation. Financing is based on HBOR loan funds, whereas the Ministry provides the funds for subsidising a portion of the agreed regular interest rate, which is 2 or 2.7 percent, depending on the currency in which the loan is applied for.

Cooperation with HAMAG-BICRO

In 2019, business cooperation with HAMAG-BICRO was extended by the inclusion of HBOR in two new guarantee programmes:

- ESIF individual guarantees for rural development, which, in accordance with the terms and conditions of the Rural Development Programme of the Republic of Croatia 2014 - 2020, aims to facilitate access to finance for micro, small and medium-sized enterprises in the agricultural, processing and forestry industries,
- Programme Plus (Program Plus), which aims to facilitate access to finance for micro, small and medium-sized companies investing in eligible branches of industry.

Natural Capital Financing Facility (NCF)

HBOR and the European Investment Bank signed the Finance Contract providing for the disbursement of up to EUR 15 million for the financing of projects under the Natural Capital Financing Facility - NCF. NCF is a financial instrument for the financing of sustainable projects promoting conservation, restoration, management and enhancement of natural capital for biodiversity and the benefits of climate change adaptation, including ecosystem-based solutions to the challenges of land, soil, forestry, agriculture, water and waste within the EU. Potential investors and beneficiaries of this instrument are public (counties, cities, municipalities and public undertakings) and private sector entities. In addition to funding, HBOR and final beneficiaries are provided with free technical assistance of the European Union for the preparation, implementation, supervision and evaluation of NCF projects.

The Natural Capital Financing Facility will be fully available in 2020, when the necessary preparation activities have been completed.

EXPORT CREDIT INSURANCE IN 2019

HBOR performs export credit insurance and reinsurance activities as mandate activities with an objective of encouraging exports, promoting internationalisation of operations and increasing competitiveness of Croatian exporters in foreign markets.

In 2019, HBOR was extremely active as a member of the Berne Union – the leading global association of export credit insurers that has 85 members from 73 countries worldwide. HBOR has been a member of the Management Committee of the Berne Union in the past three years, and HBOR's representative was appointed Vice-Chair of the Prague Club Committee in October 2019, which enabled HBOR to become even more active as a member of the Berne Union and to gather knowledge and exchange experience in the field of export credit insurance.

In 2019, HBOR actively joined the EU Council's Export Credits Group presiding team and started preparations for the chairing of the Group together with the Ministry of Finance set to start on 1 January 2020 under the Croatian presidency of the Council of the European Union.

The task of the EU Council's Export Credits Group is to coordinate export promotion activities of the EU Member States under the Common Commercial Policy. As a national export-credit agency, HBOR joined the activities of the Group in 2013, however, in 2019, HBOR's representatives participated very actively in both the preparations and the activities of the Group in cooperation with the Secretariat of the Council of the EU and the Finland's Presidency Team as part of the preparations for the Croatia Presidency of the Council of the European Union.

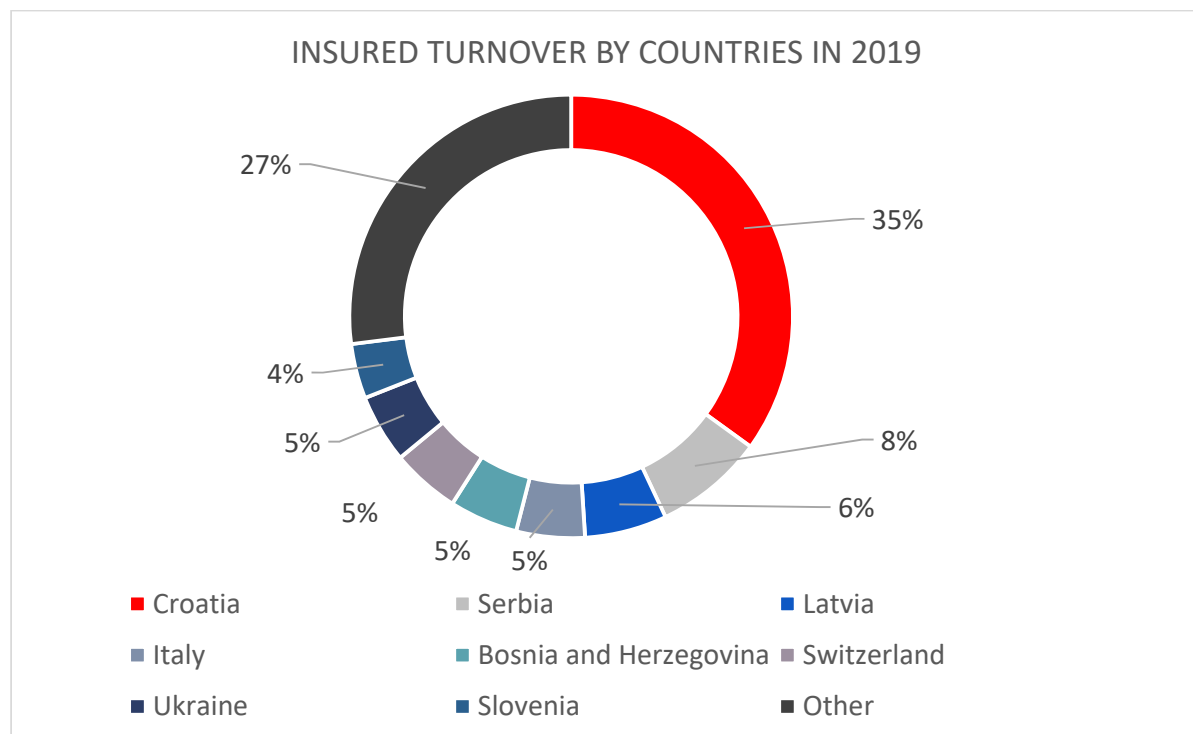
During the presidency of the Export Credits Group, the role of HBOR will include, in addition to the organisation and presiding over the meetings at Brussels, also the presiding over EU coordination meetings on negotiations at the level of OECD about officially supported export credits and on negotiations at the level of the International Working Group on Export Credits.

Summary of results by export credit insurance transactions, in HRK million

Description	2017	2018	2019
Total approved sum insured	1,002.32	1,787.58	669.07
Total insured export turnover	1,727.86	2,692.00	1,141.20
Gross exposure as at 31 December	2,128.97	2,959.73	1,662.67
Insurance premium collected	14.18	17.48	16.41
Indemnities paid	30.04	0.21	138.67
Recourse collections from debtors	0.04	40.66	32.04
Guarantee Fund balance as at 31 December	327.95	387.74	301.97

TOTAL EXPORT TURNOVER INSURED

In 2019, through its export credit insurance programmes, HBOR supported exports of Croatian goods and services to 48 countries worldwide and insured export transactions in the total amount of HRK 1.14 billion. The decreased volume of insured turnover in 2019 is a result of the absence of major capital projects in the shipbuilding industry as well as of the increase in the supply in the private insurance and reinsurance market, which was mostly reflected in the decrease in the reinsurance of export turnover.



GROSS EXPOSURE

As at 31 December 2019, gross exposure of HBOR under the export credit insurance activities stood at HRK 1.66 billion, a decrease of 44% on the same date in 2018. This decrease is the consequence of the expiry of insurance policies and the decrease in the volume of new export transactions insured in 2019.

INSURANCE OF SHORT-TERM EXPORT RECEIVABLES

Under the programme for the insurance of short-term export receivables, HBOR provides cover against non-marketable and temporary non-marketable risks for short-term receivables of exporters for which deferral of payment of up to 2 years has been agreed.

Through the programme for the insurance of short-term export receivables, in 2019, HBOR insured the turnover of HRK 367.36 million. The majority of insured transactions related to the cover provided for exporters involved in the production of freight wagons, wood products, pharmaceutical products, air-conditioning chambers, welding electrodes and wires. The largest volume of insured export turnover was realised for buyers in Switzerland, Ukraine, Italy, Germany, France and the Netherlands.

INSURANCE OF SHORT-TERM EXPORT RECEIVABLES FOR SMALL EXPORTERS

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

In 2019, for this category of exporters, the approved volume of insurance totalled HRK 2.08 million. The majority of transactions insured related to the export of goods and services in the processing industry and to the export of agricultural and food products.

The largest volume of insured export turnover was realised for buyers in Slovenia, Italy, the United States of America, Switzerland and Bosnia and Herzegovina.

REINSURANCE OF SHORT-TERM EXPORT RECEIVABLES

The programme for the reinsurance of short-term export receivables is intended for insurance companies operating in the market of the Republic of Croatia that provide cover for export receivables of Croatian exporters.

Under the programme for the reinsurance of short-term export receivables, in 2019, HBOR reinsured the export turnover in the amount of HRK 194.29 million. The majority of transactions covered the export of goods and services in the processing industry, most of which related to the export of glass packaging products, heating and cooling products, pharmaceutical products and sanitary equipment. The largest volume of reinsured export turnover was realised for buyers in Serbia, Bosnia and Herzegovina, Macedonia, Montenegro and Kosovo.

INSURANCE OF DIRECT DELIVERIES OF GOODS AND SERVICES/SUPPLIER CREDITS

Under the programme for the insurance of direct deliveries of goods and services, that provides cover primarily for the export of capital equipment and related services with longer payment collection deadlines, the volume of insured export turnover equalled HRK 131 million in 2019, an increase of 389% on 2018.

The growth of insurance volume under this programme is the result of increased sales activities and growing awareness in the market of the payment collection insurance for medium to long-term export projects.

The volume of insured transactions under the programme included the export of telecommunications equipment and services to the markets of Cuba and Belarus, the export of transformers to the markets of Hungary and Spain, the export of ship parts to Italy and the export of trams to Latvia.

INSURANCE OF PRE-EXPORT FINANCE LOANS

The programme for the insurance of pre-export finance loans providing cover for banks enables the financing of working capital for exporters at the stage of export goods production and facilitates access to loans for exporters who would otherwise not be able to obtain loans due to insufficient collateral.

In 2019, through the programme for the insurance of pre-export finance loans, the volume of cover provided to banks amounted to HRK 397.24 million.

Under this programme, support was provided to exporters in the following industries: shipbuilding, metal structures, fisheries, IT, freight wagons and welding electrodes and wires.

INSURANCE OF EXPORT PERFORMANCE-RELATED GUARANTEES

In 2019, the volume of insurance granted by HBOR under this programme totalled HRK 49.23 million.

The largest share in the guarantees insured under this programme related to the guarantees issued for power transmission line construction projects in Norway, for the production of a high-pressure steam boiler for a customer from Slovenia, for the production and installation of transformer stations in Ukraine and for the transfer of licensed technology (safety signal systems) for railways in India.

INDEMNITIES PAID

In 2019, eight indemnities were paid in the total amount of HRK 138.67 million. Of the said eight indemnities, six were paid under the programme for the insurance of pre-export finance loans, one was paid under the programme for the insurance of export performance-related guarantees, and one was paid under the programme for the insurance of short-term receivables.

In 2019, the amount of HRK 274 thousand was paid to the insured as compensation for costs incurred for the purpose of reducing possible damage or for the purpose of enforced collection.

Also, in 2019, 16 debtor non-payment notifications were received, mostly relating to the programme for the insurance of pre-export finance loans (debtors from Croatia).

RECOURSE COLLECTIONS FROM DEBTORS

In 2019, HBOR succeeded in collecting a significant amount of recoveries under previously paid indemnities equalling HRK 32.04 million. Almost 94 percent of the stated amount of recourse collections in 2019 relates to a recovery from a public debtor from Bosnia and Herzegovina, whereas the remaining amount relates to a recovery from a debtor from Croatia (under the programme for the insurance of pre-export finance loans) and to recoveries from debtors from Italy and Russia (under the short-term insurance programmes).

NEW PROGRAMME – INSURANCE OF WORKING CAPITAL LOAN PORTFOLIO FOR EXPORTERS

As part of export credit insurance and reinsurance activities in 2019, in cooperation with commercial banks, HBOR developed and launched a programme for the insurance of working capital loan portfolio for exporters. The programme is implemented in cooperation with commercial banks as insured parties with the purpose of facilitating access to working capital finance for small and medium-sized enterprises. Under this programme, commercial banks as insured persons decide on their own, in accordance with the in advance agreed eligibility criteria and insurance costs, on the loans to be included in the loan portfolio, for which HBOR provides 80% coverage of principal and regular interest, thus assuming a large share of the loan repayment risk.

The insured portfolio under this programme may include working capital loans of up to HRK 1 million approved to entrepreneurs who have fewer than 250 employees, who have generated an annual operating income of up to HRK 50 million in the last business year and who have concluded export contracts in the amount of loans at the moment of disbursement of loans.

The new programme is a continuation of endeavours aimed at encouraging entrepreneurs to export and to enter foreign markets. In this way, HBOR has become one of the few export credit agencies in the world that develop special products for smaller enterprises also in the form of portfolio insurance.

2020-2024 BUSINESS STRATEGY

In order to fulfil its development role and respond to new market challenges as adequately as possible, HBOR began to implement the project of developing its medium-term business and development strategy in the last quarter of 2018.

Funds for the implementation of this significant project have been provided under the EU Structural Reform Support Programme (SRSP) of the European Commission. The European Commission selected PricewaterhouseCoopers (PwC) as a consultant, with whom HBOR actively cooperated on the preparation of the strategy in 2019.

The analysis of existing internal and external conditions of HBOR's operations, including good business practices of other EU promotional banks, was the basis for the development of the strategy.

In accordance with the performed analyses and the consultant's recommendations, HBOR's 2020 – 2024 Business Strategy defines HBOR as a driver of innovation and sustainable growth of the Croatian economy. Taking into account the continuous changes in the domestic and international business environments as well as the current and future needs of the public and private sectors, HBOR's mission will be to provide proactive support for the development of Croatia. Strategic guidelines for HBOR's operations in the coming five-year period will focus on:

- Promotion of development of equity and quasi-equity market in the Republic of Croatia,
- Promotion of balanced and sustainable economic and social regional, rural and urban development of the Republic of Croatia,
- Promotion of internationalisation and globalisation of the Croatian economy,
- Promotion of competitiveness by emphasizing innovation, digital transformation and Industry 4.0,
- Promotion of climate and energy neutral economy through energy efficiency, renewable energy and environmental protection.

Special focus is on supporting small and medium-sized enterprises and underdeveloped areas by providing access to national sources of finance and in particular to the available EU funds.

The strategic goals will be attained through HBOR's flexible and sustainable operations and proactive business approach. The Strategy will enable HBOR to respond to the requirements of the Croatian economy, to the changes in the financial market and in the macroeconomic environment in a faster and a more effective manner by offering suitable products and services to the Croatian economy.

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, HBOR continuously identifies, assesses, measures, monitors, contains and controls risks it is or may be exposed to in its operations and reports thereupon to the relevant bodies. These procedures and adequate internal documents are the basis for a comprehensive and complete risk management system. The most significant risks HBOR is exposed to in its everyday operations are credit risk, liquidity risk, interest risk in the Bank's book, currency risk, operational risk and outsourcing risk. These risks are managed in day-to-day operations through policies, ordinances, procedures, methodologies, limits, controls and decisions/conclusions of the Supervisory Board, the Management Board and the Risk Management Committee.

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

When assessing and measuring risks, HBOR takes into account historical data, business plans, current and expected market conditions and specific features of the Bank as a special financial institution. The results of measurements/assessments, of analyses and stress tests are reported to the Risk Management Committees, the Management Board and the Supervisory Board. A system of limits has been established for the purpose of monitoring and controlling credit risk, liquidity risk, interest rate risk in the banking book and currency risk. Reports are systematically submitted to relevant bodies on: credit portfolio quality, high exposure and maximum permitted exposure, regulatory capital adequacy, collection of receivables and risky placements, changes in commercial banks' internal ratings and actions taken in the event of their deterioration, liquidity status ratios and liquidity projections, open foreign currency positions, potential losses by significant currencies, interest gap, projections of average weighted interest rates on sources and placements of financial institutions, etc. The dynamics of reporting and the methodologies for measuring and assessing risks have been prescribed by the internal documents of the Bank.

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

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

- Asset and Liability Management Committee – manages liquidity risk, interest rate risk in the banking book and currency risk through the prescribed ordinances and procedures that regulate this area

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

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

Credit risk

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

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

The Credit Risk Management Ordinance represents a comprehensive document comprised of separate methodologies aiming to evaluate various client target groups.

In order to mitigate credit risk and reduce operating costs, the Bank, in accordance with the HBOR Act, on-lends part of its placements via financial institutions that assume the risk of collecting repayments from final borrowers. For the purpose of facilitating access to HBOR's funds, the Bank on-lends part of its placements in cooperation with commercial banks through risk-sharing models.

Generally, all direct placements and placements through the risk-sharing models are secured by mortgages on immovable property, and, if possible, the Bank requires guarantees issued by HAMAG BICRO and also other types of guarantees and warranties as collateral. The Bank has determined the required ratio between placement value and collateral value according to the type of collateral, the loan programme, the general terms and conditions of security and the decision of the body in charge.

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

Liquidity risk, currency risk and interest rate risk in the banking book

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

Liquidity risk

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

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

Interest rate risk in the banking book

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

Currency risk

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

For measuring the exposure to currency risk, the Bank monitors the open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the preparing of its development projections, the Bank calculates risk values and regularly reports to relevant bodies on the highest possible losses by significant currencies for the purpose of assessing and measuring currency risk. Scenario analyses and sensitivity analyses are performed both under regular business conditions and under stress.

Operational risk

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

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

Outsourcing risk

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

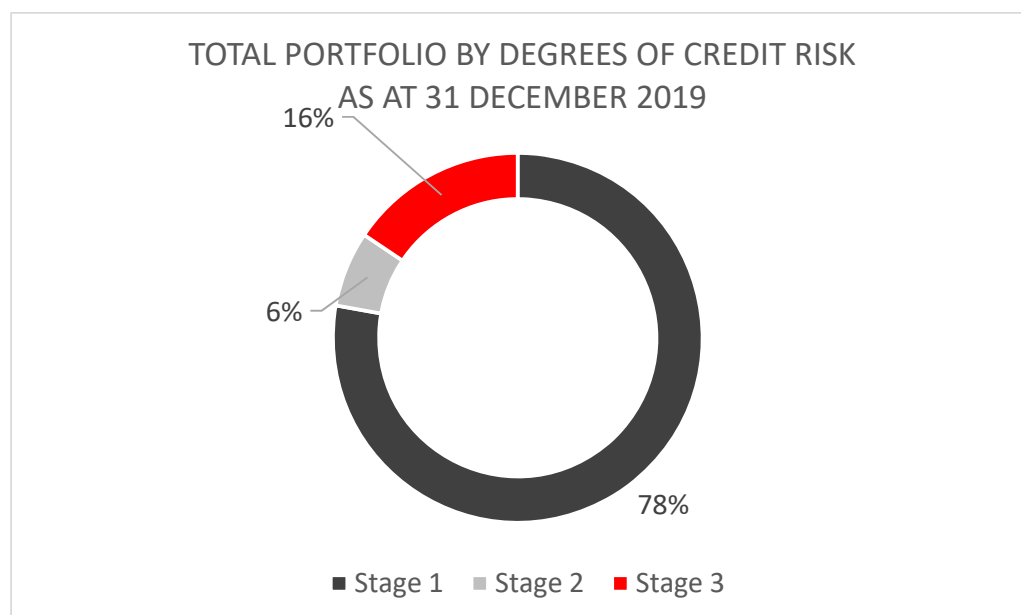
The central records of outsourced activities have been established. Reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on an annual basis.

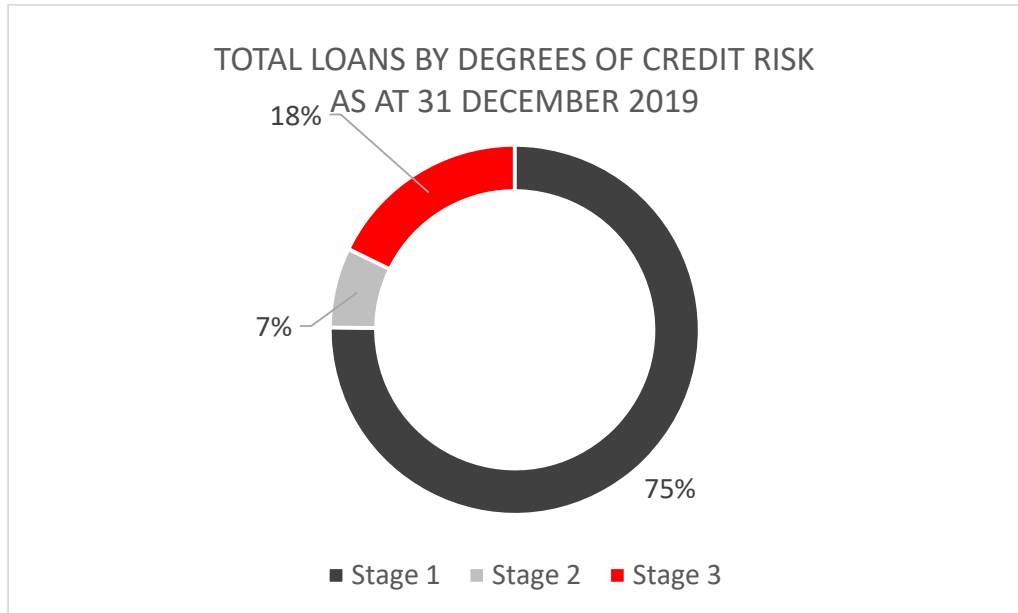
Asset quality of HBOR

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

As at 31 December 2019, HBOR's total portfolio amounted to approximately HRK 34.02 billion. Of the total portfolio, 77.8 percent was allocated to Stage 1, 6.6 percent was allocated to Stage 2 and 15.6 percent was allocated to Stage 3.

Due to the fact that gross loans account for 77.8 percent of the total portfolio, there is no significant difference in quality between total portfolio and total loans. 75.2 percent of total loans were allocated to Stage 1, 7.0 percent were allocated to Stage 2 and 17.8 percent were allocated to Stage 3.





INTERNAL AUDIT

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

COMPLIANCE MONITORING FUNCTION

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

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

HUMAN RESOURCES

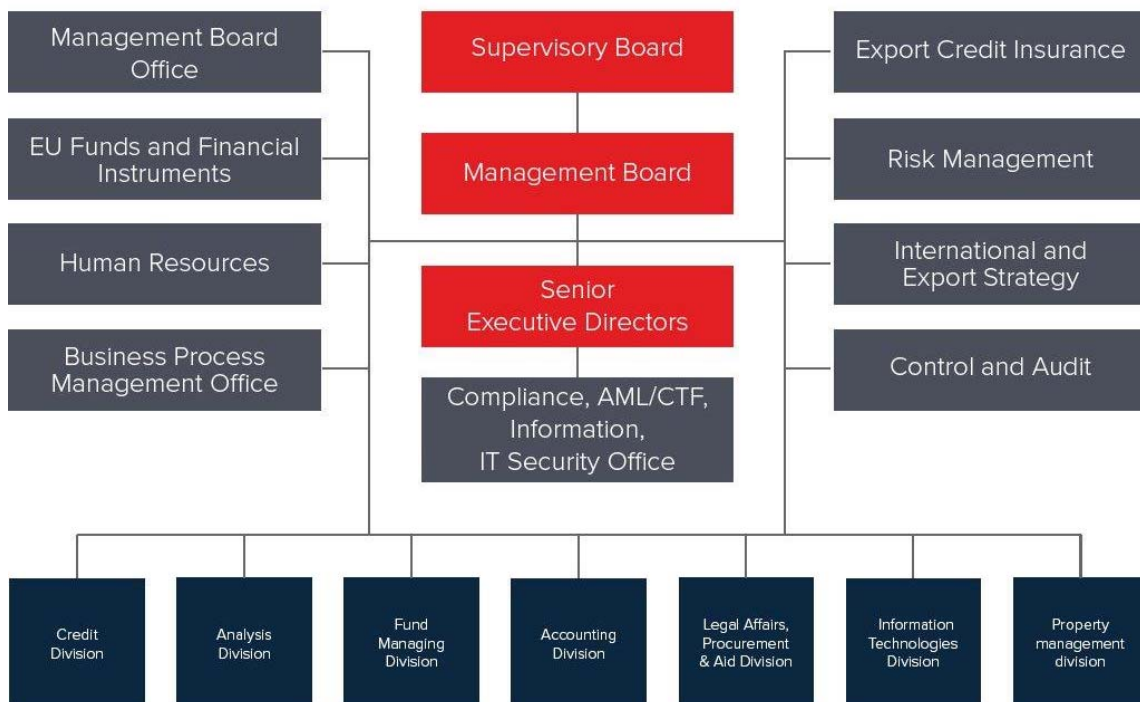
In 2019, HBOR renewed the Employer Partner Certificate that is awarded by Selectio d.o.o. for excellence in human resource management. Since 2006, when HBOR joined the project, permanent growth and development have been observed in all aspects of human resource management. In 2019, HBOR achieved 86 percent of total scores, thus retaining the high standard across all 45 human resource management processes under certification.

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

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

As at 31 December 2019, there were altogether 372 employees, of which 327, i.e. 88 percent, holding a university degree. The average age of employees was 43. The share of women in the total number of employees was 65 percent and the share of men 35 percent.

Organisational structure of HBOR as at 31 December 2019



OTHER ACTIVITIES

In June 2019, HBOR published its Social Responsibility and Sustainability Report for 2018, i.e. HBOR's tenth report on the manner of and progress in the implementation of the UN Global Compact principles in the areas of human rights, labour standards, environment and anti-corruption. The Report identified material issues and Sustainable Development Goals of relevance for HBOR and presented the measures taken by HBOR in order to implement investments that contribute to the sustainable and balanced development. In addition, the activities were documented through case studies for the first time.

Besides, in 2019, HBOR announced the public invitation called "LET US GIVE KNOWLEDGE AND ENCOURAGE INITIATIVE" earmarked for projects promoting employment, self-employment and social entrepreneurship. Grants were awarded to 15 projects totalling HRK 695,766.18. Data on all grant recipients were published on HBOR's websites.

In 2019, HBOR implemented the necessary processes to comply with the new Whistleblower Protection Act (Official Gazette of the Republic of Croatia, No. 17/19) that entered into force on 1 July 2019. To comply with the Act, HBOR amended its system for reporting irregularities, passed new internal documents in accordance with the Act and appointed a Confidential Person and a Deputy Confidential Person by 31 December 2019.

International co-operation and internationalisation

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

In 2019, HBOR hosted the meetings of the China-CEEC Inter-Bank Association. The meetings took place in Cavtat in April 2019, on the sidelines of the 16+1 summit. The Initiative for Cooperation of the China-CEEC Interbank Association in the Field of SME Development Promotion was signed by the representatives of financial institutions from Central and Eastern European Countries and the People's Republic of China.

In addition to being a member of the Administrative Board of the European Association of Public Banks (EAPB), Ms. Tamara Perko, President of HBOR's Management Board, was appointed a member of the Management Board of the European Long-Term Investors association (ELTI) in October. The above associations gather financial institutions from all over Europe, and these appointments increase the impact of smaller development banks on the activities and standpoints of the associations.

In 2019, HBOR actively participated in the meetings of the Export Credits Group of the Council of the European Union as deputy chair and in the meetings of the OECD and of the International Working

Group on Export Credits (IWG) making a considerable contribution as a member of the Croatian delegation.

Cooperation with the Croatian Exporters Association was continued, and the internationalisation of the economy was supported also by the participation in economic delegations to foreign countries and in economic fora taking place in the Republic of Croatia. In November 2019, HBOR's 18th International Conference on Export Promotion was held under the auspices of the Government of the Republic of Croatia and gathered almost 200 representatives of Croatian major exporters, foreign and domestic banks and relevant institutions.

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

Personal data protection

In 2019, HBOR conducted data mapping of personal data processes, identified risky processes and assessed the impact on the protection of data under the riskiest processes. Many changes in the manner of processing have significantly reduced the risks of processing personal data of HBOR's employees and clients. In addition, new methodologies for assessing the general risk of processing and assessing the degree of data violation have been introduced, guidelines and relevant documents have been prepared in accordance with the General Data Protection Regulation.

Function of preventing money laundering and terrorist financing

In its operations, HBOR implements the measures, actions and procedures aimed at the prevention of money laundering and terrorist financing in accordance with the provisions of the Anti-Money Laundering and Terrorist Financing Act, the regulations made on the basis of the Act and on the basis of the provisions of HBOR's Anti-Money Laundering and Terrorist Financing Ordinance and HBOR's Methodology for the Implementation of Anti-Money Laundering and Terrorist Financing Measures, Actions and Procedures.

Regional offices

In the second half of 2019, the sixth regional office was opened in Varaždin.

Thus, HBOR expanded its regional presence to cover 19 counties with regional offices in Split, Rijeka, Pula, Gospić, Osijek and Varaždin. The decision to open HBOR's regional office in Varaždin was based on recognised trends in economic growth and development in the north-western part of Croatia.

The Varaždin regional office officially started to operate on 15 October 2019. It covers the territory of five counties: Varaždin, Međimurje, Krapina-Zagorje, Koprivnica-Križevci and Bjelovar-Bilogora with a task of promoting the increase in the volume of lending to borrowers in this area through direct access to entrepreneurs (especially SMEs and exporters) and units of local and regional government.

With regard to development and economic environment, regional offices have become a recognisable part of HBOR's overall organisational structure in terms of direct and fast access to information and support for entrepreneurs.

In the performance of their activities, regional offices successfully cooperate with offices for the economy at local government units, with relevant chambers of commerce, chambers of trades and crafts, entrepreneurial centres, development agencies, employment agencies and local action groups.

Public disclosure of activities

HBOR puts a special focus on providing information to the public about its goals and about the measures for their attainment as well as about the results of its activities by simultaneously following the principle of bank secrecy and its function. Therefore, through various forms of providing information, HBOR regularly informed the public about all its important activities in 2019.

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

During the reporting period, 21 public procurement procedures were published in the Electronic Public Procurement Classifieds. Since 1 July 2017, simple procurements procedures have also been published on HBOR's websites.

In 2019, altogether 38 requests for access to information pursuant to the Act on the Right of Access to Information were received.

OPERATIONS OF HKO GROUP

HKO and PIS

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

In 2019, HKO offered the following insurance products: insurance of domestic and export receivables.

In October 2010, HKO established the company called PIS and started to operate as the HKO Group and to prepare consolidated financials. Within the HKO Group, PIS is in charge of analysing and assessing credit risks relating to insurance transactions.

As at 31 December 2019, there were 20 employees at HKO Group, of which 15 were employed with HKO and 5 with PIS. Eighteen employees have university degrees and two have secondary school education.

Ownership structure

HKO is 100% owned by HBOR.

Management

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

People authorised to represent

Management Board in 2019

Zvonimir Samodol, Chairman of the Management Board

Ružica Adamović, Member of the Management Board

Supervisory Board of HKO

In 2019, the membership of the Supervisory Board of HKO was as follows:

Tamara Perko, MSc, Chairman of the Supervisory Board, until 15 May 2019,

Vedran Jakšić, MSc, Chairman of the Supervisory Board, since 15 May 2019,
Marko Topić, Deputy Chairman of the Supervisory Board, until 15 May 2019,
Andreja Mergeduš, Deputy Chairman of the Supervisory Board, since 15 May 2019,
Ante Artuković, Member of the Supervisory Board,
Gordan Kuvsek, Member of the Supervisory Board, since 15 May 2019,
Marija Jerkić, Member of the Supervisory Board, since 15 May 2019.

PIS

Jelena Boromisa performed the function of the Manager of PIS.

Ivana Paić was the authorised representative of the Company.

HKO Audit Committee

In 2019, the membership of the Audit Committee of HKO was as follows:

Ante Artuković, Chairman of the Audit Committee,

Vedran Jakšić, MSc, Deputy Chairman of the Audit Committee,

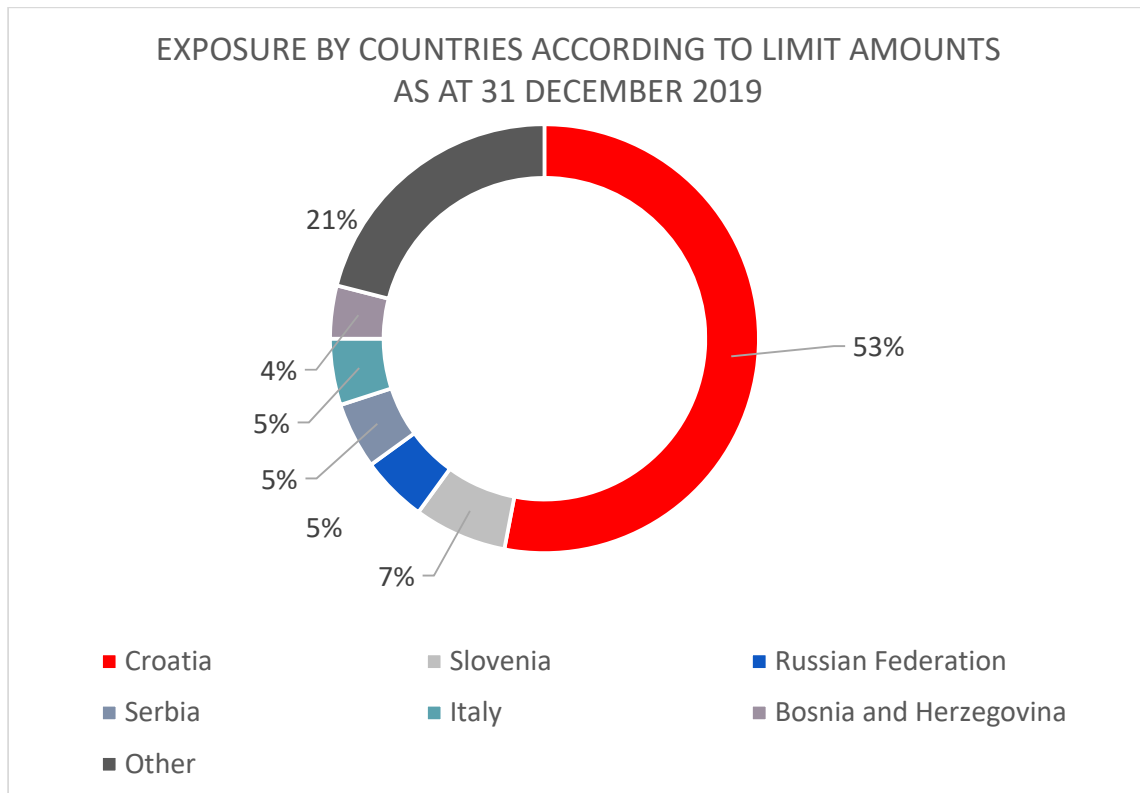
Andrea Svečnjak, Member of the Audit Committee.

Reporting to the supervisory bodies

In 2019, the Company provided regular reports to the supervisory bodies on all relevant facts and changes in the Company pursuant to the Insurance Act, the ordinances of the Croatian Financial Services Supervisory Agency and other regulations in force. The Company regularly met all requirements of the supervisory bodies in terms of control of operations and submission of the Company's data.

OPERATIONS IN 2019

As at 31 December 2019, HKO had 102 active insurance contracts in place and generated premium income under 109 insurance contracts in 2019. Altogether 5,959 credit limits were covered by the insurance, an increase of 29.12 percent on the previous year. Within the total structure of limits, 4,325 credit limits were related to domestic receivables and 1,634 credit limits were related to export receivables towards 65 countries of the world.



The total volume of insured transactions in 2019 amounted to HRK 5.58 billion, whereas in 2018 it amounted to HRK 4.17 billion, an increase of 34 percent.

In 2019, the total charged premium amounted to HRK 12.01 million, an increase of 15 percent on 2018 when it stood at HRK 10.46 million.

In the reporting period, the Company paid 25 indemnities. In 2019, the total amount of paid indemnities amounted to HRK 7.07 million, whereas the amount of paid indemnities in the previous year equalled HRK 9.78 million. The paid indemnities were related to buyers in Croatia, Slovenia, Austria, Spain, Ireland and Canada.

Insurance business indicators, HRK million

	2017	2018	2019
Volume of insured receivables	3,904.43	4,169.29	5,578.50
Exposure as at 31 December	1,886.03	2,091.81	2,900.20
Gross premium charged	10.59	10.46	12.01
Amount of paid indemnities	6.21	9.78	7.07
Number of active limits as at 31 December	4,203	4,615	5,959

Acquisition costs, marketing costs, administration costs and other operating expenses of the HKO Group in 2019 amounted to HRK 6.98 million, whereas, at the Company level, they amounted to HRK 5.84 million.

Risk assessment fee income stood at HRK 1.58 million, whereas they amounted to HRK 1.27 million in 2018.

Net investment income in 2019 stood at HRK 1.73 million (1.26 million in 2018).

The business year 2019 is the ninth full year of operations. Prior to consolidation with the parent's financial statements, the HKO Group recorded profit before taxes for the year in the amount of HRK 554 thousand, whereas 2018 ended with a profit of HRK 293 thousand.

As at 31 December 2019, the total assets of the HKO Group amounted to HRK 60.28 million, an increase of 7.20 percent on the previous year. As at 31 December 2019, the total capital amounted to HRK 42.65 million and technical reserves to HRK 10.76 million net.

PRINCIPLES OF FINANCIAL REPORTING

The HBOR Group prepares:

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

When preparing and presenting its annual financial statements, the HBOR Group (the parent company and subsidiary companies) applies the International Financial Reporting Standards adopted by the European Union („EU IFRS“).

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

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

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

OVERVIEW OF FINANCIAL PERFORMANCE IN 2019

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

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

The separate and consolidated Annual Financial Statements of HBOR for 2019, which can be found enclosed, have been audited by the audit companies KPMG Croatia d.o.o. and BDO Croatia d.o.o. that expressed an unqualified opinion in the Independent Joint Auditor's Report.

OVERVIEW OF FINANCIAL OPERATIONS OF HBOR GROUP

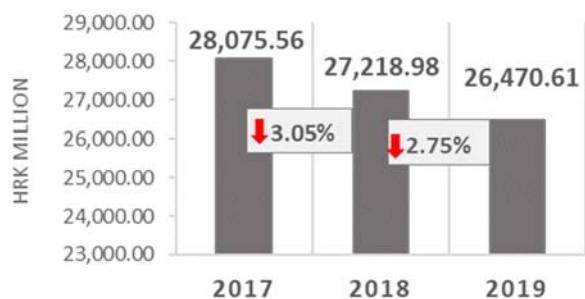
Having in mind the size of the subsidiary companies and the volume of their operations compared with the operations of the parent company, their financial data are not significant so as to be particularly highlighted within the framework of the consolidated financial statements. Consequently, they do not have a material effect on the consolidated financial statements in comparison with the separate statements of HBOR as the parent company. The HKO Group represents only 0.23 percent of the parent company's assets.

BREAKDOWN OF THE MOST SIGNIFICANT FINANCIAL INFORMATION OF HBOR GROUP

- IN HRK MILLION -

	2017	2018	2019
Total assets	28,075.56	27,218.98	26,470.61
Gross loans	26,332.99	26,243.12	26,571.11
Total equity	10,275.78	10,061.10	10,274.58
Total income	930.81	801.40	713.70
Total expense	(768.61)	(596.67)	(559.40)
Profit	162.20	204.73	154.30
Interest income calculated on the basis of effective interest rate method	867.83	733.08	665.90
Interest expense	(390.46)	(356.07)	(311.60)
Net interest income	477.37	377.01	354.30

TOTAL ASSETS



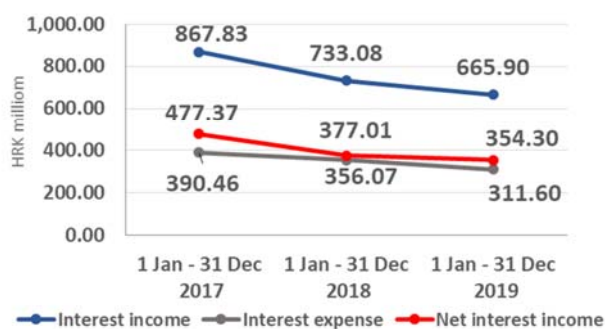
GROSS LOANS



TOTAL INCOME, TOTAL EXPENSE AND PROFIT



INTEREST INCOME, INTEREST EXPENSE AND NET INTEREST INCOME



Results of the HBOR Group

In 2019, the HBOR Group generated profit after tax in the amount of HRK 154.30 million. The recorded profit is by 24.63 percent lower as compared to the previous year, and the reasons are stated in the description of HBOR's financial performance.

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

In 2019, total income on consolidated basis amounted to HRK 713.70 million, whereas total expenses amounted to HRK 559.40 million.

In the structure of income of the HBOR Group, the largest portion, i.e. 93.30 percent, relates to interest income as a result of operation of the parent company.

The major part of total expenses, i.e. 55.70 percent, relates to interest expenses as a result of operation of the parent company.

The consolidated operating expenses in 2019 amounted to HRK 171.27 million and consisted of general and administrative expenses and other operating expenses.

There were 392 employees in the HBOR Group on 31 December 2019, whereas there had been 390 employees in the HBOR Group at the end of 2018.

Assets and liabilities of the HBOR Group

Total assets of the HBOR Group on consolidated basis amount to HRK 26,470.61 million, a decrease of 2.75 percent compared with the beginning of the year. The reasons for such tendency are given in the description of financial operations of HBOR.

In the structure of assets, the major portion relates to the lending activities of the parent company, i.e. net loans account for 87.45 percent of total assets.

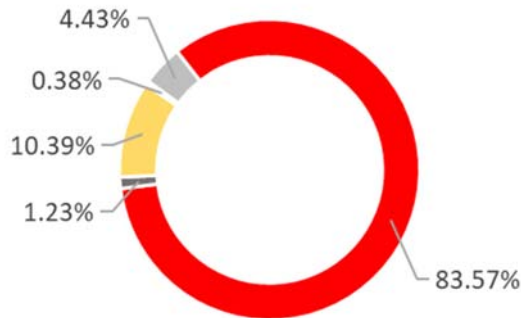
Total liabilities and total equity as at 31 December 2019 amount to HRK 26,470.61 million and, out of this amount, total liabilities amount to HRK 16,196.03 million, i.e. 61.18 percent.

In total liabilities and total equity of the HBOR Group, the major portion, i.e. 58.78 percent, consist of borrowings and bonds payable of the parent company.

At the end of the reporting period, total equity on consolidated basis amounted to HRK 10,274.58 million and accounted for 38.82 percent of total liabilities and total equity of the HBOR Group.

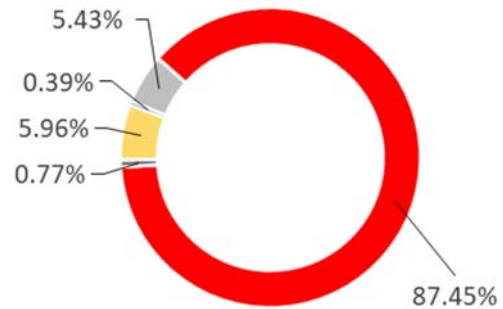
TOTAL ASSETS
31 December 2018

- Cash on hand and deposits with other banks
- Total loans, net
- Financial assets at FVPL
- Financial assets at FVOCI
- Other assets*



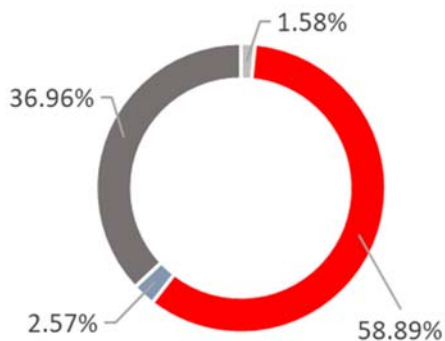
TOTAL ASSETS
31 December 2019

- Cash on hand and deposits with other banks
- Total loans, net
- Financial assets at FVPL
- Financial assets at FVOCI
- Other assets*



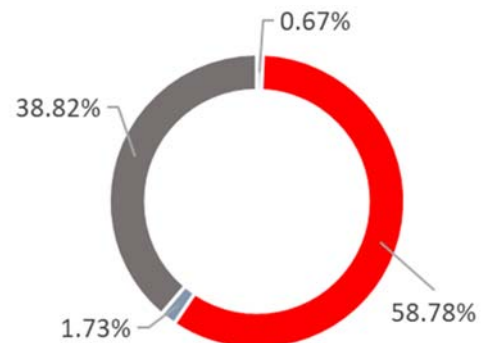
TOTAL LIABILITIES AND TOTAL EQUITY
31 December 2018

- Deposits from customers
- Borrowings and Debt securities issued
- Other liabilities and provisions**
- Total equity



TOTAL LIABILITIES AND TOTAL EQUITY
31 December 2019

- Deposits from customers
- Borrowings and Debt securities issued
- Other liabilities and provisions**
- Total equity



*Property, plant and equipment and intangible assets, Foreclosed assets, Debt securities at AC and Other assets.

**Provisions include provisions for guarantees, liabilities taken over and other liabilities.

OVERVIEW OF FINANCIAL PERFORMANCE OF HBOR

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

Financial performance

In 2019, HBOR generated total income of HRK 702.69 million, expenses in the amount of HRK 547.64 million and profit in the amount of HRK 155.05 million. HBOR's profit generated in 2019 decreased by HRK 49.28 million compared with the profit generated in 2018, i.e. by 24.12 percent.

The circumstances which resulted in the lower profit generated in 2019 compared to the profit generated in 2018 are as follows:

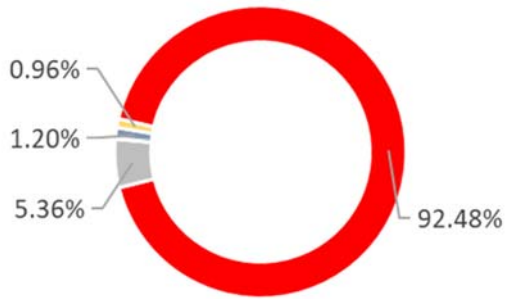
- Decrease in interest income of HRK 67.12 million,
- Decrease in interest expenses of HRK 44.51 million,
- Decrease in fee and commission income of HRK 17.16 million,
- Decrease in net gains from financial activities of HRK 4.77 million,
- Decrease in operating expenses of HRK 1.85 million,
- Increase in losses from impairment and provisions of HRK 8.09 million in comparison with 2018.

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

TOTAL INCOME

1 January - 31 December 2018

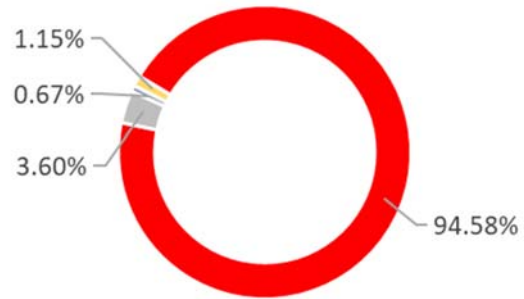
- Interest income
- Fee and commission income
- Net gains on financial operations
- Other income



TOTAL INCOME

1 January - 31 December 2019

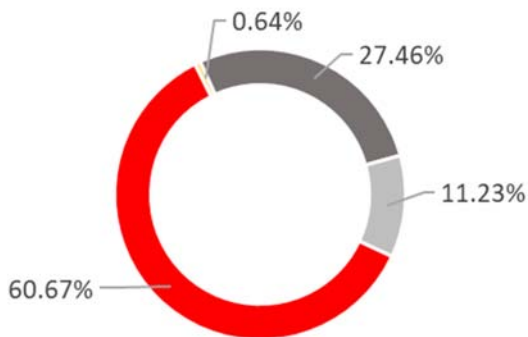
- Interest income
- Fee and commission income
- Net gains on financial operations
- Other income



TOTAL EXPENSE

1 January - 31 December 2018

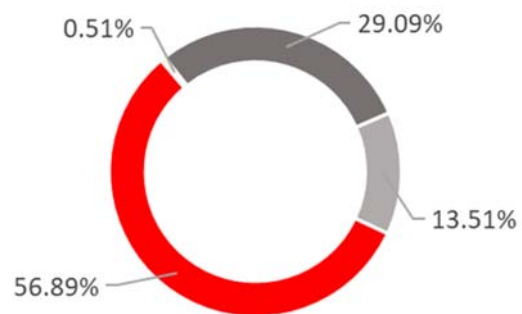
- Interest expense
- Fee and commission expense
- Operating expenses
- Impairment loss and provisions



TOTAL EXPENSE

1 January - 31 December 2019

- Interest expense
- Fee and commission expense
- Operating expenses
- Impairment loss and provisions



Net interest income

Net interest income amounted to HRK 353.03 million, a decrease of 6.02 percent on the same period of the previous reporting year.

Interest income calculated on the basis of the effective interest rate method amounted to HRK 664.59 million, a decrease of 9.17 percent on the same reporting period last year due to decreased interest income from long-term loans due to the long-term implementation of measures of interest rate reduction, decrease in interest income from interest rate subsidy, significant amounts of premature loan repayments in 2017, 2018 and 2019, implemented restructurings and the manner of recording of interest income from exposures classified to stage 3 and POCI assets (unwinding).

Unwinding, i.e. interest income for the mentioned exposures is calculated after the date of transfer of exposure to stage 3 or after the date of classification of assets as POCI and is recorded as provisions for the financial instrument with simultaneous decrease of interest income. On this basis, interest income was reduced by HRK 33.62 million in 2019.

Interest expenses amounted to HRK 311.56 million, a decrease of 12.50 percent on the same reporting period last year, which was mostly affected by the repayment of loans and the utilisation of credit lines of special financial institutions at favourable interest rates.

Having in mind the described trends in interest income and interest expenses, net interest margin decreased by 0.04 percentage points compared with the same reporting period last year and stood at 1.32 percent.

Net fee income

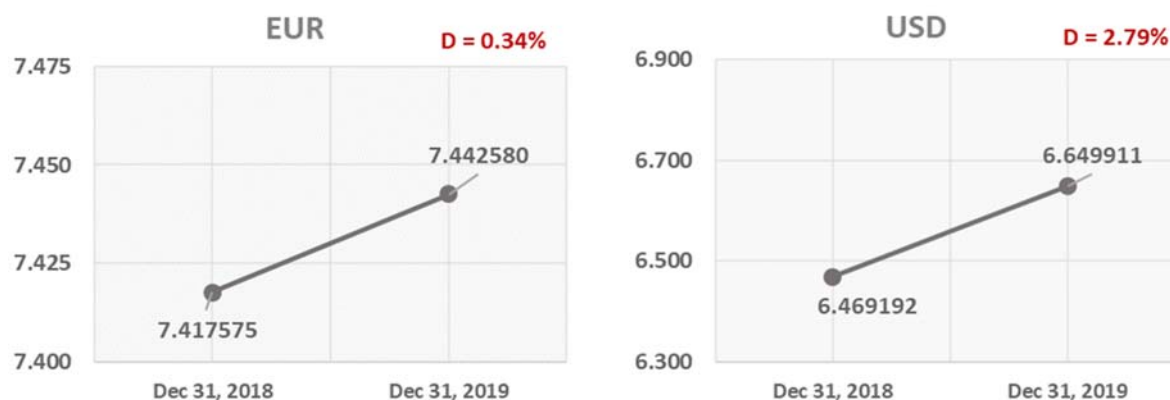
Net fee income amounted to HRK 22.50 million, a decrease of 41.79 percent compared with the previous year due to a lower volume of guarantees issued.

Net gains/(losses) from financial activities

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

In the reporting period, net gains from financial activities amounted to HRK 4.74 million, whereas net gains stood at HRK 9.51 million in the same period previous year.

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



Note:

D= HRK depreciation 2019/2018

D = HRK depreciation 2019/2018

Foreign currency and 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 valid 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 Income Statement in net figures.

Operating expenses

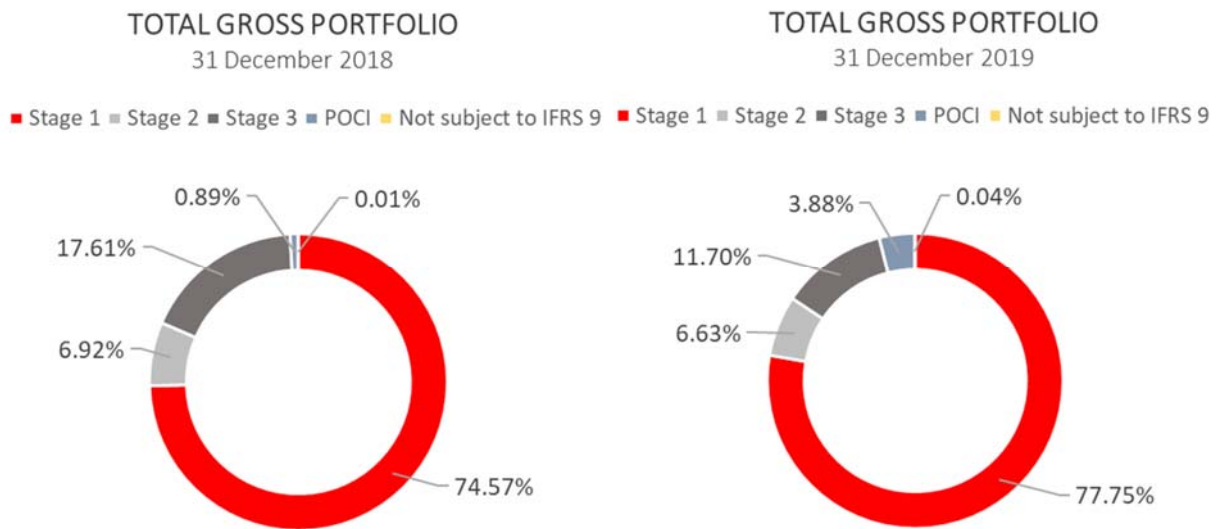
Operating expenses that include general and administrative expenses and other operating expenses stood at HRK 159.31 million, a decrease of 1.15 percent compared with the previous year as a result of a decrease in other expenses of 23.12 percent. This decrease is the result of decrease in recalculation and write-offs under financial instruments by 31.56 percent.

At the end of 2019, total number of HBOR's employees equalled 372 (31 December 2018: 370 employees).

Impairment loss and provisions

In the reporting period, placement impairment net losses stood at HRK 74.00 million.

The text to follow contains a breakdown of portfolio quality:



	2018		2019	
	In HRK millions	Breakdown (percent)	In HRK millions	Breakdown (percent)
Total gross portfolio	35,808.08	100.00	34,024.75	100.00
Of which:				
- financial institutions	13,194.50	36.85	13,186.68	38.76
- direct	22,613.58	63.15	20,838.07	61.24
Total provisions	3,795.63	100.00	3,518.65	100.00
Of which:				
- financial institutions	122.62	3.23	65.86	1.87
- direct	3,673.01	96.77	3,452.80	98.13
Provisions/gross portfolio	10.60 percent	-	10.34 percent	-

Significant changes in financial position

Total assets of HBOR as at 31 December 2019 amounted to HRK 26,446.49 million, a decrease of 2.77 percent compared with 2018, mostly due to repayment of obligations and prepayment of loans.

Cash on hand and deposits with other banks

At the end of 2019, cash on hand and deposits with other banks amounted to HRK 1,434.96 million representing 5.43 percent of total assets, an increase of 19.28 percent compared with the previous year due to reallocation of liquidity reserve funds.

Loans to financial institutions and other customers

Total net loans rose by 1.77 percent on the previous year and stood at HRK 23,147.34 million at the end of 2019 representing 87.52 percent of total assets.

Total gross loans amounted to HRK 26,571.11 million, an increase of 1.25 percent compared with the previous year. Gross loans to other customers increased by 7.39 percent compared with the beginning of the year, mostly as a result of disbursements of loans for the financing of reconstruction and development of infrastructure in the Republic of Croatia. Gross loans to financial institutions decreased by 8.17 percent on the previous year as a result of loan prepayments.

At the end of 2019, the proportion between gross loans on-lent through financial institutions and direct placements stood at 35.78 percent: 64.22 percent.

Financial assets at fair value through profit or loss

Loans at fair value (HBOR has determined that mezzanine loans are classified here), investments in investment funds and a part of equity instruments are classified to these assets. As at 31 December 2019, the total amount of these assets equalled HRK 194.00 million representing 0.73 percent of total assets.

Financial assets at fair value through other comprehensive income

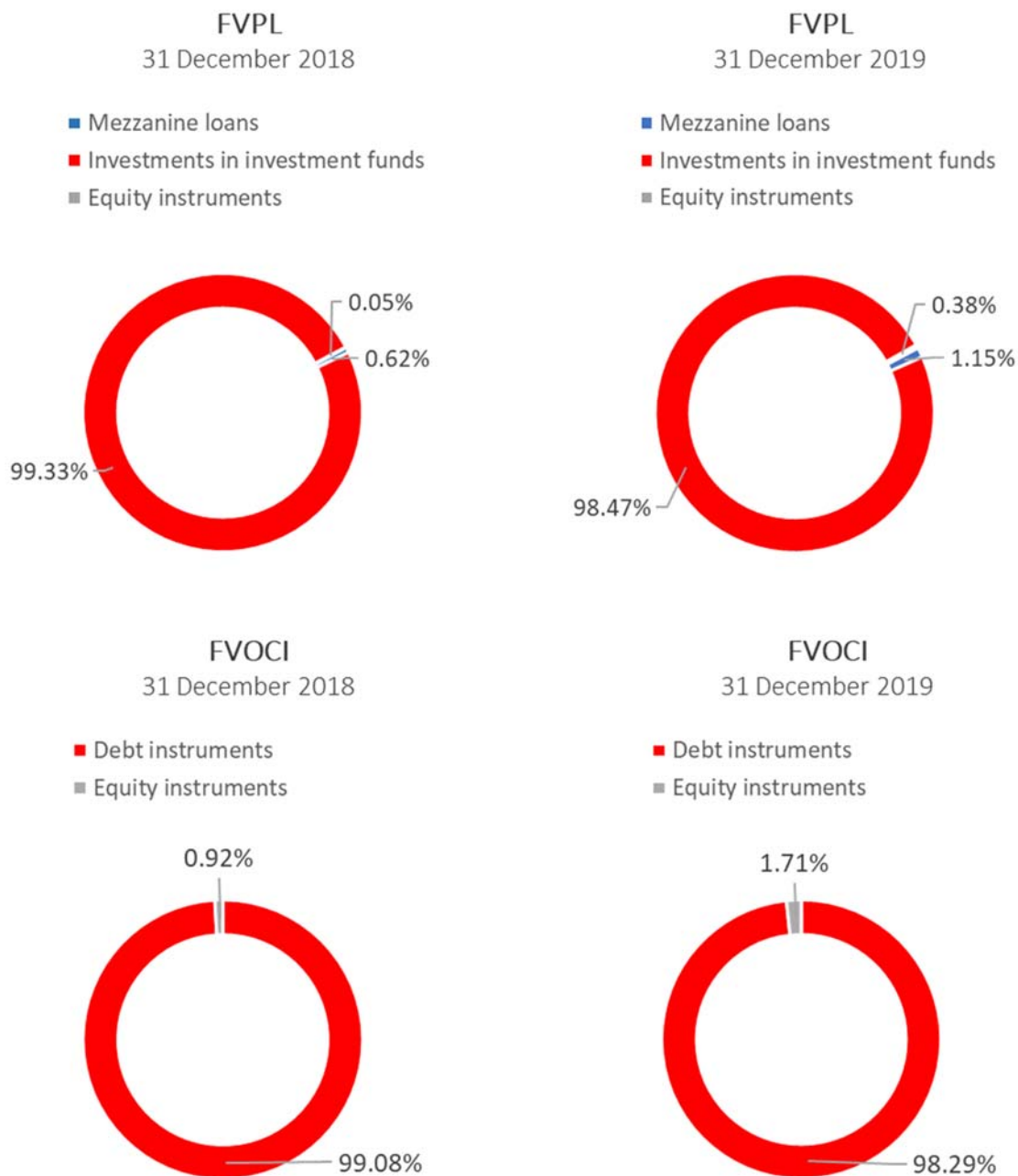
a) Debt securities

Bonds of the Republic of Croatia and of companies, treasury bills of the Ministry of Finance as part of liquidity reserve are classified to these assets. On the reporting date, they amounted to HRK 1,512.40 million, representing 5.72 percent of total assets. The impairment of these financial assets is calculated through the application of the model of expected credit losses in the manner that provisions are recognised in the accounts of other comprehensive income, thus not reducing the carrying amount of these financial assets in the statement on financial position. On the reporting date, they amounted to HRK 3.28 million in other reserves.

b) Equity instruments

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

On the reporting date, these assets amounted to HRK 26.25 million, representing 0.10 percent of total assets.



Total liabilities

At the end of 2019, total liabilities amounted to HRK 16,179.39 million, which represents 61.18 percent of total liabilities and total equity. The major part of total liabilities consists of HBOR's foreign borrowings and bonds payable in the total amount of HRK 15,558.74 million.

Borrowings and bonds payable decreased by 2.93 percent compared with the beginning of the year, whereas changes in these liabilities are shown in the following table:

	(HRK millions)
- Draw-down of funds borrowed under previously contracted funds of special financial institutions	3,036.23
- Repayments of borrowings	(3,581.20)
- Foreign exchange gains or losses	70.93
- Other calculations*	4.24
Total changes	(469.80)

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

In 2019, HBOR continued to raise special-purpose funds from special financial institutions, and four loan agreements were executed as follows:

- on 30 April 2019: two Finance Contracts with the European Investment Bank:
 - o in the amount of EUR 50,00 million for Rijeka Clinical Hospital Centre for the financing of the construction of mother and child care unit, new thermal power block and new parking lot, and
 - o in the amount of EUR 292,50 million for the strengthening of productivity and competitiveness of Croatian enterprises and the creation of new jobs, particularly intended for young people,
- on 12 August 2019: two Loan Agreements with the Council of Europe Development Bank:
 - o in the amount of EUR 200,00 million for the financing of SMEs and local and regional government units and/or other public sector entities, and
 - o in the amount of EUR 50,00 million for the financing of the project of Rijeka Clinical Hospital Centre.

Total equity

Total equity amounted to HRK 10,267.10 million, representing 38.82 percent of total liabilities and total equity.

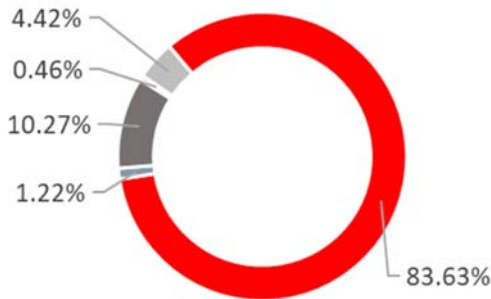
Total equity of HBOR is comprised of the founder's capital contributed from the budget of the Republic of Croatia, retained earnings from the profits generated in the previous years, other reserves, guarantee fund and profits for the current period.

In the reporting period, the amount of HRK 50.00 million was contributed from the budget of the Republic of Croatia into the founder's capital. At the end of 2019, the total amount of capital contributed from the budget of the Republic of Croatia stood at HRK 6,683.00 million, and the remaining amount to be contributed to the founder's capital up to the total amount of HRK 7,000.00 million set by the HBOR Act is HRK 317.00 million.

Pursuant to the provisions of the HBOR Act, the entire profits of the Bank generated in the reporting period are allocated to the reserves.

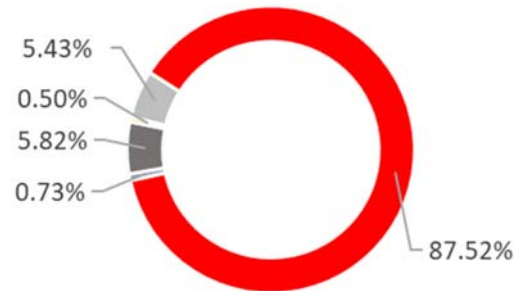
TOTAL ASSETS
31 December 2018

- Cash on hand and deposits with other banks
- Total loans, net
- Financial assets at FVPL
- Financial assets at FVOCI
- Other assets*



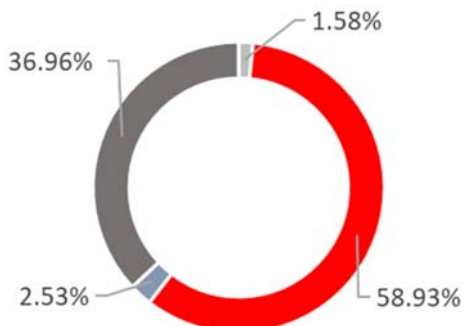
TOTAL ASSETS
31 December 2019

- Cash on hand and deposits with other banks
- Total loans, net
- Financial assets at FVPL
- Financial assets at FVOCI
- Other assets*



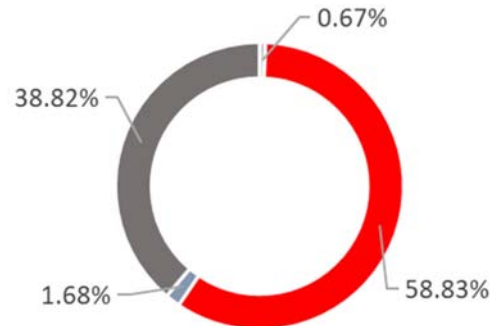
TOTAL LIABILITIES AND TOTAL EQUITY
31 December 2018

- Deposits from customers
- Borrowings and Debt securities issued
- Other liabilities and provisions**
- Total equity



TOTAL LIABILITIES AND TOTAL EQUITY
31 December 2019

- Deposits from customers
- Borrowings and Debt securities issued
- Other liabilities and provisions**
- Total equity



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

**Provisioning includes provisioning for guarantees, commitments and other liabilities.

CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

Annual financial statements for 2019

Zagreb, March 2020

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

The Management Board of the Croatian Bank for Reconstruction and Development ("HBOR" or "the Bank") is required to prepare separate and consolidated financial statements for each financial year which give a true and fair view of the financial position of the Bank and Group of the Croatian Bank for Reconstruction and Development ("the Group") and of the results of their operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities.

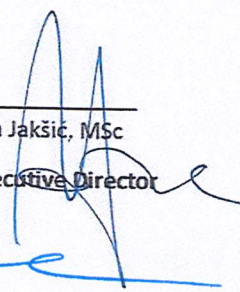
The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making judgments and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is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

The Management Board is responsible for submission of its Annual Report to the Supervisory Board, after which the Supervisory Board submits it for approval to the Parliament of the Republic of Croatia.

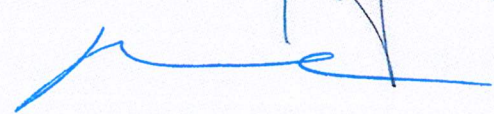
The separate and consolidated financial statements set out on pages 62 to 220 were authorised by the Management Board on 23 March 2020 for issue to the Supervisory Board and are signed below to signify this.

The Management Board is also responsible for the preparation and content of the Management Report and Statement on the Code of Corporate Governance Application as required by the Croatian Accounting Law, and other information (together "other information"). The Management Report presented on pages 4 to 6, Statement on the Code of Corporate Governance Application presented on pages 7 to 10 and other information presented on pages 11 to 51 were approved by the Management Board on 23 March 2020.

Signed on behalf of the Croatian Bank for Reconstruction and Development

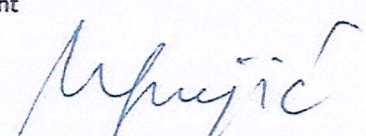

Vedran Jakšić, MSc

Senior Executive Director

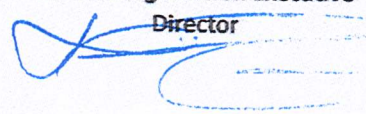

Tamara Perko, MSc

President of the Management Board




Marin Pranjić

Accounting Division Executive Director


Hrvoje Čuvalo, MSc

Member of the Management Board

Zagreb, 23 March 2020

Independent Joint Auditor’s Report to the owner of Croatian Bank for Reconstruction and Development

Report on the Audit of the Financial Statements

Opinion

We have audited the separate financial statements of Croatian Bank for Reconstruction and Development (“the Bank”) and the consolidated financial statements of the Bank and its subsidiary (“the Group”), which comprise the separate and consolidated statements of financial position of the Bank and the Group, respectively, as at 31 December 2019, and their respective separate and consolidated income statements, statements of profit or loss and comprehensive income, cash flows and changes in equity for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as “the financial statements”).

In our opinion, the accompanying financial statements give a true and fair view of the unconsolidated financial position of the Bank and consolidated financial position of the Group as at 31 December 2019 and of their respective unconsolidated and consolidated financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (“EU IFRS”).

Basis for Opinion

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

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters

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

Impairment of loans to other customers

As at 31 December 2019, in the financial statements of the Bank and the Group, gross loans to other customers: HRK 17,065 million, related impairment allowance: HRK 3,365 million and release of impairment loss recognised in the income statement for the year then ended: HRK 33 million (31 December 2018: gross loans to other customers: HRK 15,891 million, impairment allowance: HRK 3,380 million: release of impairment loss recognised in the income statement for the year ended 31 December 2018: HRK 211 million).

Please refer to note 4 *Summary of significant accounting policies*, note 10 *Impairment loss and provisions*, note 15 *Loans to other customers*, and credit risk section of the note 34 *Risk management*.

Key audit matter

Loss allowances represent the Management Board's best estimate of the expected credit losses ("ECL") within the loans to other customers at the reporting date. We focused on this area as the determination of loss allowances requires a significant judgment over the amounts of any such impairment.

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

For non-performing exposures exceeding HRK 1.5 million individually, the impairment assessment is based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Related loss allowances are determined on an individual basis by means of a discounted cash flows analysis.

How our audit addressed the matter

Our audit procedures in this area included, among others:

- Inspecting the Bank's and the Group's impairment provisioning methodology and assessing its compliance with the relevant requirements of the financial reporting standards;
- Inquiring of the risk management and information technology (IT) personnel to update our understanding of the provisioning process, IT applications used therein, key data sources and assumptions for data used in the ECL model. Also, assessing and testing of IT control environment for data security and access, assisted by our own IT specialists;
- Assessing and testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of events of default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the loss allowances;
- On a sample basis, assessing and recalculating PD, LGD, EAD and ECL parameters and agreeing them to those used in the ECL calculations by the Bank and the Group, referred to below.

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters (continued)

Key audit matter

For the above reasons, impairment of loans to other customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered the area to be our key audit matter.

How our audit addressed the matter

For the sample selected, critically assessing, by reference to the underlying documentation (loan files) and through inquiries of the Bank's and the For loss allowances calculated individually:

- Selecting a sample of individual exposures, with focus on those with the greatest potential impact on the financial statements due to their magnitude and risk characteristics, as well as lower value items, which we independently assessed as high-risk, such as watchlisted, restructured or rescheduled exposures, loans to clients operating in higher risk industries, non-performing exposures with low provision coverage and loans with significant change in the provision coverage;
- Group's loan officers and credit risk management personnel, the existence of any triggers for classification to Stage 2 or Stage 3 as at 31 December 2019;
- For those loans where triggers for classification in Stage 2 were identified, developing an independent estimate of the related ECL by using the parameters for Stage 2 exposures as determined by the Bank and the Group and as tested by us on a sample basis;
- For those loans where triggers for classification in Stage 3 were identified, challenging key assumptions applied in the Bank's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values and realization period. We sought the Management Board's explanations for any material discrepancies identified as a result of the above procedures.

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters (continued)

Key audit matter

For the above reasons, impairment of loans to other customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered the area to be our key audit matter.

How our audit addressed the matter

For loss allowances calculated on a collective basis:

- Obtaining the relevant forward-looking information and macroeconomic forecasts used in the Bank's and the Group's ECL estimate. Independently assessing the information by reference to publicly available information;
- For a sample of underlying exposures, agreeing EAD data on exposures back to contractual data;
- Challenging LGD and PD parameters, assessed as significant, by performing back-testing of historical default rates and by reference to historical realized losses on defaults;
- For a sample of exposures, assessing the appropriateness of the staging.

For loss allowances in total:

- Critically assessing the overall reasonableness of the impairment allowances, including both the share of the gross non-performing exposure in total gross exposure, and the non-performing loans provision coverage;
- Evaluating the accuracy and completeness of the related financial statement disclosures.

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

Other Information

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

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

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

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

- the Management Report has been prepared in accordance with the requirements of Articles 21 and 24 of the Accounting Act,
- the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

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

- the information given in the Management Report and Corporate Governance Statement for the financial year for which the financial statements are prepared, is consistent, in all material respects, with the financial statements;
- the Management Report has been prepared, in all material respects, in accordance with the requirements of Article 21 and 24 of the Accounting Act;
- the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

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

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

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

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

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

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and the Group's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank and/or the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Independent Joint Auditor's Report to the owner of Croatian Bank for Reconstruction and Development (continued)

Report on the Audit of the Financial Statements (continued)

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

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial statements of the Group. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

KPMG Croatia d.o.o. za reviziju was appointed by those charged with governance on 14 March 2018, while BDO Croatia was appointed on 2 September 2019 to audit the financial statements of the Bank and the Group for the year ended 31 December 2019. Total uninterrupted period of engagement of KPMG Croatia d.o.o. za reviziju is 2 years. The total uninterrupted period of engagement of BDO Croatia d.o.o. is 1 year.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 20 March 2020;
- for the period to which our statutory audit relates, we have not provided any non-audit services (NASs), hence we have not provided any prohibited non-audit services referred to in Article 44 of the Audit Act. We also remained independent of the audited entity in conducting the audit.

KPMG Croatia d.o.o. za reviziju

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

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

Katarina Kecko
Member of the Management Board, Croatian
Certified Auditor

23 March 2020

BDO Croatia d.o.o

Croatian Certified Auditors
Trg J. F. Kennedy 6b
10000 Zagreb
Croatia

Ivan Čajko
Member of the Management Board, Croatian Certified
Auditor

BDO CROATIA
BDO Croatia d.o.o.
za pružanje revizorskih, konzalting
i računovodstvenih usluga
Zagreb, J. F. Kennedy 6/b

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

Consolidated Financial Statements of the Group
Income Statement
for the year ended 31 December
(All amounts are expressed in HRK thousand)

	Notes	2019 HRK '000	2018 HRK '000
Interest income calculated using the effective interest method	5	665,903	733,083
Interest expense	6	(311,602)	(356,066)
Net interest income		354,301	377,017
Fee and commission income	7	28,252	44,983
Fee and commission expense	7	(2,774)	(3,778)
Net fee and commission income		25,478	41,205
Net gains on financial operations	8	5,202	9,234
Other income		14,151	14,098
		399,132	441,554
Employee expenses	9a)	(95,078)	(93,845)
Depreciation and amortization	9 b)	(8,517)	(6,329)
Other expenses	9 c)	(67,677)	(70,726)
Impairment loss and provisions	10	(73,762)	(65,891)
Profit before income tax		154,098	204,763
Income tax	11	200	(26)
Profit for the year		154,298	204,737
Attributable to:			
Owner of the Bank		154,298	204,737

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

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

(All amounts are expressed in HRK thousand)

	2019	2018
	HRK '000	HRK '000
Profit for the year	154,298	204,737
Other comprehensive income		
Items that are not transferred subsequently to profit or loss:		
Unrealized actuarial gains/(losses)	56	(144)
Deferred tax-adjustment for previous period	-	(17)
Total items that are not transferred subsequently to profit or loss	56	(161)
Items that may be reclassified subsequently to profit or loss:		
Net changes in financial assets at fair value through other comprehensive income	9,290	(2,734)
Net foreign exchange on equity instruments	87	(325)
Deferred tax – other comprehensive income	(297)	(23)
Total items that may be reclassified subsequently to profit or loss	9,080	(3,082)
Other comprehensive income after income tax	9,136	(3,243)
Total comprehensive income after income tax	163,434	201,494
Attributable to:		
Owner of the Bank	163,434	201,494

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

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

(All amounts are expressed in HRK thousand)

	Notes	2019 HRK '000	2018 HRK '000
Assets			
Cash on hand and current accounts with banks	12	884,407	944,417
Deposits with other banks	13	553,470	261,925
Loans to financial institutions	14	9,447,706	10,234,988
Loans to other customers	15	13,699,634	12,510,686
Financial assets at fair value through profit or loss	16	203,833	336,266
Financial assets at fair value through other comprehensive income	17	1,578,810	2,829,470
Debt instruments at amortised cost	18	457	1,363
Investments in associates	20	-	-
Property, plant and equipment and intangible assets	21	48,281	50,832
Foreclosed assets	22	24,198	25,330
Other assets	23	29,815	23,704
Total assets		26,470,611	27,218,981
Liabilities			
Deposits from customers	24	176,769	429,096
Borrowings	25	14,400,453	14,877,987
Debt securities issued	26	1,158,291	1,150,557
Provisions for guarantees, commitments and other liabilities	27	120,780	321,491
Other liabilities	28	339,737	378,743
Total liabilities		16,196,030	17,157,874
Equity			
Founder's capital	29	7,109,632	7,059,632
Retained earnings and reserves		2,921,855	2,717,118
Other reserves		76,610	67,474
Profit for the year		154,298	204,737
Guarantee fund	30	12,186	12,146
Total equity		10,274,581	10,061,107
Total liabilities and total equity		26,470,611	27,218,981

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

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

(All amounts are expressed in HRK thousand)

	Notes	2019 HRK '000	2018 HRK '000
Operating activities			
Profit before income tax		154,098	204,763
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>			
Depreciation and amortization		8,517	6,329
Income tax		200	26
Impairment loss and provisions		73,762	65,891
Accrued interest		(37,112)	34,720
Deferred fees		331	(1,832)
Other changes in assets at fair value		(5,592)	11,712
<i>Operating profit before working capital changes</i>		<i>194,204</i>	<i>321,609</i>
<i>Changes in operating assets and liabilities:</i>			
Net increase in deposits with other banks, before impairment		(291,554)	(233,822)
Net decrease in loans to financial institutions, before impairment		843,474	711,348
Net increase in loans to other customers, before loss impairment		(1,481,521)	(571,291)
Net loss on financial assets at fair value through profit or loss		-	66
Decrease of discount in debt securities issued		3,812	3,702
Net decrease/(increase) in foreclosed assets		352	(8,476)
Net increase in other assets, before impairment		(11,154)	(21,803)
Net decrease in deposits from banks and companies		(252,327)	(215,645)
Net decrease in other liabilities, before provisions		(42,815)	(84,038)
Net cash used in operating activities		(1,037,529)	(98,350)
Investment activities			
Purchase of financial assets at fair value through profit or loss		(2,981)	(1,500)
Sale of financial assets at fair value through profit or loss		143,549	474,578
Purchase of financial assets at fair value through other comprehensive income		(512,904)	(1,860,561)
Sale of financial assets at fair value through other comprehensive income		1,771,593	1,522,138
Investments in subsidiaries – sales and write-offs		5,500	-
Net purchase of property, plant and equipment and intangible assets		(4,229)	(3,540)
Net cash provided from investment activities		1,400,528	131,115
Financing activities			
Increase in founder's capital		50,000	50,000
Increase in borrowings – withdrawn funds		3,036,226	2,284,763
Decrease in borrowings – repayments of principal		(3,581,195)	(2,658,936)
Other		175	1,093
Net cash used in financing activities		(494,794)	(323,080)
Effect of foreign currency to cash and cash equivalents			
Net foreign exchange		70,600	(168,138)
Net effect		70,600	(168,138)
Net decrease in cash and cash equivalents		(61,195)	(458,453)
Cash and cash equivalents balance as of 1 January, before impairment		946,085	1,404,538
Net decrease in cash and cash equivalents		(61,195)	(458,453)
Cash and cash equivalents balance as of 31 December before impairment	12	884,890	946,085
Additional note - Operational cash flows			
Interest paid		307,480	336,550
Interest received		549,245	651,445

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

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

(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit for the year HRK '000	Guarantee fund HRK '000	Total HRK '000
Balance as of 1 January 2018	7,009,632	2,554,917	70,717	162,201	12,303	9,809,770
Profit for the year	-	-	-	204,737	-	204,737
Other comprehensive income	-	-	(3,243)	-	-	(3,243)
Total comprehensive income	-	-	(3,243)	204,737	-	201,494
Net foreign exchange - Guarantee fund	-	-	-	-	(157)	(157)
Capital paid-in from the State Budget	50,000	-	-	-	-	50,000
Transfer of profit 2017 to retained earnings	-	162,201	-	(162,201)	-	-
Balance as of 31 December 2018	7,059,632	2,717,118	67,474	204,737	12,146	10,061,107
Profit for the year	-	-	-	154,298	-	154,298
Other comprehensive income	-	-	9,136	-	-	9,136
Total comprehensive income	-	-	9,136	154,298	-	163,434
Net foreign exchange - Guarantee fund	-	-	-	-	40	40
Capital paid-in from the State Budget	50,000	-	-	-	-	50,000
Transfer of profit 2018 to retained earnings	-	204,737	-	(204,737)	-	-
Balance as of 31 December 2019	7,109,632	2,921,855	76,610	154,298	12,186	10,274,581

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

Separate Financial Statements of the Bank
Income Statement
for the year ended 31 December
(All amounts are expressed in HRK thousand)

	Notes	2019 HRK '000	2018 HRK '000
Interest income calculated using the effective interest method	5	664,586	731,708
Interest expense	6	(311,558)	(356,066)
Net interest income		353,028	375,642
Fee and commission income	7	25,267	42,428
Fee and commission expense	7	(2,774)	(3,778)
Net fee and commission income		22,493	38,650
Net gains on financial operations	8	4,743	9,506
Other income		8,090	7,596
		388,354	431,394
Employee expenses	9a)	(91,317)	(90,469)
Depreciation and amortization	9 b)	(8,164)	(6,284)
Other expenses	9 c)	(59,827)	(64,407)
Impairment loss and provisions	10	(73,996)	(65,906)
Profit before income tax		155,050	204,328
Income tax	11	-	-
Profit for the year		155,050	204,328
Attributable to:			
Owner of the Bank		155,050	204,328

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

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

(All amounts are expressed in HRK thousand)

	2019 HRK '000	2018 HRK '000
Profit for the year	155,050	204,328
Other comprehensive income		
Items that are not transferred subsequently to profit or loss:		
Unrealized actuarial gains/(losses)	56	(144)
Total items that are not transferred subsequently to profit or loss	56	(144)
Items that may be reclassified subsequently to profit or loss:		
Net changes in financial assets at fair value through other comprehensive income	7,849	(2,860)
Net foreign exchange on equity instruments	87	(325)
Total items that may be reclassified subsequently to profit or loss	7,936	(3,185)
Other comprehensive income after income tax	7,992	(3,329)
Total comprehensive income after income tax	163,042	200,999
Attributable to:		
Owner of the Bank	163,042	200,999

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

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

(All amounts are expressed in HRK thousand)

		2019	2018
	Notes	HRK '000	HRK '000
Assets			
Cash on hand and current accounts with banks	12	881,487	941,071
Deposits with other banks	13	553,470	261,925
Loans to financial institutions	14	9,447,706	10,234,988
Loans to other customers	15	13,699,634	12,510,686
Financial assets at fair value through profit or loss	16	193,994	330,803
Financial assets at fair value through other comprehensive income	17	1,538,641	2,792,072
Investments in subsidiaries	19	36,124	36,124
Investments in associates	20	-	-
Property, plant and equipment and intangible assets	21	47,309	50,764
Foreclosed assets	22	24,198	25,330
Other assets	23	23,922	15,164
Total assets		26,446,485	27,198,927
Liabilities			
Deposits from customers	24	176,769	429,096
Borrowings	25	14,400,453	14,877,987
Debt securities issued	26	1,158,291	1,150,557
Provisions for guarantees, commitments and other liabilities	27	120,631	321,361
Other liabilities	28	323,247	365,914
Total liabilities		16,179,391	17,144,915
Equity			
Founder's capital	29	7,109,632	7,059,632
Retained earnings and reserves		2,919,356	2,715,028
Other reserves		70,870	62,878
Profit for the year		155,050	204,328
Guarantee fund	30	12,186	12,146
Total equity		10,267,094	10,054,012
Total liabilities and total equity		26,446,485	27,198,927

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

Separate Financial Statements of the Bank
Statement of Cash Flows
for the year ended 31 December
(All amounts are expressed in HRK thousand)

	Notes	2019 HRK '000	2018 HRK '000
Operating activities			
Profit before income tax		155,050	204,328
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>			
Depreciation and amortization		8,164	6,284
Impairment loss and provisions		73,996	65,906
Accrued interest		(37,120)	34,626
Deferred fees		331	(1,832)
Other changes in assets at fair value		(5,402)	11,533
<i>Operating profit before working capital changes</i>		<i>195,019</i>	<i>320,845</i>
<i>Changes in operating assets and liabilities:</i>			
Net increase in deposits with other banks, before impairment		(291,554)	(233,822)
Net decrease in loans to financial institutions, before impairment		843,474	711,348
Net increase in loans to other customers, before impairment		(1,481,521)	(571,291)
Decrease of discount in debt securities issued		3,812	3,702
Net decrease/(increase) in foreclosed assets		352	(8,476)
Net increase in other assets, before impairment		(13,824)	(20,457)
Net decrease in deposits from banks and companies		(252,327)	(215,645)
Net decrease in other liabilities, before provisions		(42,667)	(83,830)
Net cash used in operating activities		(1,039,236)	(97,626)
Investment activities			
Sale of financial assets at fair value through profit or loss		143,000	473,600
Purchase of financial assets at fair value through profit or loss income		(2,739)	-
Sale of financial assets at fair value through other comprehensive income		1,771,593	1,517,138
Purchase of financial assets at fair value through other comprehensive income		(511,652)	(1,857,535)
Investments in subsidiaries – sales and write-offs		5,500	-
Net purchase of property, plant and equipment and intangible assets		(2,968)	(3,470)
Net cash provided from investment activities		1,402,734	129,733
Financing activities			
Increase in founder's capital		50,000	50,000
Increase in borrowings – withdrawn funds		3,036,226	2,284,763
Decrease in borrowings – repayments of principle		(3,581,195)	(2,658,936)
Other		78	1,063
Net cash used in financing activities		(494,891)	(323,110)
Effect of foreign currency to cash and cash equivalents			
Net foreign exchange		70,637	(168,279)
Net effect		70,637	(168,279)
Net decrease in cash and cash equivalents		(60,756)	(459,282)
Cash and cash equivalents balance as of 1 January, before impairment		942,722	1,402,004
Net decrease in cash and cash equivalents		(60,756)	(459,282)
Cash and cash equivalents balance as at 31 December, before impairment	12	881,966	942,722
Additional note – operating activities			
Interest paid		307,480	336,550
Interest received		547,769	649,694

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

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

(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit for the year HRK '000	Guarantee fund HRK '000	Total HRK '000
Balance as at 1 January 2018	7,009,632	2,554,245	66,207	160,783	12,303	9,803,170
Profit for the year	-	-	-	204,328	-	204,328
Other comprehensive income	-	-	(3,329)	-	-	(3,329)
Total comprehensive income	-	-	(3,329)	204,328	-	200,999
Net foreign exchange - Guarantee fund	-	-	-	-	(157)	(157)
Capital paid-in from the State Budget	50,000	-	-	-	-	50,000
Transfer of profit 2017 to retained earnings	-	160,783	-	(160,783)	-	-
Balance as at 31 December 2018	7,059,632	2,715,028	62,878	204,328	12,146	10,054,012
Profit for the year	-	-	-	155,050	-	155,050
Other comprehensive income	-	-	7,992	-	-	7,992
Total comprehensive income	-	-	7,992	155,050	-	163,042
Net foreign exchange - Guarantee fund	-	-	-	-	40	40
Capital paid-in from the State Budget	50,000	-	-	-	-	50,000
Transfer of profit 2018 to retained earnings	-	204,328	-	(204,328)	-	-
Balance as at 31 December 2019	7,109,632	2,919,356	70,870	155,050	12,186	10,267,094

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019
(All amounts are expressed in HRK thousand)

1. General information

1.1. Group:

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

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

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

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

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

As of 31 December 2019, the Group had 392 employees (31 December 2018: 390 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.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

1. General information (continued)

1.2. Bank (continued):

Supervisory Board

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

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

Management Board

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

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

As of 31 December 2019, HBOR had 372 employees (31 December 2018: 370 employees).

Audit Committee

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

1. General information (continued)

1.2. Bank (continued):

1.2.1. Activities of the Bank:

The principal activities of the Bank comprise the following:

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

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

2. Basis of Preparation of the Financial Statements

2.1. Statement of compliance

These consolidated and separate financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU. They were authorised for issue by the Bank's Management Board on 23 March 2020.

This is the first set of the Banks and Groups annual financial statements in which IFRS 16 Leases has been applied. Changes to significant accounting policies are described in Note 4.1.

2.2. Measurement

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

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

2.3. Functional and presentation currency

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

3. Use of judgements and estimates

For the preparation of financial statements in accordance with IFRSs, the Management Board is required to give estimations and make assumptions that influence the reported balances of assets and liabilities and to disclose contingent assets and liabilities at the date of financial statements, and present income and expense for the reporting period. Estimations and related assumptions are based on historical experience and various other factors that are considered to be reasonable in the given circumstances and with available information as of the date of preparation of the financial statements, which together form the basis for estimating the carrying amount of assets and liabilities that cannot be easily identified from other sources. Actual results may differ from these estimations. Estimations and related assumptions are continuously reviewed. Changes in accounting estimates are recognised in the period in which the estimate is changed if the change affects only that period, or in the period of change or future periods if the change affects the current and future periods.

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

Judgements

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

Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2019 is included in the following notes.

- impairment of financial instruments: determination of inputs into the ECL measurement model, incorporation of forward-looking information (Note 4.2.G.ix.).
- impairment of financial instruments: key assumptions used in estimating recoverable cash flows (Note 4.2.G.ix.).
- Significant accounting estimates and judgements related to the application of IFRS 9 are described in Note (Note 4.2.G.).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies

4.1. Changes in the accounting policies

As of January 1, 2019, the Group has initially adopted IFRS 16 Leases (see 4.1.1.) and the accounting policy of the item Property, plant, equipment and intangible assets has been changed, as described in Note 4.1.2.

A number of other new standards are also effective from 1 January 2019 but they do not have a material effect on the Group's financial statements.

4.1.1. IFRS 16 Leases

Since 1 January 2019, the Group has applied the International Standard of Financial Reporting (IFRS) 16 Leases. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The Group applied a simplified approach as at 1 January 2019, and the future minimum lease payments of the Group on irrevocable operating leases amounted to HRK 2,258 thousand, on a discounted basis, recognized as lease liabilities and in the same amount of property with right of use.

These assets are stated in Note 23. Other assets, and liabilities for leases are stated in Note 28. Other liabilities, due to immaterial amount.

4.1.2. Change in accounting estimates for Property, plant and equipment and intangible assets

Since 1 January 2019, the Group has amended the Accounting Estimates and has changed the depreciation and amortisation rates pursuant to the provisions of the Income Tax Act.

The effect of the changed depreciation and amortisation rates at the annual level stands at HRK 1,113 thousand.

Comparative review of useful life and depreciation rates for 2019 and 2018:

		2019		2018
	Useful life expressed in years	Annual depreciation rates	Useful life expressed in years	Annual depreciation rates
Buildings	20	5%	33	3.03%
Computers	2	50%	3	33.3%
Furniture and Equipment	4	25%	5 - 8	20%; 12.5%
Vehicles	5	20%	3	33.3%
Other assets and investments not mentioned	10	10%	5	20%
Intangible Assets	4	25%	3 - 5	33.3%; 20%

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies

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

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

A. Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Group 'controls' an entity if it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Group having power over an investee.

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

Non-controlling interests

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

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

Loss of control

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

Transactions eliminated on consolidation

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

Associates

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

The Group's share of its associates' post-acquisition gains or losses is recognised in the income statement and its share of their post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

A. Basis of consolidation (continued)

Associates (continued)

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise any further losses, unless it has incurred obligations or has made payments on behalf of the associate.

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

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

B. Foreign currency transactions and foreign currency clause

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

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

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

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

31 December 2019	1 EUR = HRK 7.442580	1 USD = HRK 6.649911
31 December 2018	1 EUR = HRK 7.417575	1 USD = HRK 6.469192

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

C. Interest income and expense

Effective interest rate

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

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

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

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

Amortised cost and gross carrying amount

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

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

Calculation of interest income and expense

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

C. Interest income and expense (continued)

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

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

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

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

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

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

D. Fee and commission income

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

E. Leases

Policy applicable until 1 January 2019

Group acting as a lessee - Finance leases

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

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

Group acting as a lessee - Operating leases

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

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

F. Income tax

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities

i. Recognition and initial measurement

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

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

ii. Classification

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

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

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

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

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

ii. Classification (continued)

Business models

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

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

Business models of the Group are:

- Business model, whose objective is to hold assets for the collection of contractual cash flows – it includes all financial assets held for the purpose of collection of contractual cash flows over the lifetime of the financial instrument.
For the purpose of classification in this business model, financial assets goes through the SPPI (Solely payment of principal and interest) test, and the following financial assets are allocated to this model:
 - o current accounts with banks,
 - o Deposits with banks,
 - o Loans and reversed repo placements,
 - o Other receivables,Credit risk is a basic risk managed under this business model.

- Business model aimed to collect the contractual cash flows and sale of financial assets – it includes financial assets held for the purpose of collecting the agreed cash flows and sale of financial assets.
The following financial assets are allocated to the business model for the purpose of collection and sale:
 - o Debt securities (pass SPPI test),
 - o Equity securities (fail SPPI test),
 - o Shares in investment funds (fail SPPI test),Liquidity risk is a basic risk managed under this business model.

- Business model under which financial assets are measured at fair value through profit and loss account (fail SPPI test) – combines all financial assets that are not held under the previously mentioned two business models.
Financial assets under this business model are managed for the purpose of generating cash flows from the sale of assets and generating short-term profit.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

iii. SPPI test

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

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

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

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

SPPI test is performed:

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

iv. Reclassification of financial assets

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

v. Derecognition

Financial assets

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

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received for the part derecognised (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in other comprehensive income in respect of equity investment securities designated as at fair value through other comprehensive income is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

Financial liabilities

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

vi. Modification of financial assets

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

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

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

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

viii. Fair value measurement

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

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

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

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

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

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

viii. Fair value measurement (continued)

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

The fair value of bonds issued by HBOR on 31 December 2019 is stated in Note 26. and is presented by using level 2 inputs that are observable at Bloomberg service on the basis of mid-rate of Bloomberg Generic (BGN) prices.

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

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

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

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

Comparison between the fair value and the carrying value of financial instruments that are not measured at fair value is given in Note 35.1.2.

ix. Impairment

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

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

Impairment is performed by applying the general and simplified approach.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

ix. Impairment (continued)

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

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

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

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

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

Financial instruments which are not deemed instruments of low credit risk only due to the value of collaterals.

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

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

ix. Impairment (continued)

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

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

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

ix. Impairment (continued)

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

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

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

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

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

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

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

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

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

Details regarding the methodology are stated in Note 40. Risk Management.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories

Financial assets of the Group are comprised of:

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

Current accounts with banks

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

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

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

Deposits with banks

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories (continued)

Loans

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. *Financial assets-categories* (continued)

Debt securities

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

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

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

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

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

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories (continued)

Equity securities

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

Investments are broken down as follows:

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

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

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

The same accounting treatment is used for every investment category.

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

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

Investments without significant influence – equity stake below 20 %

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories (continued)

Equity securities (continued)

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

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

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

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

Investments in associates – significant influence (exceeding 20%)

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

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

Shares in investment funds

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories (continued)

Derivative financial assets

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

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

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

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

Other receivables

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

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

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

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

G. Financial assets and financial liabilities (continued)

x. Financial assets-categories (continued)

Other receivables (continued)

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

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

H. Property, plant and equipment and intangible assets

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

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

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

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

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

Land is not depreciated.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

H. Property, plant and equipment and intangible assets (continued)

Policy applicable from 1 January 2019

Since 1 January 2019, the Group has amended the Accounting Policies and has changed the depreciation and amortisation rates pursuant to the provisions of the Income Tax Act.

The effect of the changed depreciation and amortisation rates at the annual level stands at HRK 1,113 thousand.

Comparative review of useful life and depreciation rates for 2019 and 2018 is given in Note 4.1.2..

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

I. Investment property

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

Subsequent cost of replacing part of an existing asset is recognized in the carrying amount of an investment property at the time that cost is incurred, when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed during the period in which they are incurred.

Land is not depreciated. Depreciation is provided on other investment property on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful life of the asset.

The estimated useful life of the assets expressed in years is as follows:

	2019	2018
	years	years
Leased property	20 ²	33

² Policy applied from January 1, 2019 as described in Note H.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

I. Investment property (continued)

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

Investment property is stated in Note 23. Other assets due to immaterial amount.

J. Foreclosed assets

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

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

Depreciation on these assets is not charged.

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

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

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

K. Deposits, borrowings and debt securities issued

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

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

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

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

L. Government grants

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

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

M. Loan commitments

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

For other loan commitments:

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

Liabilities arising from loan commitments are included within provisions.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.2. Significant accounting policies (continued)

N. Employee benefits

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

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

O. Segment reporting

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

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

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

P. Managed funds for and on behalf of third parties

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

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

Revenues and expense relating to this business activity are charged to third parties, and the Bank does not have other liabilities nor bears any risks. For services provided within the framework of some of the programmes, the Bank charges a fee, whereas other programmes are performed by the Bank free of charge (see Note 32.).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

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

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Group has not early adopted them in preparing these consolidated financial statements.

The following amended standards are not expected to have a significant impact on the Group's consolidated financial statements.

- Amendments to References to Conceptual Framework in IFRS Standards,
- Amendment to IFRS 3 Business Combinations,
- IFRS 17 Insurance Contracts.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

5. Interest income calculated using the effective interest method

Interest income by borrowers:

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
Public sector	95,596	98,383	94,279	97,008
State-owned companies	36,215	32,585	36,215	32,585
Foreign companies	43,811	29,077	43,811	29,077
Domestic companies	284,255	332,255	284,255	332,255
Domestic financial institutions	155,724	203,566	155,724	203,566
Foreign financial institutions	601	476	601	476
Penalty interest	30,455	9,526	30,455	9,526
Other	19,246	27,215	19,246	27,215
	665,903	733,083	664,586	731,708

Interest income by type of facility:

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
Interest on loans				
- financial institutions	155,581	204,190	155,581	204,190
- other customers	478,965	495,078	478,965	495,078
	634,546	699,268	634,546	699,268
Investments in securities	30,591	33,325	29,274	31,951
- <i>Bonds of the Republic of Croatia</i>	29,865	29,996	28,589	28,667
- <i>Corporate bonds</i>	177	113	136	68
- <i>Treasury bills of the Ministry of Finance</i>	549	3,216	549	3,216
Deposits	766	490	766	489
	665,903	733,083	664,586	731,708

The main 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 28 Other liabilities) and is recognized in profit or loss on a time basis during the repayment of the loan. Interest income earned on this basis in 2019 amounts to HRK 48,956 thousand (31 December 2018: HRK 70,011 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

6. Interest expense

Interest expense by type of payee:

	2019	Group 2018	2019	Bank 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Domestic financial institutions	5,803	5,003	5,803	5,003
Foreign financial institutions	305,612	351,063	305,612	351,063
Other	187	-	143	-
	311,602	356,066	311,558	356,066

Interest expense by type of facility:

	2019	Group 2018	2019	Bank 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Borrowings	239,518	285,204	239,518	285,204
Debt securities	70,598	70,449	70,598	70,449
Deposits	1,299	413	1,299	413
Leases – interest expenses on long term contracts	187	-	143	-
	311,602	356,066	311,558	356,066

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.

7. Net fee and commission income

	2019	Group 2018	2019	Bank 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Fee and commission income from contracts with customers:				
Asset management - from managed funds for and on behalf of third parties	16,608	13,423	16,608	13,423
From payment operations	261	271	261	271
Other	4	12	4	12
Total fee and commission income from contracts with customers	16,873	13,706	16,873	13,706
From issued guarantees	8,394	28,722	8,394	28,722
Reinsurance commission income	2,985	2,555	-	-
Total fee and commission income	28,252	44,983	25,267	42,428
Fee and commission expense	(2,774)	(3,778)	(2,774)	(3,778)
Net fee and commission income	25,478	41,205	22,493	38,650

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

8. Net gains/(losses) on financial operations

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:				
Cash on hand, accounts at banks and due from banks	9,473	1,732	9,473	1,732
Loans given to financial institutions and other customers	55,501	(159,219)	55,501	(159,219)
Financial assets at fair value through profit or loss	188	(4)	188	-
Debt instruments at amortised cost	3	(15)	-	-
Financial assets at fair value through other comprehensive income	689	(8,695)	653	(8,570)
Other	1,483	1,170	1,484	1,170
	67,337	(165,031)	67,299	(164,887)
Net foreign exchange gains/(losses) on foreign currency liabilities:				
Deposits	1,547	4,836	1,547	4,836
Borrowings and issued long-term securities	(71,212)	178,007	(71,212)	178,007
Other	(574)	(1,483)	(579)	(1,397)
	(70,239)	181,360	(70,244)	181,446
Net foreign exchange gains/(losses) on foreign currency assets and liabilities	(2,902)	16,329	(2,945)	16,559
Gains/(losses) on assets at fair value through profit or loss	7,625	(7,086)	7,607	(7,020)
Realized gains/(losses) on financial assets at fair value through other comprehensive income	479	(9)	81	(33)
Net gains on financial operations	5,202	9,234	4,743	9,506

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

9. Operating expenses

Operating expenses can be shown as follows:

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
9 a) Employee expenses	95,078	93,845	91,317	90,469
9 b) Depreciation	8,517	6,329	8,164	6,284
9 c) Other expenses	67,677	70,726	59,827	64,407
<i>From what:</i>				
<i>Administration expenses</i>	<i>20,772</i>	<i>20,892</i>	<i>20,267</i>	<i>20,376</i>
<i>Material and services</i>	<i>28,933</i>	<i>30,165</i>	<i>27,652</i>	<i>28,541</i>
<i>Other expenses</i>	<i>17,972</i>	<i>19,669</i>	<i>11,908</i>	<i>15,490</i>
	171,272	170,900	159,308	161,160

Material and services contain audit costs as follows:

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
Audit services	741	540	563	366
Non-audit services (subproject audit)	-	33	-	33
	741	573	563	399

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

	2019	Group	2019	Bank
	HRK '000	2018	HRK '000	2018
		HRK '000		HRK '000
Change in the claims provision	55	(5,112)	-	-
Change in the claims provision, reinsurer's share	1,066	4,454	-	-
Expenses of insurance operations	1,121	(658)	-	-

Provisions for losses as at 31 December 2019 consisted of reported and unreported losses in the framework proportion 47:53. At the end of 2019, total gross provisions for losses decreased compared to the end of 2018 by 3%. The Bornhuetter-Ferguson method was used with respect to the gross amount of reserves for the losses not reported, whereas the amount of the actual losses incurred was used with respect to the reported losses. The reinsurance share was determined in accordance with the terms and conditions of reinsurance in force.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

10. Impairment loss and provisions

The provision for impairment losses/(gains) on placements may be summarized as follows:

a) Impairment loss and provisions on financial instruments in accordance with IFRS 9

	Group		Bank	
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Impairment losses on cash on hand and due from financial institutions	(1,190)	1,625	(1,177)	1,608
Impairment losses on deposits with other banks	(112)	1,216	(112)	1,216
Impairment losses on loans to financial institutions	(58,486)	(13,149)	(58,486)	(13,149)
Impairment losses on loans to other customers and interest	(33,136)	(211,161)	(33,136)	(211,161)
Modification loss – financial institutions	6,462	3,021	6,462	3,021
Modification loss – other customers	39,551	5,543	39,551	5,543
POCI assets – fair value adjustment at initial recognition	322,431	62,368	322,431	62,368
Impairment of financial assets at fair value through other comprehensive income	(3,401)	2,477	(3,186)	2,481
Provisions for impairment losses on debt instruments at amortised cost	(2)	-	-	-
Impairment losses on other assets	1,561	20,915	1,584	20,814
Provisions for commitments	(47,722)	68,931	(47,722)	68,931
Provision for guarantees	(156,368)	141,180	(156,368)	141,180
Total	69,588	82,966	69,841	82,852

b) Other impairment losses and provisions

	Group		Bank	
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Impairment losses on foreclosed assets	780	(157)	780	(157)
Value adjustment from previous years	482	-	482	-
Provision for other liabilities	2,912	(16,918)	2,893	(16,789)
Total	4,174	(17,075)	4,155	(16,946)
Total	73,762	65,891	73,996	65,906

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

11. Income tax

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

	2019	Group 2018
	HRK '000	HRK '000
Recognised in Income Statement		
Current tax - recognised in Income Statement	200	(26)
Income tax	200	(26)
Income tax reconciliation		
Profit before tax	154,098	204,763
Profit of the Bank not subject to income tax	(155,050)	(204,328)
Profit before tax subject to income tax	(952)	435
Income tax at 18% rate	257	-
Income tax at 12% rate	(57)	(24)
Non-deductible expense	-	(2)
Total income tax expense	200	(26)

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

12. Cash on hand and current accounts with banks

	Group		Bank	
	31 December 2019 HRK 000	31 December 2018 HRK 000	31 December 2019 HRK 000	31 December 2018 HRK 000
Account with the Croatian National Bank	233,240	921,278	233,240	921,278
Cash on hand	5	2	5	2
Foreign currency account - domestic banks	708	6,232	703	6,231
Foreign currency account - foreign banks	649,833	18,129	648,018	15,211
Domestic currency account - domestic banks	1,104	444	-	-
	884,890	946,085	881,966	942,722
Loss allowances	(483)	(1,668)	(479)	(1,651)
	884,407	944,417	881,487	941,071

The following tables sets out information about the credit quality of financial assets measured at amortised cost, The amounts in the table represent gross carrying amounts:

31 December 2019

	Group				Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	884,885	-	-	884,885	881,961	-	-	881,961
Loss allowances	(483)	-	-	(483)	(479)	-	-	(479)
Balance as of 31 December 2019	884,402	-	-	884,402	881,482	-	-	881,482

31 December 2018

	Group				Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	946,083	-	-	946,083	942,720	-	-	942,720
Loss allowances	(1,668)	-	-	(1,668)	(1,651)	-	-	(1,651)
Balance as of 31 December 2018	944,415	-	-	944,415	941,069	-	-	941,069

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

12. Cash on hand and current accounts with banks (continued)

The movements in the loss allowances on amounts due from banks may be summarized as follows:

	Jan 1 – Dec 31, 2019	Group Jan 1 - Dec 31, 2018	Jan 1 - Dec 31, 2019	Bank Jan 1 - Dec 31, 2018
	HRK 000	HRK 000	HRK 000	HRK 000
Balance as of 1 January	1,668	41	1,651	41
Net (decrease)/increase of loss allowances on amounts due from banks	(1,190)	1,625	(1,177)	1,608
<i>Total recognised through Income Statement (Note 10)</i>	<i>(1,190)</i>	<i>1,625</i>	<i>(1,177)</i>	<i>1,608</i>
Net foreign exchange gain/loss on loss allowances	5	2	5	2
Balance at the end of the reporting period	483	1,668	479	1,651

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

13. Deposits with other banks

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Deposits with foreign banks	372,501	-	372,501	-
Deposits with domestic banks	182,343	263,283	182,343	263,283
Accrued interest	(118)	3	(118)	3
	554,726	263,286	554,726	263,286
Loss allowances	(1,256)	(1,361)	(1,256)	(1,361)
	553,470	261,925	553,470	261,925

The following tables sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

31 December 2019	Stage 1	Stage 2	Stage 3	Group	Stage 1	Stage 2	Stage 3	Bank
	HRK 000	HRK 000	HRK 000	Total HRK 000	HRK 000	HRK 000	HRK 000	Total HRK 000
Gross amount	554,726	-	-	554,726	554,726	-	-	554,726
Loss allowances	(1,256)	-	-	(1,256)	(1,256)	-	-	(1,256)
Balance as of 31 December 2019	553,470	-	-	553,470	553,470	-	-	553,470

31 December 2018	Stage 1	Stage 2	Stage 3	Group	Stage 1	Stage 2	Stage 3	Bank
	HRK 000	HRK 000	HRK 000	Total HRK 000	HRK 000	HRK 000	HRK 000	Total HRK 000
Gross amount	263,286	-	-	263,286	263,286	-	-	263,286
Loss allowances	(1,361)	-	-	(1,361)	(1,361)	-	-	(1,361)
Balance as of 31 December 2018	261,925	-	-	261,925	261,925	-	-	261,925

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

13. Deposits with other banks (continued)

The movements in the loss allowances on deposits with other banks may be summarized as follows:

	Jan 1 – Dec 31, 2019	Group Jan 1 - Dec 31, 2018	Jan 1 – Dec 31, 2019	Bank Jan 1 - Dec 31, 2018
	HRK 000	HRK 000	HRK 000	HRK 000
Balance as of 1 January	1,361	152	1,361	152
Net (decrease)/increase of loss allowances on deposits with other banks	(112)	1,216	(112)	1,216
<i>Total recognised through Income Statement (Note 10)</i>	<i>(112)</i>	<i>1,216</i>	<i>(112)</i>	<i>1,216</i>
Net foreign exchange gain/loss on loss allowances	7	(7)	7	(7)
Balance at the end of the reporting period	1,256	1,361	1,256	1,361

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

14. Loans to financial institutions

	31 December 2019 HRK '000	Group and Bank 31 December 2018 HRK '000
Long-term loans under loan programmes	9,395,321	9,695,037
Short-term loans and reverse repo transactions	141,075	691,269
Accrued interest	5,936	7,350
Deferred recognition of loan origination fees	(35,928)	(41,514)
	<u>9,506,404</u>	<u>10,352,142</u>
Loss allowances	(58,698)	(117,154)
	<u>9,447,706</u>	<u>10,234,988</u>

The following tables sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

31 December 2019	Group and Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	9,400,433	83,619	22,352	9,506,404
Loss allowances	(37,098)	(10,543)	(11,057)	(58,698)
Balance as of 31 December 2018	<u>9,363,335</u>	<u>73,076</u>	<u>11,295</u>	<u>9,447,706</u>
31 December 2018	Group and Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	10,142,966	158,678	50,498	10,352,142
Loss allowances	(78,126)	(20,941)	(18,087)	(117,154)
Balance as of 31 December 2018	<u>10,064,840</u>	<u>137,737</u>	<u>32,411</u>	<u>10,234,988</u>

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

14. Loans to financial institutions (continued)

The movements in the loss allowances on loans to financial institutions may be summarized as follows:

	Jan 1 - Dec 31, 2019 HRK 000	Group and Bank Jan 1 - Dec 31, 2018 HRK 000
Balance as of 1 January	117,154	131,020
Net decrease of loss allowances on loans to financial institutions	(58,486)	(13,149)
<i>Total recognised through Income Statement (Note 10)</i>	<i>(58,486)</i>	<i>(13,149)</i>
Net foreign exchange gain/loss on loss allowances	29	(964)
Loss allowances transferred to loans to other customers	(3)	(28)
Unwinding – changes due to the lapse of time	4	275
Balance at the end of the reporting period	58,698	117,154

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

14. Loans to financial institutions (continued)

Loans to financial institutions, impaired for loss allowances, by purpose of the loan programs:

	31 December 2019 HRK '000	Group and Bank 31 December 2018 HRK '000
Loan programme for reconstruction and development of the economy	1,637,578	1,915,895
Export financing	2,279,986	2,448,494
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	1,350,974	1,130,702
Loan programme for small and medium-sized enterprises	4,121,003	4,192,912
Loan programme for war-torn and demolished housing and business facilities	5,780	7,034
Other	141,075	691,269
Accrued interest	5,936	7,350
Deferred recognition of loan fees	(35,928)	(41,514)
	<u>9,506,404</u>	<u>10,352,142</u>
Loss allowances	(58,698)	(117,154)
	<u>9,447,706</u>	<u>10,234,988</u>

Average interest rates for total loans to financial institutions are stated at 0.58% (31 December 2018: 0.74%) and are equal to average interests rates for loans under HBOR loan programmes excluding the liquidity reserve.

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

Item "Other" refers to reverse repo agreements in the total amount of HRK 41,075 thousand (31 December 2018: HRK 691,269 thousand). The above placements are collateralized by securities in the amount of HRK 43,115 thousand (31 December 2018: HRK 737,701 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)
(All amounts are expressed in HRK thousand)

15. Loans to other customers

Loans to other customers, impaired for loss allowances, may be summarized by sectors as follows:

	Group and Bank	
	31 December 2019 HRK '000	31 December 2018 HRK '000
Domestic companies	10,551,828	10,252,669
State-owned companies	1,253,879	1,103,711
Public sector	3,710,224	2,995,506
Foreign companies	794,802	787,639
Non-profit institutions	5,900	5,902
Other	557,577	588,164
Accrued interest	281,512	251,405
Deferred recognition of loan origination fees	(91,014)	(94,014)
	<u>17,064,708</u>	<u>15,890,982</u>
Loss allowances	<u>(3,365,074)</u>	<u>(3,380,296)</u>
	<u>13,699,634</u>	<u>12,510,686</u>

The following tables sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

31 December 2019	Group and Bank				
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000
Gross amount	10,387,025	1,764,833	3,727,938	1,184,912	17,064,708
Loss allowances	<u>(302,945)</u>	<u>(627,951)</u>	<u>(2,313,514)</u>	<u>(120,664)</u>	<u>(3,365,074)</u>
Balance as of 31 December 2019	<u>10,084,080</u>	<u>1,136,882</u>	<u>1,414,424</u>	<u>1,064,248</u>	<u>13,699,634</u>
31 December 2018	Group and Bank				
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000
Gross amount	9,760,653	1,636,528	4,198,058	295,743	15,890,982
Loss allowances	<u>(351,878)</u>	<u>(494,557)</u>	<u>(2,469,639)</u>	<u>(64,222)</u>	<u>(3,380,296)</u>
Balance as of 31 December 2018	<u>9,408,775</u>	<u>1,141,971</u>	<u>1,728,419</u>	<u>231,521</u>	<u>12,510,686</u>

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

15. Loans to other customers (continued)

The movements in the loss allowances on loans to other customers may be summarized as follows:

	Jan 1 - Dec 31, 2019 HRK 000	Group and Bank Jan 1 - Dec 31, 2018 HRK 000
Balance as of 1 January	3,380,296	3,593,205
Net release of loss allowances on loans to other customers and interest	(33,136)	(211,161)
<i>Total recognised through Income Statement (Note 10)</i>	<u>(33,136)</u>	<u>(211,161)</u>
Net foreign exchange gain/loss on loss allowances	9,126	(15,114)
Write-offs	(26,751)	(43,258)
Write-off due to sale of receivables	(52)	-
Loss allowances transferred from loans to financial institutions	3	28
Unwinding – changes due to the lapse of time	33,618	57,089
Acquisition of immovable property	(6,475)	(989)
Conversion of receivables into shares	(1,812)	-
Interest transferred from the off-balance sheet records and other	10,257	496
Balance at the end of the reporting period	<u>3,365,074</u>	<u>3,380,296</u>

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

15. Loans to other customers (continued)

Loans to other customers, net of loss allowances, may be summarized by loan programme as follows:

	Group and Bank	
	31 December 2019	31 December 2018
	HRK '000	HRK '000
Loan programme for reconstruction and development of the economy	3,968,956	3,588,290
Export financing	5,169,252	5,428,712
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	4,347,002	3,771,861
Loan programme for small and medium-sized enterprises	1,616,868	1,818,620
Other	1,772,132	1,126,108
Accrued interest	281,512	251,405
Deferred recognition of loan origination fees	(91,014)	(94,014)
	<u>17,064,708</u>	<u>15,890,982</u>
Loss allowances	<u>(3,365,074)</u>	<u>(3,380,296)</u>
	<u>13,699,634</u>	<u>12,510,686</u>

Average interest rates on loans to other customers are stated at 1.79% (31 December 2018: 1.79%).

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

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

16. Financial assets at fair value through profit or loss

	Group		Bank	
	31 December 2019 HRK '000	31 December 2018 HRK '000	31 December 2019 HRK '000	31 December 2018 HRK '000
Loans at FVPL:				
Mezzanine loans	2,234	2,045	2,234	2,045
	2,234	2,045	2,234	2,045
Investments in investment				
Investments in investment funds at FVPL	200,868	334,060	191,029	328,597
	200,868	334,060	191,029	328,597
Unlisted equity instruments:				
Investments in corporate	31	-	31	-
Depository receipt - DR	539	-	539	-
Investments in financial institutions' shares	161	161	161	161
	731	161	731	161
	203,833	336,266	193,994	330,803

Shares of companies that are not listed relate to the shares of the company Vinka d.d. for the production of agricultural products acquired through company restructuring measures in replacement of a portion of placements. The percentage of HBOR's share in the equity of the company Vinka d.d., Vinkovci representing a 0.9365%. The shares of the company Vinka d.d., Vinkovci (LPVC-R-B) are not listed and the fair value is estimated to be HRK 0 thousand (31 December 2018: HRK 0 thousand).

The shares of companies not listed on the stock exchange in the amount of HRK 31 thousand (0.03% portion) relate to the shares of the company Helios Faros d.d., in bankruptcy, acquired by HBOR in the reporting period in substitution for a portion of receivables by accepting the company's bankruptcy restructuring plan.

Non-listed equity securities in the amount of HRK 539 thousand relate to depository receipts (DR) of the Fortenova Group STAK Stichting taken over through the Settlement under the Extraordinary Administration Proceedings against the company Agrokor d.d. et al.

The shares of financial institutions that are not listed relate to the shares of Tržište novca i kratkoročnih vrijednosnica d.d. (Money Market and Short-Term Securities) and are stated in the amount of HRK 161 thousand (31 December 2018: HRK 161 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

17. Financial assets at fair value through other comprehensive income

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Republic of Croatia	1,122,448	1,124,611	1,083,749	1,088,457
Corporate bonds	1,000	770	-	-
Treasury bills of the Ministry of Finance	414,788	1,666,299	414,788	1,666,299
Accrued interest	11,232	11,313	10,762	10,839
	1,549,468	2,802,993	1,509,299	2,765,595
Unlisted debt instruments:				
Corporate bonds	573	535	573	535
Convertible bonds - CB	2,155	-	2,155	-
Accrued interest	369	233	369	233
	3,097	768	3,097	768
Equity instruments:				
Unlisted equity instruments:				
Investments in shares of foreign legal entities - SWIFT	40	38	40	38
Shares of foreign financial institutions – EIF	26,205	25,671	26,205	25,671
	26,245	25,709	26,245	25,709
	1,578,810	2,829,470	1,538,641	2,792,072

Non-listed convertible bonds (CB) of the Fortenova Group TopCo B.V. in the amount of HRK 2,155 thousand have been taken over through the Settlement under the Extraordinary Administration Proceedings against the company Agrokor d.d. et al.

The following tables sets out information about the credit quality of financial assets measured at FVOCI. The amounts in the table represent gross carrying amounts:

31 December 2019	Group				Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	1,549,468	875	2,222	1,552,565	1,509,299	875	2,222	1,512,396
Balance as of 31 December 2019	1,549,468	875	2,222	1,552,565	1,509,299	875	2,222	1,512,396
31 December 2018	Group				Bank			
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Total HRK 000
Gross amount	2,802,223	770	768	2,803,761	2,765,595	-	768	2,766,363
Balance as of 31 December 2018	2,802,223	770	768	2,803,761	2,765,595	-	768	2,766,363

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

17. Financial assets at fair value through other comprehensive income (continued)

Changes in the loss allowances of financial assets at fair value through other comprehensive income, do not impair the carrying value of financial assets, may be summarized as follows:

	Group		Bank	
	Jan 1 – Dec 31, 2019	Jan 1 – Dec 31, 2018	Jan 1 – Dec 31, 2019	Jan 1 – Dec 31, 2018
	HRK 000	HRK 000	HRK 000	HRK 000
Balance as of 1 January	6,746	4,288	6,459	3,997
Net (release)/increase of loss allowances	(3,401)	2,477	(3,186)	2,481
<i>Total recognised through Income Statement (Note 10)</i>	<i>(3,401)</i>	<i>2,477</i>	<i>(3,186)</i>	<i>2,481</i>
Net foreign exchange gain/loss on loss allowances	10	(19)	10	(19)
Balance at the end of the reporting period	3,355	6,746	3,283	6,459

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

17. Financial assets at fair value through other comprehensive income (continued)

The following text contains investment breakdown:

	Date of issue	Date of maturity	Interest rate (%)	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Listed debt instruments:							
Debt instruments:							
<i>Bonds of the Republic of Croatia with a currency clause:</i>							
RHMF-O-19BA	29.11.2004.	29.11.2019.	5.375	-	44,711	-	43,777
RHMF-O-227E	22.7.2011.	22.7.2022.	6.5	164,005	169,815	164,005	169,815
RHMF-O-247E	10.7.2013.	10.7.2024.	5.75	18,264	18,083	12,894	12,728
RHMF-O-203E	5.3.2010.	5.3.2020.	6.5	753	797	-	-
RHMF-O222E	5.2.2019.	5.2.2022.	0.5	14,963	-	14,963	-
<i>Bonds of the Republic of Croatia in foreign currency:</i>							
XS1117298916	11.3.2015.	11.3.2025.	3.0	58,954	55,867	58,954	55,867
XS1843434876	19.6.2019.	19.10.2029.	1.125	15,376	-	15,376	-
<i>Bonds of the Republic of Croatia in HRK:</i>							
RHMF-O-203A	5.3.2010.	5.3.2020.	6.75	32,965	35,074	30,331	32,270
RHMF-O-257A	9.7.2015.	9.7.2025.	4.5	10,229	9,861	-	-
RHMF-O-26CA	14.12.2015.	14.12.2026.	4.25	47,643	44,544	37,700	35,261
RHMF-O-217A	8.7.2016.	8.7.2021.	2.75	226,436	229,636	224,355	227,522
RHMF-O-222A	7.2.2017.	7.2.2022.	2.25	72,918	73,106	72,918	73,106
RHMF-O-282A	7.2.2017.	7.2.2028.	2.875	14,026	12,653	11,800	10,641
RHMF-O-023BA	27.11.2017.	27.11.2023.	1.75	440,453	427,470	440,453	427,470
RHMF-O-297A	9.7.2018.	9.7.2029.	2.38	3,483	2,994	-	-
RHMF-O-34BA	27.11.2019.	27.11.2034.	1.00	1,980	-	-	-
<i>Corporate bonds in HRK:</i>							
JDGL-O-20CA	21.12.2015.	21.12.2020.	5.81	-	770	-	-
JDGL-O-24XA	18.12.2019.	18.12.2024.	1.75	1,000	-	-	-
Treasury bills in HRK up to 364 days			0.111-	399,912	1,369,700	399,912	1,369,700
Treasury bills with currency clause up to 295 days			0.097	14,876	-	14,876	-
Treasury bills in foreign currency up to 455 days			0.093	-	296,599	-	296,599
Accrued interest				11,232	11,313	10,762	10,839
				1,549,468	2,802,993	1,509,299	2,765,595
Unlisted debt instruments:							
<i>Corporate bonds with a currency clause:</i>							
LNGU-O-31AE	24.7.2015.	15.10.2031.	4.5	573	535	573	535
<i>Bonds of foreign corporate in foreign currency</i>							
Fortenova Group TopCo B.V.	1.4.2019.	1.4.2029.	2.5	2,155	-	2,155	-
Accrued interest				369	233	369	233
				3,097	768	3,097	768
Equity instruments:							
<i>Unlisted equity instruments:</i>							
Investments in shares of foreign legal entities - SWIFT				40	38	40	38
Investments in shares of foreign financial institutions - EIF				26,205	25,671	26,205	25,671
				26,245	25,709	26,245	25,709
Total				1,578,810	2,829,470	1,538,641	2,792,072

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

18. Debt instruments at amortised cost

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
<i>Debt instruments:</i>				
Listed debt instruments:				
Bonds of the Republic of Croatia	448	1,352	-	-
Accrued interest	9	13	-	-
	<u>457</u>	<u>1,365</u>	<u>-</u>	<u>-</u>
Loss allowances	-	(2)	-	-
	<u>457</u>	<u>1,363</u>	<u>-</u>	<u>-</u>

The following tables sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

31 December 2019	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Group Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Bank Total HRK 000
Gross amount	457	-	-	457	-	-	-	-
Loss allowances	-	-	-	-	-	-	-	-
Balance as of 31 December 2019	<u>457</u>	<u>-</u>	<u>-</u>	<u>457</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

31 December 2018	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Group Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	Bank Total HRK 000
Gross amount	1,365	-	-	1,365	-	-	-	-
Loss allowances	(2)	-	-	(2)	-	-	-	-
Balance as of 31 December 2018	<u>1,363</u>	<u>-</u>	<u>-</u>	<u>1,363</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

The movements in the loss allowances on debt instruments at amortised cost may be summarized as follows:

	2019 HRK '000	Group 2018 HRK '000	2019 HRK '000	Bank 2018 HRK '000
Balance as of 1 January	2	2	-	-
Net release of loss allowances on debt instruments at amortised cost	(2)	-	-	-
Balance as of 31 December	<u>-</u>	<u>2</u>	<u>-</u>	<u>-</u>

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203E) issued with foreign currency clause on 5 March 2010 are repayable over 10 years with an interest rate of 6.5%. As of 31 December 2018, the value of these outstanding bonds amounted to HRK 448 thousand (31 December 2018: HRK 454 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%. The bonds were redeemed upon maturity on 29 November 2019 (31 December 2018: HRK 898 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

19. Investments in subsidiaries

As at 31 December 2019, the Bank's subsidiaries are as follows:

Consolidated company	Activity	Ownership 31 December 2019	Ownership 31 December 2018	Investment 31 December 2019	Investment 31 December 2018
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%	100%	36,124	36,124
Total				36,124	36,124

Result of the subsidiary has been disclosed in Appendix – Financial performance of the HKO Group.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

20. Investments in associates

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Investments in associates	12,000	17,500	12,000	17,500
Value adjustments	(12,000)	(17,500)	(12,000)	(17,500)
	-	-	-	-

Investments in associates were carried out within a Program of investments in the equity of companies – small and medium sized entrepreneurs or pursuant to single decisions of authorized bodies of HBOR. The investments were made for a period ranging from 4 to 6 years with the right of HBOR to sell the shares after the contracted term of holding an equity stake.

Line of business	% ownership in 2019	% ownership in 2018
THC d.o.o., Obrovac	38.45%	38.45%
Pounje d.d., Hrvatska Kostajnica	13.55%	13.55%
Metal-Sint Oklaj d.d., Oklaj	-	40.84%

The value of investment was 100% adjusted in prior years due to assessed non-recoverability of the investment.

Pursuant to the decision of the Bank's Management Board dated 26 July 2019 to resume the sale of 55,000 preference shares of the company Metal-Sint Oklaj d.d., Oklaj owned by HBOR through a public tender procedure, the shares have been sold pursuant to the Share Purchase Agreement dated 10 September 2019, and the shares have been derecognised from HBOR's books.

Changes in provisions for possible losses from investments in associates can be presented as follows:

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Balance as of 1 January	17,500	21,873	17,500	21,873
Derecognition against provisions formed in previous years	(5,500)	-	(5,500)	-
Write-offs due to the conclusion of the bankruptcy proceedings	-	(4,373)	-	(4,373)
Balance as at 31 December	12,000	17,500	12,000	17,500

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

21. Property, plant and equipment and intangible assets

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2019							
Cost							
At 31 December 2018	77,102	9,713	15,103	896	102,814	30,357	133,171
Additions	1,093	17	-	3,084	4,194	112	4,306
Transfer from assets not yet ready for use	-	558	180	(1,831)	(1,093)	996	(97)
Returned to use	-	130	-	-	130	-	130
Transfer from advance payments	-	-	27	-	27	-	27
Disposals and write-offs	-	(716)	(544)	-	(1,260)	-	(1,260)
At 31 December 2019	78,195	9,702	14,766	2,149	104,812	31,465	136,277
Accumulated depreciation and write-off							
At 31 December 2018	32,817	8,546	13,470	-	54,833	27,506	82,339
Depreciation for 2018	4,075	830	639	-	5,544	1,232	6,776
Returned to use	-	130	-	-	130	-	130
Disposals and write-offs	-	(716)	(533)	-	(1,249)	-	(1,249)
At 31 December 2019	36,892	8,790	13,576	-	59,258	28,738	87,996
Net book value at 31 December 2019	41,303	912	1,190	2,149	45,554	2,727	48,281
Net book value at 31 December 2018	44,285	1,167	1,633	896	47,981	2,851	50,832

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

21. Property, plant and equipment and intangible assets (continued)

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2018							
Cost							
At 31 December 2017	77,102	9,977	15,381	708	103,168	28,652	131,820
Additions	-	47	-	3,470	3,517	24	3,541
Transfer from assets not yet ready for use	-	780	821	(3,282)	(1,681)	1,681	-
Disposals and write-offs	-	(1,091)	(1,099)	-	(2,190)	-	(2,190)
At 31 December 2018	77,102	9,713	15,103	896	102,814	30,357	133,171
Accumulated depreciation and write-off							
At 31 December 2017	30,481	9,206	13,941	-	53,628	24,635	78,263
Depreciation for 2018	2,336	431	627	-	3,394	2,871	6,265
Disposals and write-offs	-	(1,091)	(1,098)	-	(2,189)	-	(2,189)
At 31 December 2018	32,817	8,546	13,470	-	54,833	27,506	82,339
Net book value at 31 December 2018	44,285	1,167	1,633	896	47,981	2,851	50,832
Net book value at 31 December 2017	46,621	771	1,440	708	49,540	4,017	53,557

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

21. Property, plant and equipment and intangible assets (continued)

Bank	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2018							
Cost							
At 31 December 2018	77,102	9,278	14,912	895	102,187	29,694	131,881
Additions	-	-	-	2,982	2,982	-	2,982
Transfer from assets not ready for use	-	552	190	(1,729)	(987)	987	-
Returned to use	-	130	-	-	130	-	130
Disposals and write-offs	-	(714)	(501)	-	(1,215)	-	(1,215)
At 31 December 2019	77,102	9,246	14,601	2,148	103,097	30,681	133,778
Accumulated depreciation and write-off							
At 31 December 2018	32,817	8,139	13,297	-	54,253	26,864	81,117
Depreciation for 2018	3,856	804	540	-	5,200	1,223	6,423
Returned to use	-	130	-	-	130	-	130
Disposals and write-offs	-	(714)	(487)	-	(1,201)	-	(1,201)
At 31 December 2019	36,673	8,359	13,350	-	58,382	28,087	86,469
Net book value at 31 December 2019	40,429	887	1,251	2,148	44,715	2,594	47,309
Net book value at 31 December 2018	44,285	1,139	1,615	895	47,934	2,830	50,764

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

21. Property, plant and equipment and intangible assets (continued)

Bank	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
2018							
Cost							
At 31 December 2017	77,102	9,589	15,177	707	102,575	28,013	130,588
Additions	-	-	-	3,470	3,470	-	3,470
Transfer from assets not ready for use	-	780	821	(3,282)	(1,681)	1,681	-
Disposals and write-offs	-	(1,091)	(1,086)	-	(2,177)	-	(2,177)
At 31 December 2018	77,102	9,278	14,912	895	102,187	29,694	131,881
Accumulated depreciation and write-off							
At 31 December 2017	30,481	8,823	13,769	-	53,073	24,001	77,074
Depreciation for 2018	2,336	407	614	-	3,357	2,863	6,220
Disposals and write-offs	-	(1,091)	(1,086)	-	(2,177)	-	(2,177)
At 31 December 2018	32,817	8,139	13,297	-	54,253	26,864	81,117
Net book value at 31 December 2018	44,285	1,139	1,615	895	47,934	2,830	50,764
Net book value at 31 December 2017	46,621	766	1,408	707	49,502	4,012	53,514

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

22. Foreclosed assets

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Foreclosed assets	24,198	25,330	24,198	25,330
	24,198	25,330	24,198	25,330

In 2019, acquisition of property took place with present value in the amount of HRK 3,084 thousand, acquisition value of HRK 14,215 thousand and provisions of HRK 11,131 thousand, and relates to buildings (in 2018, acquisition of property took place with present value in the amount of HRK 8,538 thousand, acquisition value of HRK 10,195 thousand and provisions of HRK 1,657 thousand, and relates to land plot in the amount of HRK 2,286 thousand, acquisition value of HRK 2,584 thousand and provisions of HRK 298 thousand and buildings in the amount of HRK 6,252 thousand, acquisition value of HRK 7,611 thousand and provisions of HRK 1,359 thousand).

Fair value of acquired property at the end of 2019 amounted to HRK 14,674 thousand.

In 2019, sale of foreclosed assets took place with present value in the amount of HRK 4,244 thousand, acquisition value and provisions of HRK 9,361 thousand and provisions of HRK 5,117 thousand, and relates to land plot in the amount of HRK 2,297 thousand, buildings in the amount of HRK 1,916 thousand and apartments of HRK 31 thousand.

In 2019, foreclosed assets was transferred to lease on the item Investments in property in the amount of HRK 1,124 thousand (2018: HRK 1,743 thousand), which is presented under Other assets due to immaterial significance. In 2019, this property was depreciated in the amount of HRK 83 thousand (2018: HRK 64 thousand).

The fair value of foreclosed assets at the beginning of the reporting period stood at HRK 38,261 thousand and the end of the reporting period at HRK 46,275 thousand.

Adjustment increase amount for the Group and the Bank that has an effect on the profit or loss stood at HRK 780 thousand in 2019 (in 2018: increase of HRK 157 thousand).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

23. Other assets

	Group			Bank
	31 December 2019 HRK '000	31 December 2018 HRK '000	31 December 2019 HRK '000	31 December 2018 HRK '000
Fees receivable	27,855	27,161	27,855	27,161
Other receivables	13,922	11,070	13,922	10,904
Prepaid expenses	2,537	3,002	2,397	3,002
Accrued income	9,257	6,437	9,257	6,437
Premium receivables	4,308	7,371	-	-
Receivables for reinsurance commissions	1,061	867	-	-
Receivables for risk assessment fees	299	371	-	-
Leased assets	5,061	-	4,854	-
Other assets	1,085	1,543	1,073	1,543
	<u>65,385</u>	<u>57,822</u>	<u>59,358</u>	<u>49,047</u>
Loss allowances	(35,570)	(34,118)	(35,436)	(33,883)
	<u>29,815</u>	<u>23,704</u>	<u>23,922</u>	<u>15,164</u>

Lease assets are recognised in accordance with the application of the IFRS 16 and depreciation during the year stood at HRK 1,741 thousand for the Group and HRK 1,658 thousand for the Bank.

The following tables sets out information about the credit quality of financial assets measured at amortised cost. The amounts in the table represent gross carrying amounts:

31 December 2019	Group					Bank				
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000
Gross amount	10,290	73	37,038	44	47,445	4,622	73	37,038	44	41,777
Loss allowances	(164)	(18)	(35,382)	(6)	(35,570)	(30)	(18)	(35,382)	(6)	(35,436)
Balance as of 31 December 2019	<u>10,126</u>	<u>55</u>	<u>1,656</u>	<u>38</u>	<u>11,875</u>	<u>4,592</u>	<u>55</u>	<u>1,656</u>	<u>38</u>	<u>6,341</u>

31 December 2018	Group					Bank				
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Total HRK 000
Gross amount	11,596	12	35,232	-	46,840	2,821	12	35,232	-	38,065
Loss allowances	(281)	-	(33,837)	-	(34,118)	(46)	-	(33,837)	-	(33,883)
Balance as of 31 December 2018	<u>11,315</u>	<u>12</u>	<u>1,395</u>	<u>-</u>	<u>12,722</u>	<u>2,775</u>	<u>12</u>	<u>1,395</u>	<u>-</u>	<u>4,182</u>

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

23. Other assets (continued)

The following text contains the breakdown of positions stated as credit risk:

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Fees receivable	27,855	27,161	27,855	27,161
Other receivables	13,922	11,070	13,922	10,904
Premium receivables	4,308	7,371	-	-
Receivables for reinsurance	1,061	867	-	-
Receivables for risk assessment fees	299	371	-	-
	<u>47,445</u>	<u>46,840</u>	<u>41,777</u>	<u>38,065</u>
Loss allowance	(35,570)	(34,118)	(35,436)	(33,883)
Subtotal – credit risk	<u>11,875</u>	<u>12,722</u>	<u>6,341</u>	<u>4,182</u>

The movements in the loss allowances on other assets may be summarized as follows:

	Jan 1 - Dec 31, 2019 HRK 000	Group Jan 1 - Dec 31, 2018 HRK 000	Jan 1 - Dec 31, 2019 HRK 000	Bank Jan 1 - Dec 31, 2018 HRK 000
Balance as of 1 January	34,118	13,223	33,883	13,087
Net increase of loss allowances on other assets	1,561	20,915	1,584	20,814
<i>Total recognised through Income statement (Note 10)</i>	<u>1,561</u>	<u>20,915</u>	<u>1,584</u>	<u>20,814</u>
Write-offs	(114)	(10)	(38)	(10)
Acquisition of immovable property	-	(14)	-	(14)
Net foreign exchange gain/loss on loss allowances	7	6	7	6
Other adjustments	(2)	(2)	-	-
Balance at the end of the reporting period	<u>35,570</u>	<u>34,118</u>	<u>35,436</u>	<u>33,883</u>

Net foreign exchange gain/loss on loss allowances are shown within net gains/(losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

24. Deposits from customers

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Bank deposits	1,320	149,140	1,320	149,140
Foreign currency regular accounts of companies	6	6	6	6
Foreign currency account of the Ministry of Finance of the Republic of Croatia	12,874	22,593	12,874	22,593
Foreign currency special purpose accounts of the companies	22,189	10,725	22,189	10,725
Foreign currency special accounts of foreign financial institutions	6,244	-	6,244	-
State institutions' deposits	121,958	237,972	121,958	237,972
Other deposits	12,178	8,660	12,178	8,660
	176,769	429,096	176,769	429,096

Banks' deposits and foreign exchange deposits of foreign financial institutions in 2018 related mostly to loro deposit of UniCredit Bank Austria AG in the amount of HRK 148,352 thousand.

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 6,889 thousand (31 December 2018: HRK 9,693 thousand), grant funds provided by the Global Environment Facility (GEF) aimed at the Renewable Energy Resources Project of HRK 0 thousand (31 December 2018: HRK 7,078 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 5,985 thousand (31 December 2018: HRK 5,822 thousand), all managed by HBOR for and on behalf of the Republic of Croatia.

State institutions' demand deposits relate to the Bank's operations carried out for and on behalf of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development, EU Funds, the company Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs, Innovations and Investments ("HAMAG-BICRO").

Foreign currency special purpose accounts of the companies relate to the inflow of funds and disposition of the advance payment funds paid to the company's account in relation to the issued guarantees of HBOR for the repayment of advance for export transactions. The funds of the advance are used exclusively for the specified purpose of implementation of an export contract, with the consent of HBOR.

Foreign currency special accounts of foreign financial institutions relate to the proceeds of ELENA grant, and it relates to the first tranche of 40% of ELENA grant amount upon signing of the Finance Contract in the amount of EUR 839 thousand.

HBOR does not pay interest on the above deposits.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

25. Borrowings

	Group	
	31 December 2019	31 December 2018
	HRK '000	HRK '000
Balance as of 1 January	14,863,426	15,399,788
New borrowings	3,036,226	2,284,763
Repayments	(3,581,195)	(2,658,936)
Net foreign exchange gain/loss	67,178	(162,189)
	<u>14,385,635</u>	<u>14,863,426</u>
Accrued interest	46,498	55,014
Deferred fees	(31,680)	(40,453)
	<u>14,400,453</u>	<u>14,877,987</u>

The bank is subject to various financial clauses from the Contract. During 2019 and as of 31 December 2019 the Bank was in compliance with all required financial clauses from the Contract.

26. Debt securities issued

The book value of bonds includes interest.

Group and Bank	Effective interest rate	Fair value	Net book value	Fair value	Net book value
		31 December 2019	31 December 2019	31 December 2018	31 December 2018
		HRK '000	HRK '000	HRK '000	HRK '000
Bonds EUR 150 million	6.37	1,141,506	1,114,976	1,190,721	1,107,413
Accrued interest		-	43,374	-	43,347
Deferred fees		-	(59)	-	(203)
		<u>1,141,506</u>	<u>1,158,291</u>	<u>1,190,721</u>	<u>1,150,557</u>

Bonds were issued on the Luxembourg Stock Exchange and are listed. The fair value of bonds issued by HBOR is presented by using level 2 inputs corroborated by the market and observable at Bloomberg service on the basis of the mid-rate of Bloomberg Generic prices (BGN).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

27. Provisions for guarantees, commitments and other liabilities

	Group		Bank	
	31 December	31 December	31 December	31 December
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Provisions for guarantees and commitments	57,716	261,283	57,716	261,283
Provisions for other liabilities	63,064	60,208	62,915	60,078
	120,780	321,491	120,631	321,361

The movements in the loss allowances on guarantees, commitments and other liabilities may be summarized as follows:

	Group		Bank	
	Jan 1 - Sep 30,	Jan 1 - Dec 31,	Jan 1 - Sep 30,	Jan 1 - Dec 31,
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	261,283	49,347	261,283	49,347
Net (release)/increase of loss allowances on guarantees	(156,368)	141,180	(156,368)	141,180
<i>Total recognised through Income Statement (Note 10)</i>	<i>(156,368)</i>	<i>141,180</i>	<i>(156,368)</i>	<i>141,180</i>
Net (release)/increase of loss allowances on commitments	(47,722)	68,931	(47,722)	68,931
Total recognised through Income Statement (Note 10)	(47,722)	68,931	(47,722)	68,931
Net foreign exchange on loss allowances	523	1,825	523	1,825
Balance at the end of the reporting period - Provisions for guarantees and commitments	57,716	261,283	57,716	261,283
Balance as of 1 January	60,208	76,980	60,078	76,723
Net increase/release of loss allowances on other liabilities	2,912	(16,918)	2,893	(16,789)
<i>Total recognised through Income Statement (Note 10)</i>	<i>2,912</i>	<i>(16,918)</i>	<i>2,893</i>	<i>(16,789)</i>
Unrealized actuarial gains/(losses)	(56)	144	(56)	144
Other adjustments	-	2	-	-
Balance at the end of the reporting period - Provisions for other liabilities	63,064	60,208	62,915	60,078

Net foreign exchange gain/loss on loss allowances are shown within net gains/ (losses) from financial activities in the Income Statement.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

27. Provisions for guarantees, commitments and other liabilities (continued)

Out of the total provisions for guarantees and commitments, the amount of HRK 5,413 thousand relates to financial institutions (31 December 2018: HRK 2,444 thousand), HRK 52,262 thousand relates to domestic companies (31 December 2018: HRK 258,622 thousand), HRK 20 thousand relates to the public sector (31 December 2018: HRK 147 thousand), HRK 21 thousand relates to other (31 December 2018: HRK 70 thousand).

In 2019, provisions for other liabilities for the Group totalled HRK 63,064 thousand (31 December 2018: HRK 60,208 thousand) and for the Bank stood at HRK 62,915 thousand (31 December 2018: HRK 60,078 thousand). The total amount of provisions for other liabilities was comprised of HRK 7,313 thousand for court proceedings initiated against the Bank (31 December 2018: HRK 6,787 thousand), HRK 30,490 thousand for liabilities for the Group and for the Bank based on benefits defined in accordance with IAS 19 Employee Benefits (31 December 2018: HRK 28,494 thousand), and in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets HRK 25,261 thousand for provisions for other liabilities for the Group (31 December 2018: HRK 24,927 thousand) and HRK 25,112 thousand for the Bank (31 December 2018: HRK 24,797 thousand).

The latest actuarial assessment of present value of liabilities based on defined benefits as at 31 December 2019 was performed by a certified actuary. The model took into account mortality, fluctuation of employees, growth rate in defined benefits and discount rate, and the calculations for every employee considered age, gender, years of service, expected mortality and discount rate, i.e. the long-run sustainable yield rate on bonds of the Republic of Croatia.

The applied discount rate that represents the yield rate on bonds sustainable in the long run is 2.80%, whereas it stood at 4.25% in the previous year.

Unrealised actuarial gains/(losses) arising from the calculation of provisions are stated within the framework of other comprehensive income so that net assets or liability may reflect the entire value of deficit or surplus planned.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

28. Other liabilities

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Deferred recognition of interest income	162,937	226,064	162,937	226,064
Liabilities in respect of subsidized interest	132,912	120,726	132,912	120,726
Accrued salaries	7,480	7,405	7,285	7,218
Liabilities to suppliers	4,977	2,766	4,879	2,662
Liabilities for prepaid receivables	4,335	2,378	4,335	2,378
Deferrable premium	3,560	2,880	-	-
Provisions for claims	5,449	4,527	-	-
Provisions for return premiums	991	791	-	-
Liabilities to re-insurers	3,149	2,407	-	-
Deferred tax liabilities	694	669	-	-
Corporate income tax-current liability	29	-	-	-
Lease liabilities	5,944	-	4,926	-
Other liabilities	7,280	8,130	5,973	6,866
	339,737	378,743	323,247	365,914

Liabilities in respect of subsidized interest represent advances taken in respect of interest subsidies on loans, which are provided for final customers at a lower interest rate in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia. These liabilities include:

- HRK 132,912 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (31 December 2018: HRK 120,433 thousand),
- HRK 0 thousand in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet – Ministry of Agriculture (31 December 2018: HRK 293 thousand).

Deferred recognition of interest income of HRK 162,937 thousand (31 December 2018: HRK 226,064 thousand) consists of state subsidies for interest in respect of loans which are provided and drawn down by final borrowers at lower interest rates but are not yet in repayment stage, amounting to HRK 13,158 thousand (31 December 2018: HRK 7,694 thousand), and in respect of those already in repayment stage amounting to HRK 149,779 thousand (31 December 2018: HRK 218,370 thousand) (see Note 4.2. L. Government grants).

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

29. Founder's capital

Under the HBOR Act, the prescribed founder's capital should amount to HRK 7,000,000 thousand, paid from the State Budget and from other sources as specified by separate laws.

The schedule of annual amounts of payment and the time schedule of payments out of the State Budget into the capital are not set in advance, but are determined by the Croatian Parliament as part of the process of adoption of the State Budget of the Republic of Croatia.

Within its Accounting policies, the Group has set out its objectives of capital management, category of capital managed by the Bank as well as measuring and assessing the policies for capital management. Capital management is described and presented in Note 37.

Founder's capital of the subsidiary Hrvatsko kreditno osiguranje d.d. amounts to HRK 37,500 thousand and is 100% owned by the Bank, and the founder's capital of the company Poslovni info servis d.o.o. amounts to HRK 300 thousand and is 100% owned by Hrvatsko kreditno osiguranje d.d.. The capital of both companies is subscribed and paid in full.

30. Guarantee fund

Group and Bank	HRK '000
Balance as of 1 January 2018	12,303
Net foreign exchange	(157)
Balance as of 31 December 2018	12,146
Net foreign exchange	40
Balance as of 31 December 2019	12,186

The Guarantee fund of HRK 12,186 thousand and HRK 12,146 thousand as of 31 December 2019 and 2018 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.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

31. Guarantees and commitments

In its regular activities, the Group contracts various commitments and contingent liabilities. The purpose of these instruments is to ensure that the funds are available to a customer when required.

These obligations contain credit risk and are therefore part of the overall risk of the Group although they are not recognised in the Statement of financial position.

Group and Bank

	31 December 2019 HRK '000	31 December 2018 HRK '000
Guarantees issued in HRK	62,102	33,917
Guarantees issued in foreign currency	210,972	1,994,851
Undrawn loans	3,995,159	3,379,519
Open letters of credit	11,693	-
EIF – subscribed, not called up capital	47,632	47,472
EIF CROGIP Contracted Liability	259,858	-
EIF FRC2 Contracted Liability	12,362	-
Other irrevocable contingent liabilities	93	93
	<u>4,599,871</u>	<u>5,455,852</u>
Provisions for guarantees and commitments	<u>(57,716)</u>	<u>(261,283)</u>
	<u>4,542,155</u>	<u>5,194,569</u>

The following tables set out information about the credit quality of guarantees and commitments. For loan commitments and financial guarantee contracts, the amounts in the tables represent the amount committed or guaranteed:

	Group and Bank					
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Without stage HRK 000	Total HRK 000
Gross amount	3,567,744	393,223	179,200	128,159	11,693	4,280,019
Loss allowances	(24,946)	(14,289)	(15,918)	(2,563)	-	(57,716)
Balance as of 31 December 2019	<u>3,542,798</u>	<u>378,934</u>	<u>163,282</u>	<u>125,596</u>	<u>11,693</u>	<u>4,222,303</u>

	Group and Bank					
	Stage 1 HRK 000	Stage 2 HRK 000	Stage 3 HRK 000	POCI HRK 000	Without Stage HRK 000	Total HRK 000
Gross amount	2,708,846	669,160	2,009,169	21,205	-	5,408,380
Loss allowances	(9,170)	(65,094)	(175,996)	(11,023)	-	(261,283)
Balance as of 31 December 2018	<u>2,699,676</u>	<u>604,066</u>	<u>1,833,173</u>	<u>10,182</u>	<u>-</u>	<u>5,147,097</u>

Without Stage position relates to Opened letters of credit covered by deposits.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

31. Guarantees and commitments (continued)

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 40%, collateralized by the guarantees, deposits and bank guarantees.

Commitments upon undrawn loans

The Bank has an obligation to disburse funds for loans and revolving loans upon committed undrawn loans. The expiry date of disbursement or other termination clause is determined by the contract. Disbursements are exercised in several withdrawals, depending on the purpose of the loan, phase of the project or documentation needed for disbursement. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash outflows.

Committed undrawn loans include less potential credit risk than loans, since most commitments depend upon meeting specific terms and conditions by the customers in order to use the funds. The Bank monitors the terms to maturity of loan commitments.

Other irrevocable contingent liabilities

Other irrevocable contingent liabilities relate to HBOR's obligation based on the Agreement concluded on 24 January 2014 with HBOR – Export Credit Insurance performing transactions for and on behalf of the Republic of Croatia. Pursuant to this Agreement, HBOR shall, in case of disposal of the real estate taken over and the recovery from debtors in a pre-bankruptcy settlement, provided that certain conditions have been fulfilled, pay the recovered funds to the Guarantee fund of the Export Credit Insurance.

The above contingent liability was reduced due to the completion of bankruptcy proceedings during which recourse payment was not collected.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

32. Managed funds for and on behalf of third parties

The Group manages funds on behalf of and for the account of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the Ministry of Environment and Energy, the company Vodovod i kanalizacija d.o.o., Split, the Croatian Agency for SMEs, Innovations and Investments (“HAMAG-BICRO”) and commercial banks, that are mainly used for various reconstruction and development programmes. These assets are separated from the Group’s assets. The income and expense relating to these transactions are charged to the principal, and the Group does not have any other liabilities. The Group charges a fee for part of the services and part of the services are performed free of charge depending on the contract with the customer and taking into account that the stated amounts are insignificant for the Group.

Agency business funds per individual programmes amount to:

Group and Bank	31 December	31 December
Program	2019	2018
	HRK '000	HRK '000
Development and Reconstruction of Rural Housing	19,810	27,220
Employment of Former Soldiers	273,873	345,318
Municipal Environmental Infrastructure Investment Program – MEIP	868,298	868,298
Collection of receivables under HAMAG-BICRO guarantees	137	155
Insurance of export transactions	310,852	396,366
Programme of Preferential Financing through HBOR’s Loan Programmes - Ministry of Finance	132,912	120,433
Programme for Regional Development of the Republic of Croatia - loans	5,183	7,090
Renewable Energy Resources Project	15,444	24,676
VIK – EKO account A – dedicated water charge	680,788	659,036
VIK – EKO account B – VAT	156,502	156,050
Programme of Issuing Bank Guarantees for Energy Efficiency Projects – IBRD	5,985	5,822
Financing the Establishment of Fishing Infrastructure – Ministry of the Sea, Transport and Infrastructure	46,665	46,665
Model for the Reconstruction and Modernisation of the Fishing Fleet – Ministry of Agriculture – interest subsidy	-	293
Micro-Loans with EU Support – commercial banks	604	428
Transactions related to investments in the Economic Co-operation Funds ³	473,507	496,822
ESIF – Growth and Expansion Loans	835,953	420,846
ESIF - Energy Efficiency in Public Sector Buildings	47,985	47,682
ESIF - Loans for Public Lighting	38,318	38,061
Investment loans for rural development	136,594	134,196
	4,049,410	3,795,457

³ The fair value of net assets value of the Economic Co-operation Funds in 2019 is recognised on the basis of the latest available data and does not represent the final fair value, whereas, in 2018, the amount was recognised in accordance with the audited financial statements.

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(All amounts are expressed in HRK thousand)

33. Related-party transactions

Related parties are companies that directly or indirectly, through one or more intermediaries, control, or are controlled by, the reporting company.

The majority of related-party transactions relate to the transactions with the Republic of Croatia, the 100% owner of the Bank and state-owned companies over which the Republic of Croatia has the controlling influence.

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

As of 31 December 2019 and 31 December 2018 balances arising from transactions with related parties, including the Bank's key management personnel, include the following:

a) Related-party transactions

Group	Assets	Liabilities	Assets	Liabilities
	31 December 2019	31 December 2019	31 December 2018	31 December 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	3,575,330	203,649	4,335,942	189,014
Government funds, executive authorities and agencies	1,351,888	62,057	1,044,262	189,877
State-owned companies	1,154,176	27	1,118,540	19
Associates	7	-	40	10
Key management personnel	3,802	1,667	4,498	2,117
Total	6,085,203	267,400	6,503,282	381,037

Group	Income	Expense	Income	Expense
	Jan 1 – Dec 31 2019	Jan 1 – Dec 31 2019	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	56,720	10,155	56,380	6,519
Government funds, executive authorities and agencies	36,806	814	146,400	710
State-owned companies	62,038	37,007	53,209	15,469
Associates	230	1	10	3
Key management personnel	203	9,322	153	9,749
Total	155,997	57,299	256,152	32,450

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

33. Related-party transactions (continued)

a) Related-party transactions (continued)

Bank	Assets	Liabilities	Assets	Liabilities
	31 December 2019	31 December 2019	31 December 2018	31 December 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	3,575,330	203,649	4,335,942	189,014
Government funds, executive authorities and agencies	1,312,254	62,004	1,006,177	189,666
State-owned companies	1,154,165	23	1,117,758	17
Subsidiary companies	36,124	-	36,124	-
Associates	7	-	40	10
Key management personnel	3,726	1,562	4,412	2,014
Total	6,081,606	267,238	6,500,453	380,721

Bank	Income	Expense	Income	Expense
	Jan 1 – Dec 31 2019	Jan 1 – Dec 31 2019	Jan 1 – Dec 31 2018	Jan 1 – Dec 31 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	56,720	10,155	56,380	6,519
Government funds, executive authorities and agencies	35,443	650	144,853	194
State-owned companies	62,038	36,933	53,164	15,403
Subsidiary companies	-	-	-	-
Associates	230	1	10	3
Key management personnel	200	7,879	147	8,318
Total	154,631	55,618	254,554	30,437

Assets include loans to other customers, debt instruments at amortised cost, financial assets at fair value through other comprehensive income, other assets and off-balance sheet exposure relating to commitments.

Liabilities include liabilities for deposits, salaries, provisions on behalf of retirement and jubilee awards of key management and other liabilities.

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

Expenses include expenses for key management salaries, impairment loss and provisions.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

33. Related-party transactions (continued)

b) Collateral received

	Group		Bank	
	31 December	31 December	31 December	31 December
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
The Republic of Croatia	3,445,178	4,192,023	3,444,955	4,096,373
State agencies	399,285	471,641	399,285	471,641
Total	3,844,463	4,663,664	3,844,240	4,568,014

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising the Republic of Croatia guarantees, HAMAG-BICRO guarantees, insurance policies of export transactions against political and/or commercial risks and statutory guarantees in cases when the Republic of Croatia or other state executive body guarantees the liabilities of certain borrowers pursuant to provisions of certain laws.

HBOR issues reinsurance policies for and on behalf of the Republic of Croatia, i.e. covers a proportional part (quota reinsurance) of political and commercial risks of export loans and receivables arising from export of goods and services. The reinsurer covers all non-marketable (non-market) risks underwritten by the Insurer or Hrvatsko kreditno osiguranje d.d. in the percentage ranging from 15% to 90% of an insured amount.

c) Salaries of key management personnel

Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, benefits payable for past service and payments under contractual agreements. In 2019, salaries for the Group amounted to HRK 9,100 thousand (31 December 2018: HRK 9,495 thousand), and for the Bank HRK 7,771 thousand (31 December 2018: HRK 8,198 thousand).

Remuneration for the work of the members of the Supervisory Board in 2019 amounted to HRK 222 thousand for the Group (31 December 2018: HRK 254 thousand) and for the Bank HRK 108 thousand (31 December 2018: HRK 119 thousand) and it relates to the members of supervisory boards at associates and subsidiaries who were appointed by HBOR.

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management

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

In the process of risk management, the Group identifies, estimates, measures, monitors, contains and controls the risks to which it is or might be exposed in the course of business and reports about them to the relevant authorities. By the mentioned procedures and appropriate internal documents, a comprehensive and complete risk management system is provided.

The most significant risks the Group is exposed in its day-to-day business are credit risk, liquidity risk, interest rate risk in the Bank's book, foreign exchange risk, operational risk and outsourcing risk. These risks are managed daily in accordance with the policies, ordinances, procedures, methodologies and limit systems, controls as well as decisions/conclusions of the Supervisory Board, the Management Board and the risk management committees.

The Group implements the sensitivity analyses and scenario analyses, provided that one or several risk factors are changed in regular or stressful circumstances, and the systems of pro-active risk management are continuously developed for the purpose of reducing possible future risks.

34.1. Overview of the most important risks

Credit risk

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

The credit risk management system is the most important part of the HBOR business policy and is an important factor of its operation strategy.

Liquidity risk, currency risk and interest rate risk in the Bank's book

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

Liquidity risk

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

In order to manage liquidity risk, the Group has established a system of limits and early warning signals, monitors and controls limit utilisation, maintains the adequate level of liquidity reserve, continuously monitors current and planned liquidity, ensures HRK and foreign currency funds necessary for timely settlement of liabilities and for disbursements of approved loans and planned loan approvals. In terms of liquidity risk management, the Group monitors and strives to achieve compatibility of contracted and planned placements with the respective sources according to maturity. The Group does not hold deposits of citizens and is therefore not exposed to wide daily fluctuations in liquidity.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.1. Overview of the most important risks (continued)

Liquidity risk (continued)

The Group monitors liquidity risk by implementing the sensitivity analyses and scenario analyses in regular or stressful business conditions. Procedures for liquidity crisis indication or occurrence are determined by the Ordinance on Liquidity Risk Management.

Interest rate risk in the Bank's book

The basic principles for managing the Group's interest rate risk are determined in the internal documents as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. For the purpose of measurement and monitoring of interest rate risk, the Group carries out interest rate gap analysis. Interest rate gap is calculated for certain periods according to the possibilities of interest rate changes and is used for presenting the sensitivity of the Group to the changes in interest rates under regular and stress conditions. Interest rates are structured per currency, type and value and projections of average weighted interest rates for Group's funds and placements are made. Furthermore, in addition to harmonising interest rates on sources and placements, current market conditions and movements in forecasted market indicators are also monitored.

Currency risk

The basic principles for managing HBOR's currency risk are determined in the internal acts as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. Methods for the measurement, i.e. assessment, monitoring and management of currency risk have been established, limits and early warning signals as well as proceedings both for cases of crisis indication and occurrence have been determined, and reports necessary for comprehensive perception of this risk have been defined.

The Group measures exposure to currency risk by monitoring open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the projections of its developments, the Group calculates, for the measurement/assessment of currency risk, the risk value and regularly reports to the bodies in charge on maximum possible losses on significant currencies. Scenario analyses and sensitivity analyses in regular or stressful business conditions are also performed.

Operational risk

The Group has established a framework for operational risk management that is, to a considerable extent, aligned with regulations prescribed by the Croatian National Bank applicable to the Bank's business and good banking practices in the area of risk management that was introduced in 2012.

The basic principles of operational risk management were identified in the umbrella act, Operational Risk Management Policies, the structure of management and accountability in the system was set up, the approach for the calculation of capital requirements for operational risk was determined, the reporting system was established as well as the manners of establishing, managing and monitoring the exposure to operational risk. The management system covers the operational risk at business changes, new products included, and operational risk at the outsourcing of activities.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.1. Overview of the most important risks (continued)

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. The IT system security control function is in charge of monitoring the security of the IT system. Within this function, a system for the management of business continuity was established.

Outsourcing risk

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

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

34.2. Strategy and risk management systems

The Supervisory Board is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Group. The Supervisory Board adopts HBOR's Risk Management Strategy that lays out the main principles and standards of risk management and defines the tendency towards risk-taking.

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

Risk management committees

- **Assets and Liabilities Management Committee (ALCO)** – manages liquidity risk, interest rate risk in the Bank's book and currency risk within the framework of the Liquidity Risk Management Ordinance, the Currency Risk Management Ordinance and the Interest Rate Risk Management Procedures, the Assets and Liabilities Management Policies as well as other documents of the Bank that regulate this area,
- **Credit Risk Evaluation and Measurement Committee** – manages credit risk within the framework set through accepted Loan Policies, Credit Risk Management Ordinance, methodologies 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,

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.2. Strategy and risk management systems (continued)

- **Business Change Management Committee** – manages business changes (co-ordination of procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce risks associated with the implementation of business changes.

Organizational unit for Risk Management

The Risk Management unit is a functionally and organizationally separate and independent organizational unit for the control of business risks, which is directly responsible to the Management Board. This organisational unit is responsible for defining, evaluating or measuring, monitoring and controlling the risks to which the Group is exposed in the course of its business.

The Risk Management unit carries out its role by performing risk analyses and evaluations or measurements, developing risk management ordinances, procedures and methodologies, supervising and monitoring their application, recommending and controlling the accepted exposure limits, giving suggestions and recommendations for adequate risk management as well as reporting to the relevant authorities.

The risk management strategy is directed towards achieving and maintaining the system that would provide quality and efficiency in risk management complied with domestic and international banking practices and Croatian National Bank, European regulations and Basel Committee recommendations applicable to the Bank as a special financial institution.

Risk measurement and reporting systems

When assessing or measuring risk, the Group takes into account historical data, business plans, current and expected market conditions and the specific characteristics of the Group as a special financial institution. The results of risk assessments or measurements, analyses carried out and stress test are presented at the meetings of the Risk Management Committee, the Management Board and the Supervisory Board. For the purpose of risk monitoring and control, systems of limits are introduced for the management of credit risk, liquidity risk, interest rate risk in the Bank's book and currency risk.

Bodies in charge are systematically reported on the quality of the loan portfolio, high exposure and the highest permissible exposure, regulatory capital adequacy, collection of receivables and risk placements, changes in internal ratings of commercial banks and measures taken in case of rating deterioration, a number of liquidity status indicators and projections of open foreign currency positions, possible losses by significant currencies, interest rate gap, projections of average weighted rates for sources and placements of financial institutions, etc. The reporting dynamics and the risk measurement and assessment methodologies are prescribed by the Group's internal acts.

Notes to the Financial Statements which include significant accounting policies and other explanations

for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk

The Group controls credit risk by way of credit policies and ordinances for the management of this risk that determine internal control systems aiming to act preventively.

The credit risk management system is a crucial part of the Group's business policy and it is an important strategic factor of business conduct, and therefore this area is regulated by a separate act - Credit risk management ordinance, that are applied on all phases of the credit process (from the development of new bank products or from the credit application, monitoring of the client's business operations until the final loan repayment).

Credit risk management ordinance is a comprehensive document that includes the methodologies intended for the assessment of operations of different client target groups.

In the case of direct financing, the Group uses the Credit risk evaluation methodology (for loans over HRK 1,500 thousand) or the Credit scoring methodology (for loans below HRK 1,500 thousand) to determine creditworthiness. The Credit scoring methodology is used to determine creditworthiness of clients that belong to the "small loan portfolio" and contains five scoring models: placements up to HRK 300 thousand to companies, crafts businesses and farmers, placements to start-ups up to HRK 300 thousand, placements from HRK 300 thousand to HRK 1,500 thousand to companies, placements to start-ups from HRK 300 thousand to HRK 1,500 thousand and placements from HRK 300 thousand to HRK 1,500 thousand for all other entrepreneurs.

The Credit Rating Assessment Methodology is used for the assessment of the risk of the clients that have been classified to the portfolio of individually significant clients, i.e. the loans exceeding HRK 1,500 thousand. The risk assessment can be contained in the assessment of client creditworthiness, assessment of investment project success and assessment of client creditworthiness containing analysis of future operations.

Pursuant to the HBOR Act, the Group on-lends part of its placements via commercial banks or leasing companies. The assessment of commercial banks is based on the Methodology for the Evaluation and Selection of Banks and the Methodology for the Evaluation and Selection of Foreign Banks, whereas the assessment of leasing companies is based on the Methodologies for the Evaluation and Selection of Leasing Companies. With an objective of facilitating the availability of HBOR's funds, the Group channels part of its placements through the risk sharing model, under which commercial banks and HBOR participate in the financing of clients in accordance with in advance agreed proportions.

The Group, as a developmental financial institution, supports growth and development of the Croatian economy through investment. For this reason, the clients mainly approach the Group with applications for credit financing of investment projects. In order to minimize risk and objectively estimate economic sustainability of the project as well as a return on investment, the Group is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

By continuous monitoring and evaluation of the clients' businesses, the Group makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Group tries to find appropriate ways to collect receivables by considering the possibilities of alternative repayment terms with a view to continue the production process and employment increase. Special emphasis is placed on identifying and monitoring reasons for bad debts, and procedures for prevention are built in operational procedures with a view to decreasing the share of high risk placements of the Group.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

For the purpose of risk monitoring and control, the systems of limits have been established for the management of credit risk. High exposure limits and amounts of maximum permitted credit exposure to individual borrowers and persons related to borrowers have been established.

34.3.1. Risk related to loan commitments

Bank clients can be issued guarantees and letters of credit with deferred payment terms (also from loan proceeds) in accordance with the same procedure as prescribed for loan commitments to direct clients.

All guarantees are monitored on the basis of validity periods, whereas letters of credit with deferred payment terms are monitored on the basis of maturities. In the case of calling for payment, the Group shall make a payment on behalf of client. For the Group, such obligations generate exposures to risks that are similar to credit risks and they are mitigated by the same procedures that are applied to loans.

34.3.2. Impairment assessment

Impairment is formed in accordance with the International Financial Reporting Standard 9, documents made by CNB applicable to HBOR and ordinances and methodologies regulating the Group's operations.

On the basis of the assessed level of credit risk and the manner of calculating expected credit losses, clients are allocated to the following categories:

- Stage 1 – includes all clients with low credit risk and clients with respect to which no significant increase in credit risk has been established,
- Stage 2 – includes all clients with respect to which a significant increase in credit risk since initial recognition has been established
- Stage 3 – includes clients in default, i.e. clients with respect to which there is objective evidence of value impairment as well as purchased or originated credit-impaired (POCI) financial assets.

During the contractual relationship with a client, the level of expected credit losses of client is estimated. The estimation is carried out on the basis of the following three criteria:

- Debtor's creditworthiness
- Due fulfilment of obligations, and
- Quality of collateral.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment assessment (continued)

For the entire duration of contractual relationship, debtor's creditworthiness is assessed in order to identify possible changes in the client's (debtor's) financial position, i.e. the probability of deterioration in its creditworthiness. When establishing client's creditworthiness, the group of related entities is also taken into account due to the effect of contamination, i.e. the possibility of the transfer of risk among related entities. Creditworthiness of client is monitored through:

- Changes in financial rating of client and entities related to client,
- Criteria whose objective is to identify financial difficulties of client,
- Criteria contained in the client watch list, and
- Criteria for identification of increased credit risk.

A client is considered to duly meet its obligations if it settles all of its obligations fully (principal, interest, commissions, fees and other charges) in the amounts and within the deadlines determined in the respective contracts, where all placements and of-balance sheet liabilities of a client are considered as one.

Collateral assessment is based on the quality of collateral and the assessed value as well as expected period of collection through collateral.

34.3.2.1. Definition of default status and exit from default status

Default status of an individual client occurs when one or both of the following conditions are met:

- it is considered probable that client will not settle its obligations towards HBOR entirely without taking into account the possibility of collection through collateral activation,
- clients is more than 90 days overdue in settling its due obligation under any significant loan liability. The significance threshold equals HRK 1,750 and is calculated on the client level by adding due obligations under all client placements.

When assessing the probability of a debtor not settling its obligations entirely, the following elements are considered:

- recognised impairment for credit losses due to identified significant deterioration in credit quality of debtor,
- selling of credit exposure at a considerable economic loss,
- rescheduling or restructuring of credit exposure owing to financial difficulties of debtor,
- bankruptcy or similar proceedings (pre-bankruptcy settlement, liquidation) against debtor,
- appointment of extraordinary administration, revoke of operating license, application of early intervention measures,
- cancellation of contract.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment (continued)

34.3.2.1. Definition of default status and exit from default status (continued)

When determining a default status, in addition to the aforementioned, the relations within a group of related entities are also considered if the default status has been established with regard to one of the debtors within the respective group of related entities that results in the spreading of the default status on other entities within the same group.

All financial instruments of client in default status are classified to Stage 3.

Placements to clients in default status due to a material delay in the payment of obligations for more than 90 days can be classified to the rehabilitated category if 150 days have lapsed from the moment of non-existence of the default status trigger. During the 150-day trial period, client must not be more than 30 days overdue in the payment of obligations in a materially significant amount.

After the lapse of 150 days, only those clients are considered to have been cured who are found not to be in financial difficulties. If there are signs of default status recurrence, the status is not changed until a genuine and permanent improvement in the credit quality of client.

Restructured exposures caused by financial difficulties and repayment problems can be classified as cured after the lapse of two years from the last occurrence of the following events:

- restructuring day,
- default status establishment date,
- grace period expiry if approved under the restructuring process.

During the two-year trial period, the exposures that meet all of the following conditions can be classified to non-default status exposures:

- debtor has duly settled, upon maturity, at least the amount of restructured obligations in the amount of those due at the moment of the restructuring implementation,
- debtor has been regularly settling due obligations in accordance with the repayment schedule (or up to 30 days overdue),
- default status is not probable to occur,
- there are no overdue obligations after restructuring,
- there is no doubt that the debtor will continue to settle its obligations upon maturity.

All of the above conditions have to be satisfied also for the new placements to the same client. Only the placements to client that is not in financial difficulties can be reclassified to the cured category.

After all trial-period conditions have been satisfied, the financial instruments of cured clients can be reclassified to Stage 1.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment assessment (continued)

34.3.2.2. Bank's procedure of internal rating and probability of default (PD) assessment

The approach used for the modelling of PD is based on TTC (Through-the-Cycle) migration matrices for exposures in homogenous groups of direct borrowers and others. Risk categories (bucket) have been identified, and the movements of exposures among the aforementioned categories are analysed.

Risk categories for the aforementioned exposures are defined on the basis of the days overdue and the restructured exposure status. Before the modelling of PD, the data for the preceding relevant period are collected.

On the occasion of the modelling of PD, the movement of exposures among the following categories is analysed:

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

On the basis of the matrices of exposure movements from category to category, a PD 12-month value is calculated. PD marginal values are calculated by further multiplication of matrices and they are used for vector creation. PD borderline value vector is the basis for the calculation of a lifelong PD. The value of a lifelong PD depends on the tenor, i.e. the remaining period until maturity of individual exposure.

Approach based on external rating published by external credit rating agencies has been used for the calculation of PD for exposures from homogenous categories of financial institutions and central government and local and regional government.

For exposures to domestic financial institutions, owing to the fact that there is no external rating for all financial institutions in the Group portfolio, the existing internal ratings for domestic financial institutions have been mapped against the external rating, where a financial institution that has an external rating has been used as the mapping starting point, due to which the Group's internal rating has been made equal to the rating of S&P: "BB". In this way, the upper limit has been established for domestic financial institutions at the level of the government rating. Distribution of PD value for the other internal ratings is determined on the basis of the method of linear interpolation.

Ratings of external credit rating agencies are used for exposures to foreign financial institutions and, therefore, the appropriate PD value from their matrices is used, and if non-existing, the internal rating is used, i.e. the rules are applied that are identical to those applied to domestic financial institutions.

The value of 12-month PD is assessed by multiplying TTC matrix with itself. The value of lifelong PD is the cumulative value of marginal PD values or the sum of borderline PD values depending on the exposure tenor.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment assessment (continued)

34.3.2.3. Exposure at default

For the purpose of modelling exposures at the moment of the occurrence of default status (Exposure at Default, hereinafter: EAD), or for the purpose of calculating credit conversion parameter (Credit Conversion Factor, hereinafter: CCF) and prepayment ratio, the data for the preceding five-year period are taken into account.

Pursuant to the mentioned historical data, the established ratio of premature collection almost equals zero and the loan conversion factor equals 1.

EAD is calculated for each contract. There are two approaches to the calculation of EAD:

- if there is a repayment schedule for exposure – based on the cash flow from the repayment schedule,
- if there is no repayment schedule for exposure – based on exposure amount on the reporting date.

For exposures classified in risk stage 1 and for exposures due, EAD is equal to the current exposure.

For exposures not yet due, lifelong EAD is calculated based on the repayment schedule, taking into account the amounts and the maturity period, but not later than until the final date of exposure maturity (tenor).

34.3.2.4. Loss given default

For groups of direct borrowers and others, loss at the moment of occurrence of the status of non-fulfilment of obligations (Loss Given Default, hereinafter: LGD) is estimated based on transactions after the date of occurrence of loss given default. Each transaction is discounted on the date of occurrence of loss given default by an appropriate discount rate, and the discount factor depends on the time elapsed. All increases after the date of occurrence of loss given default are cumulated with an individual exposure. The result of the mentioned calculation is the collection rate for each exposure in a homogenous group, and the total collection rate for a single homogenous group is comprised of the weighted average of collection rates of all individual exposures.

The probability of exit from the loss given default status is also taken into consideration in the calculation of LGD.

A report of external credit rating agencies is used as foundation for determining LGDs for the groups central government and local and regional government and financial institutions. In the annual reports on the occurrence of loss given default and collection status, credit rating agencies publish both historical and market rates of collection. The market rate of collection is the market price of a bond as compared to its value immediately before or at the moment of bond default. Based on market rates of collection for senior unsecured debt, issuer-weighted recovery rate is determined.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment assessment (continued)

34.3.2.5. Significant increase in credit risk

For the purpose of identifying an increased credit risk, changes for all clients of the Group are monitored continuously, but at least once a year. All placements to the client, where an increased credit risk has been identified or in case of individually significant clients, whose exposure exceeds HRK 1,500 thousand and are on the client watch list, on the next reporting date, all financial instruments of the client with increased credit risk are classified to stage 2 based on the observed criteria such as:

- client's delay in the settlement of any significant obligation due towards HBOR more than 30 days (and less than 90 days),
- the client is in financial difficulties, but is not in LGD status,
- deterioration of rating, low credit rating of the client,
- non-compliance with contractual provisions
- loss of key buyers or suppliers etc.

Exit from the increased credit risk status is conditional on non-existence of all the criteria based on which the client has been grouped into the respective status upon the occurrence of the risk, and verification of all indicators is made at least once a year within the framework of the annual monitoring of the client. Deactivation of a portion of indicators can be carried out after six months. Indicators of an increased credit risk are active for a year, after which they have to be checked, and based on the monitoring results, either reactivated or deactivated. The result of any change is either the reclassification of financial instruments of the client to stage 1 or its stay in stage 2.

Financial instruments of the client with an investment rating of external credit rating agencies are deemed financial instruments of low credit risk. All exposures to the Republic of Croatia and units of local and regional government (ULRG), the Croatian National Bank, the European Investment Bank (EIB) and other development banks are also deemed financial instruments of clients with low credit risk. Financial instruments of clients with low credit risk are always grouped into stage 1.

34.3.2.6. Grouping financial assets measured on a collective basis

Credit risk is evaluated on a collective basis for all clients classified into risk stages 1 and 2 as well as for clients in the risk stage 3 belonging to the small loan portfolio. The clients belonging to the small loan portfolio are clients to which HBOR is exposed in the gross amount that is equal or less than HRK 1,500 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.2. Impairment assessment (continued)

34.3.2.6. Grouping financial assets measured on a collective basis (continued)

For the purpose of identifying a significant increase in credit risk and recognition of loss allowances for impairment on a collective basis, financial instruments are grouped into the following groups, based on the common features of credit risk, for the purpose of easier evaluation of a significant increase in credit risk:

- financial institutions,
- central government and local and regional government,
- direct borrowers – large,
- direct borrowers – small and medium-sized,
- direct borrowers – micro,
- direct borrowers – citizens,
- others.

By grouping financial instruments into homogeneous groups, it is ensured that in case of a significant increase in credit risk, the goal of recognising expected credit losses during the entire lifetime of a financial instrument is attained, even if the evidence on such significant increase in credit risk is still not available on the level of an individual instrument.

34.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD

When including any information about the future, available sources (Croatian National Bank, Croatian Bureau of Statistics) on macroeconomic conditions are used with a view to projecting their impact on the current value of risk parameters.

Based on a historical analysis of impact of macroeconomic conditions and the available macroeconomic forecasts, a potential impact of future movement of macroeconomic conditions on the value of risk parameters is established by using the scenarios with related probabilities of occurrence of an individual scenario.

When estimating expected credit losses through the application of a previous experience on credit losses, the data on earlier credit losses rates are applied to the formed homogenous groups, and through the application of a certain method, connecting of a single group of financial instruments with the data on earlier experience on credit losses in the groups of financial instruments with similar characteristics of credit risk is made possible, as well as with important relevant data reflecting the current status.

The expected credit losses reflect the Group's expectations in respect of credit losses. However, when the Group, during the estimation of such expected credit losses, considers all reasonable and reliable data that are available with no necessary costs and efforts, the Group also considers appropriate market data on the credit risk of a certain financial instrument or similar financial instruments.

For the calculation of expected credit losses, the Group uses a large number of macroeconomic conditions, of which for one of them (GDP), correlations on total PDs have been established for all homogenous groups.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD (continued)

In order to determine the impact of future macroeconomic conditions on expected credit losses, by analysis based on historical data, the connection between macroeconomic conditions and PD is identified. After that, the impact of macroeconomic forecasts on PD values is estimated and the ratio is calculated, by means of which the estimated value of PD in two scenarios, an optimistic and a pessimistic one, is corrected.

34.3.4. Quantitative analysis of the reliability of the information used to calculate the ECL allowance

For the application of macroeconomic factors, the Bank uses a methodology with the level of reliability of 90%.

34.3.5. Overview of modified and restructured loans

Any amendment to the contractual provisions resulting in the conversion of contractual cash flows from financial assets is deemed to be modification.

A change of placement terms and conditions includes changes to certain contractual terms defined, mostly for the purpose of adaptation to changes during the implementation of an investment, and possibly also during repayments, and not caused by financial difficulties of the client. The amended terms would most frequently be accepted when approved if known or are the result of circumstances not controlled by the client.

Any changes in contractual obligations, by which a concession is made to the client that is considered to be in financial difficulties, are deemed to be rescheduling or restructuring. Concession may relate to any of the following measures:

- change of earlier contractual terms and conditions that are considered impossible to be met by the client and lead to the loss of its ability to settle liabilities and which would not be approved if the borrower had no financial difficulties (e.g. interest rate reduction, reduction or cancellation of interest income, change in principal amount, change or prolongation of repayment terms etc.)
- complete or partial refinancing of placements that would not be approved if the debtor had no financial difficulties.

Evidence on concession includes the following:

- the difference in favor of the client between the changed terms and conditions of the contract and former terms and conditions of the contract,
- inclusion of more favorable terms and conditions in the changed contract as compared to the terms and conditions that other debtors with a similar risk profile in the Bank portfolio could have obtained.

Rescheduling is considered any change of the originally agreed loan terms and conditions due to temporary financial difficulties of the client. Restructuring is considered any change of the originally agreed loan terms and conditions due to significant financial difficulties of the client that needs financial, business and operational restructuring, i.e. the client that is already in default.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.6. Analysis of risk concentration

Through its development loan programmes, the Group encompasses the area of the entire Republic of Croatia with emphasis on supported areas. Credit risk is spread across geographic areas, industries, sectors and loan programmes. The Group seeks to avoid excessive concentration of credit risk and support the development of less developed areas of the Republic of Croatia through more favorable terms and conditions and new loan programmes (products) in accordance with the national strategy of development of certain activities.

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

As of 31 December 2019, the highest credit exposure of the Group to one debtor equaled HRK 2,578,585 thousand and of the Bank HRK 2,575,661 thousand (31 December 2018: HRK 2,883,122 thousand for the Group and for the Bank) without considering the effect of mitigation through collateral received.

As a special financial institution, the Bank performs its development role by granting loans to final borrowers via commercial banks with which it has entered into co-operation agreements. Since the exposure towards some of the banks has reached the maximum permitted level, the Bank, in order to be able to continue performing its development role and make the loans accessible to as many final borrowers as possible, has an approval from the Supervisory Board for an increase in the exposure towards the banks and their associated entities that have, in accordance with HBOR's internal methodology, been assigned a high rating. The exposure level is maintained by using all instruments and techniques available for mitigating HBOR's exposure towards the banks.

This exposure increase approved by the Supervisory Board was used by the Bank for further operating activities carried out with two banks.

34.3.7. Risk-Sharing Model

The Risk-Sharing Model covers the manner of implementing HBOR's loan programmes in cooperation with commercial banks, where HBOR assumes a portion of direct lending risk (e.g. 50%), whereas the commercial bank assumes the risk associated with the other part of the loan (irrespective of whether it is financed from HBOR's funds or from commercial bank's funds).

The commercial bank takes the role of the administrative payment and collateral agent and reports to HBOR monthly and quarterly, on the basis of the business cooperation agreement executed between the commercial bank and HBOR, on any changes in creditworthiness of client, changes in provisions, changes in the value of collateral, on whether payments are made duly, on pre-bankruptcy and bankruptcy proceedings and on any other changes in the operations of clients and the repayments of placements.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.7. Risk-Sharing Model (continued)

There are several groups/types of risk-sharing model as follows:

- Initially, the sharing of risk with banks was launched through the programmes of the Government of the Republic of Croatia as a promotional measure aimed at strengthening the liquidity of the economy in the economic crisis period. During that time, three risk-sharing models were implemented: the Model A, the Model A+ and the Economy Development Programme.

Due to the scope of activities and the necessity of exceptionally fast action by HBOR, within the framework of the mentioned loan programmes, commercial banks as administrative, payment and collateral agents submitted to HBOR a shortened application form, and consequently, a shortened loan application procedure was adopted.

Further to the shortened procedure, in the mentioned loan programmes, HBOR had not initially entered collaterals in its business records, because it was the obligation of commercial banks to take charge of, and to activate, the collaterals. Subsequently, HBOR entered collaterals covering outstanding placements in its business records if agency businesses with commercial banks were terminated (e.g. because the banks sold their exposures etc.) or placements restructured.

Exposure under mentioned placements was entered in the business records of HBOR.

- Other loans under the risk-sharing models under the HBOR loan programmes (primarily investment and restructuring loans, and to a lesser extent loans for liquidity) are implemented in the manner that commercial banks included in the transactions still remain agents (administrative, payment and collateral agents), but HBOR implements a customary procedure as for any other direct loan and enters both exposures and collaterals into the business records at the moment of approving and contracting of placements.

34.3.8. Collaterals and other credit quality (creditworthiness) improvement

Collateral for the Bank's placements are:

- obligatory (bills of exchange and promissory notes),
- ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local and regional authorities, guarantees from HAMAG-BICRO (Croatian Agency for SMSs, Innovation and Investment), insurance policy against political and/or commercial risks), and
- other collateral (movable property, bills of exchange or guarantees from other companies with solid creditworthiness, fiduciary or pledge of companies' equity instruments, repossession of cash receivables or assignment for collectible receivables, deposit repossession, restriction of transferability on insurance policy of assets and/or person, pledge on a trademark, etc.).

All Group placements have to be secured with obligatory collateral. Low amount placements must be secured with one obligatory instrument of collateral at least. The selection of eligible collaterals does not depend on the insurance ratio achieved only, but also on the risks identified, with marketable and more valuable collaterals being preferred.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.8. Collateral and other credit enhancements (creditworthiness) (continued)

Acceptable ordinary and other collateral are classified according to quality in five groups. The evaluation of collateral is based on quality, estimated based on marketability, documentation and possibility of supervision by the Bank as well as the possibility of enforced collection.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the security instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLPS), guarantees from HAMAG-BICRO, loan insurance policy and when the Republic of Croatia, JLPS or other government authorities guarantee for clients implicitly.

For the purpose of mitigation of credit risk and reduction of business costs, and in compliance with the Act on the Croatian Bank for Reconstruction and Development, the Group approves part of its placements through financial institutions. As collateral for placements approved to final customers through financial institutions, the Group uses mandatory collateral from commercial banks/leasing companies. The financial institution is obliged to deliver them based on the Mutual business cooperation agreement, but not for each individual placement to the final customer based on that Agreement. In the individual contracts for placements to the final customers, the use of obligatory collateral delivered with the Agreement on mutual business cooperation is contracted. As the financial institutions take on the risk of default by the final customer, they are given the option to contract sufficient collateral with the final customer/leasing company.

Where the loan is approved through a commercial bank, depending on the financial institution's internal rating, the Bank contracts a sub-mortgage. In this case, either the commercial bank transfers the ownership over the collateral, while the Bank takes a mortgage over the same collateral, or the commercial bank forms a mortgage on the collateral, while the Bank takes a sub-mortgage on the same collateral.

By signing the Agreement on mutual business cooperation, a transfer of any claims the commercial bank may have towards the final customer is made to HBOR. Pursuant to the Agreement, the commercial bank authorises HBOR to unilaterally inform the bank in written form that, in the case of the commercial bank's insolvency or threat of liquidation, untimely repayments or default on the commitments agreed in the individual contract on interbank loan or actual (insolvent or regular) liquidation, the Bank assumes the receivable towards the final customer from the commercial bank, with the effect of assignment of receivables instead of contract fulfilment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR that HBOR may, without having to obtain any further consent or approval from the commercial bank, enter itself into all public registers, books or records as the creditor instead of the commercial bank under any security arrangements for assigned receivables as well as under any other proceedings.

From the moment of the assignment, the final customer is obliged to make all payments related to the assigned receivable directly to HBOR. Should the commercial bank receive any payments in the name of collection of receivables per particular placement, the bank is obliged to immediately transfer the funds to HBOR.

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

34.3.8. Collateral and other credit enhancements (creditworthiness) (continued)

All direct placements are mainly secured with a transfer of ownership or with a mortgage over real estate and, if is possible, the Group obtains as security against credit risk a guarantee from HAMAG-BICRO, a guarantee from the local and regional authority, a guarantee from the Republic of Croatia, etc.

The Group has the right to verify the appraisal of the collateral value and such a confirmed appraisal is considered as the final collateral value.

Depending on the type of collateral, the credit programme, the general terms of security or the decision of an authorised body, the Group has determined the necessary ratio of placements and collateral.

In case of the real estate, the necessary ratio of placement and estimated market value of the real estate should be 1:1.3, except in case of investments on the islands, supported areas where such ratio is 1:1.2. In case of moveable property, the necessary ratio of placement and estimated market value of moveable property should be 1:2. If a lower ratio of the collateral value than those prescribed is proposed, reasons and justifications of deviations from the prescribed ratio are explained.

The Bank continually monitors the value of collaterals by re-estimation or confirmation/verification of the value. Monitoring of the value of mortgaged real estate is performed once a year for business real estate, and every three years for residential buildings. The Bank has formed a special organizational unit for:

- evaluation and verification of already appraised and offered collateral (real estate and movables),
- technical and technological analysis of investment projects, and
- financial supervision over the withdrawal of loan funds for the purpose of the implementation of the investment project.

In the event that it is not possible for the Bank to collect from regular operations, the Bank starts collection from the collateral at its disposal. This encompasses initiating collection from the obligatory collateral, then from first-class, unconditional collateral payable on first demand and then from the mortgage or fiduciary ownership of the real estate or movable property, including their repossession with a view to decreasing or fully settling the Bank's receivables. The Bank does not use repossessed assets for business purposes.

In the case of risk-sharing models, collateral is created by commercial banks depending on the type of the model:

- in accordance with their own internal documents and good banking practices, and, consequently, HBOR's documents and collateral ratios prescribed in them do not apply,
- or collateral is created by commercial banks and HBOR for their respective shares in the loan in accordance with their own documents, decisions and/or procedures.

Write-offs

Write-off is performed in accordance with the Methodology for Write-Off of Receivables.

The criteria for considering the write-off of receivables can be classified into 3 main groups:

- A. exhaustion of all available forms of regular and compulsory collection;
- B. implementation of settlement, sale of receivables or restructuring of placements;
- C. difficult social and/or medical condition of the debtor (and/or the co-debtor, guarantor).

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure

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

	Group		Bank	
	Highest exposure	Highest exposure	Highest exposure	Highest exposure
	31 December 2019	31 December 2018	31 December 2019	31 December 2018
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	884,402	944,415	881,482	941,069
Deposits with other banks	553,470	261,925	553,470	261,925
Loans to financial institutions	9,447,706	10,234,988	9,447,706	10,234,988
Loans to other customers	13,699,634	12,510,686	13,699,634	12,510,686
Financial assets at fair value through profit or loss	2,234	2,045	2,234	2,045
Financial assets at fair value through other comprehensive income	1,552,565	2,803,761	1,512,396	2,766,363
Debt instruments at amortised cost	457	1,363	-	-
Other assets	11,875	12,722	6,341	4,182
Total	26,152,343	26,771,905	26,103,263	26,721,258
Guarantees and commitments				
Guarantees issued in HRK	61,481	33,576	61,481	33,576
Issued guarantees in foreign currency	194,737	1,822,396	194,737	1,822,396
Open letters of credit in foreign currency	11,693	-	11,693	-
Undrawn loans	3,954,299	3,291,032	3,954,299	3,291,032
Other irrevocable contingent liabilities	93	93	93	93
Total	4,222,303	5,147,097	4,222,303	5,147,097
Total credit risk exposure	30,374,646	31,919,002	30,325,566	31,868,355

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

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

Group	Republic of Croatia	EU countries	Other countries	Total
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	236,641	633,321	14,440	884,402
Deposits with other banks	181,235	372,235	-	553,470
Loans to financial institutions	9,447,706	-	-	9,447,706
Loans to other customers	13,055,519	-	644,115	13,699,634
Financial assets at fair value through profit or loss	2,234	-	-	2,234
Financial assets at fair value through other comprehensive income	1,550,343	2,222	-	1,552,565
Debt instruments at amortised cost	457	-	-	457
Other assets	7,443	3,634	798	11,875
Total	24,481,578	1,011,412	659,353	26,152,343
Guarantees and commitments				
Guarantees issued in HRK	61,481	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	11,693
Undrawn loans	3,775,277	-	179,022	3,954,299
Other irrevocable contingent liabilities	93	-	-	93
Total	4,043,281	-	179,022	4,222,303
Total credit risk exposure	28,524,859	1,011,412	838,375	30,374,646

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

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

Group	Republic of Croatia	EU countries	Other countries	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	929,211	14,740	464	944,415
Deposits with other banks	261,922	3	-	261,925
Loans to financial institutions	10,234,988	-	-	10,234,988
Loans to other customers	11,736,094	-	774,592	12,510,686
Financial assets at fair value through profit or loss	2,045	-	-	2,045
Financial assets at fair value through other comprehensive income	2,803,761	-	-	2,803,761
Debt instruments at amortised cost	1,363	-	-	1,363
Other assets	5,362	7,293	67	12,722
Total	25,974,746	22,036	775,123	26,771,905
Guarantees and commitments				
Guarantees issued in HRK	33,576	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	1,822,396
Undrawn loans	2,788,456	-	502,576	3,291,032
Other irrevocable contingent liabilities	93	-	-	93
Total	4,644,521	-	502,576	5,147,097
Total credit risk exposure	30,619,267	22,036	1,277,699	31,919,002

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

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

Bank	Republic of Croatia	EU countries	Other countries	Total
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	233,721	633,321	14,440	881,482
Deposits with other banks	181,235	372,235	-	553,470
Loans to financial institutions	9,447,706	-	-	9,447,706
Loans to other customers	13,055,519	-	644,115	13,699,634
Financial assets at fair value through profit or loss	2,234	-	-	2,234
Financial assets at fair value through other comprehensive income	1,510,174	2,222	-	1,512,396
Other assets	6,234	24	83	6,341
Total	24,436,823	1,007,802	658,638	26,103,263
Guarantees and commitments				
Guarantees issued in HRK	61,481	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	11,693
Undrawn loans	3,775,277	-	179,022	3,954,299
Other irrevocable contingent liabilities	93	-	-	93
Total	4,043,281	-	179,022	4,222,303
Total credit risk exposure	28,480,104	1,007,802	837,660	30,325,566

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

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

Bank	Republic of Croatia	EU countries	Other countries	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	925,865	14,740	464	941,069
Deposits with other banks	261,922	3	-	261,925
Loans to financial institutions	10,234,988	-	-	10,234,988
Loans to other customers	11,736,094	-	774,592	12,510,686
Financial assets at fair value through profit or loss	2,045	-	-	2,045
Financial assets at fair value through other comprehensive income	2,766,363	-	-	2,766,363
Other assets	4,106	9	67	4,182
Total	25,931,383	14,752	775,123	26,721,258
Guarantees and commitments				
Guarantees issued in HRK	33,576	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	1,822,396
Undrawn loans	2,788,456	-	502,576	3,291,032
Other irrevocable contingent liabilities	93	-	-	93
Total	4,644,521	-	502,576	5,147,097
Total credit risk exposure	30,575,904	14,752	1,277,699	31,868,355

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, net exposure, before and after the effect of mitigation through collateral received:

Group	Highest exposure	Highest exposure after the effect of mitigation through collateral received	Highest exposure	Highest exposure after the effect of mitigation through collateral received
	31 December	31 December	31 December	31 December
	2019	2019	2018	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation and insurance	13,082,662	-	13,037,974	-
Water and electric supply and other infrastructure	1,859,000	1,571,256	1,381,948	1,029,981
Tourism	3,318,197	554,485	3,113,457	77,346
Transport, warehousing and connections	1,958,455	764,034	1,955,578	695,034
Shipbuilding	1,227,960	12,190	2,995,154	382,101
Agriculture and fishery	478,368	167,299	517,983	129,394
Food industry	864,720	500,569	824,235	117,622
Construction industry	1,217,933	113,301	1,011,185	66,009
Other industry	370,868	92,440	460,568	131,022
Public administration	3,040,733	3,040,152	3,788,365	3,788,365
Education	40,702	37,768	43,562	39,163
Manufacture of basic metals and fabricated metal products, except machinery and equipment	182,417	10,727	219,087	19,227
Manufacture of chemicals and chemical products	70,214	54,088	74,185	54,370
Manufacture of other non-metallic mineral products	175,818	62,144	207,541	65,207
Pharmaceutical industry	392,460	1,129	461,803	911
Other	2,094,139	329,475	1,826,377	312,829
Total credit risk exposure	30,374,646	7,311,057	31,919,002	6,908,581

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, net exposure, before and after the effect of mitigation through collateral received:

Bank	Highest exposure	Highest exposure after the effect of mitigation through collateral received	Highest exposure	Highest exposure after the effect of mitigation through collateral received
	31 December 2019 HRK '000	31 December 2019 HRK '000	31 December 2018 HRK '000	31 December 2018 HRK '000
Financial intermediation and insurance	13,075,404	-	13,027,345	-
Water and electric supply and other infrastructure	1,858,999	1,571,255	1,381,948	1,029,981
Tourism	3,318,194	554,481	3,113,457	77,346
Transport, warehousing and connections	1,958,417	763,997	1,955,578	695,034
Shipbuilding	1,227,960	12,190	2,995,154	382,101
Agriculture and fishery	478,368	167,299	517,943	129,354
Food industry	864,559	500,409	824,134	117,521
Construction industry	1,217,783	113,151	1,011,110	65,933
Other industry	370,867	92,440	460,205	130,659
Public administration	3,000,995	3,000,414	3,750,268	3,750,268
Education	40,702	37,768	43,562	39,163
Manufacture of basic metals and fabricated metal products, except machinery and equipment	182,351	10,661	218,982	19,122
Manufacture of chemicals and chemical products	70,192	54,066	74,166	54,351
Manufacture of other non-metallic mineral products	175,818	62,144	207,522	65,189
Pharmaceutical industry	391,331	-	460,893	-
Other	2,093,626	328,962	1,826,088	312,540
Total credit risk exposure	30,325,566	7,269,237	31,868,355	6,868,562

Concentration of assets and guarantees and commitments according to industry for both years has been compiled in accordance with the National Classification of Activities 2007 ("NKD 2007").

In the preparation of the Note, a combined approach is applied, which takes into consideration business activities of a debtor, retains the names of activities different from those in the National Classification of Activities and unites similar business activities.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

The fair value of collateral for the Group in 2019 amounted to HRK 23,063,589 thousand (31 December 2018: HRK 25,010,421 thousand) and for the Bank HRK 23,056,329 thousand (31 December 2018: HRK 24,999,793 thousand).

Net highest exposure as at 31 December 2019 for the Group amounted to HRK 7,311,057 thousand (31 December 2018: HRK 6,908,581 thousand) and for the Bank HRK 7,269,237 thousand (31 December 2018: HRK 6,868,562 thousand).

In the total net highest exposure after the effect of mitigation through collateral received as of 31 December 2019, the credit risk of HRK 4,529,750 thousand for the Group (31 December 2018: HRK 5,325,257 thousand) and HRK 4,490,125 thousand for the Bank (31 December 2018: HRK 5,287,160 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia for the Group and the Bank of HRK 2,068,112 thousand (31 December 2018: HRK 1,572,804 thousand), from local (regional) authorities of HRK 708,453 thousand (31 December 2018: HRK 647,039 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 204,175 thousand (31 December 2018: HRK 228,404 thousand), government funds of HRK 86 thousand (31 December 2018: HRK 85 thousand), government bonds and Treasury bills of the Ministry of Finance of HRK 1,548,924 thousand for the Group and HRK 1,509,299 thousand for the Bank (31 December 2018: HRK 2,803,692 thousand for the Group and HRK 2,765,595 thousand for the Bank). In addition, an amount of HRK 0 thousand (31 December 2018: HRK 73,233 thousand) relates to receivables from a majority state-owned company (controlling influence).

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and the further increase in exposure has been stopped pending the submission of the full collateral necessary for compliance with the requested collateral coverage ratio.

Financial intermediation includes mainly commercial bank.

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

Credit risk quality according to type of financial assets

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Group												
31 December 2019	Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Net exposure of portfolio after the effect of mitigation through collateral received Stage 1	Net exposure of portfolio after the effect of mitigation through collateral received Stage 2	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received POCI	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets												
Cash on hand and current accounts with banks	884,402	-	-	-	-	884,402	-	-	-	-	-	-
Deposits with other banks	553,470	-	-	-	-	553,470	-	-	-	-	-	-
Loans to financial institutions	9,363,335	73,076	11,295	-	-	9,447,706	-	-	-	-	-	-
Loans to other customers	10,084,080	1,136,882	1,414,424	1,064,248	-	13,699,634	4,065,803	164,484	194,117	597,289	-	5,021,693
Financial assets at fair value through profit or loss	-	-	-	-	2,234	2,234	-	-	-	-	2,234	2,234
Financial assets at fair value through other comprehensive income	1,549,468	875	2,222	-	-	1,552,565	1,549,468	875	2,222	-	-	1,552,565
Debt instruments at amortised cost	457	-	-	-	-	457	457	-	-	-	-	457
Other assets	10,126	55	1,656	38	-	11,875	1,195	50	1,345	-	-	2,590
Total	22,445,338	1,210,888	1,429,597	1,064,286	2,234	26,152,343	5,616,923	165,409	197,684	597,289	2,234	6,579,539
Guarantees and commitments												
Guarantees issued in HRK	49,769	-	11,712	-	-	61,481	9,003	-	6,844	-	-	15,847
Issued guarantees in foreign currency	11,072	32,095	151,570	-	-	194,737	1,764	-	59,816	-	-	61,580
Open letters of credit in foreign currency	-	-	-	-	11,693	11,693	-	-	-	-	-	-
Undrawn loans	3,481,864	346,839	-	125,596	-	3,954,299	615,977	38,021	-	-	-	653,998
Other irrevocable contingent liabilities	93	-	-	-	-	93	93	-	-	-	-	93
Total	3,542,798	378,934	163,282	125,596	11,693	4,222,303	626,837	38,021	66,660	-	-	731,518
Total credit risk exposure	25,988,136	1,589,822	1,592,879	1,189,882	13,927	30,374,646	6,243,760	203,430	264,344	597,289	2,234	7,311,057

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

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

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Group							Net exposure of portfolio after the effect of mitigation through collateral received	Net exposure of portfolio after the effect of mitigation through collateral received	Net exposure of portfolio after the effect of mitigation through collateral received	Net exposure of portfolio after the effect of mitigation through collateral received	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
31 December 2018	Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Stage 1	Stage 2	Stage 3	POCI	HRK '000	HRK '000
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets												
Cash on hand and current accounts with banks	944,415	-	-	-	-	944,415	-	-	-	-	-	-
Deposits with other banks	261,925	-	-	-	-	261,925	-	-	-	-	-	-
Loans to financial institutions	10,064,840	137,737	32,411	-	-	10,234,988	-	-	-	-	-	-
Loans to other customers	9,408,775	1,141,971	1,728,419	231,521	-	12,510,686	2,930,911	127,418	278,948	1,372	-	3,338,649
Financial assets at fair value through profit or loss	-	-	-	-	2,045	2,045	-	-	-	-	2,045	2,045
Financial assets at fair value through other comprehensive income	2,802,223	770	768	-	-	2,803,761	2,802,223	770	768	-	-	2,803,761
Debt instruments at amortised cost	1,363	-	-	-	-	1,363	1,363	-	-	-	-	1,363
Other assets	11,315	12	1,395	-	-	12,722	3,067	1	1,281	-	-	4,349
Total	23,494,856	1,280,490	1,762,993	231,521	2,045	26,771,905	5,737,564	128,189	280,997	1,372	2,045	6,150,167
Guarantees and commitments												
Guarantees issued in HRK	13,236	-	20,340	-	-	33,576	12,371	-	-	-	-	12,371
Issued guarantees in foreign currency	31,756	-	1,790,640	-	-	1,822,396	1,469	-	293,997	-	-	295,466
Undrawn loans	2,654,591	604,066	22,193	10,182	-	3,291,032	318,481	110,058	21,945	-	-	450,484
Other irrevocable contingent liabilities	93	-	-	-	-	93	93	-	-	-	-	93
Total	2,699,676	604,066	1,833,173	10,182	-	5,147,097	332,414	110,058	315,942	-	-	758,414
Total credit risk exposure	26,194,532	1,884,556	3,596,166	241,703	2,045	31,919,002	6,069,978	238,247	596,939	1,372	2,045	6,908,581

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

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

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Bank													
31 December 2019		Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Net exposure of portfolio after the effect of mitigation through collateral received Stage 1	Net exposure of portfolio after the effect of mitigation through collateral received Stage 2	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received POCI	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
		HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets													
Cash on hand and current accounts with banks													
	881,482	-	-	-	-	-	881,482	-	-	-	-	-	-
Deposits with other banks													
	553,470	-	-	-	-	-	553,470	-	-	-	-	-	-
Loans to financial institutions													
	9,363,335	73,076	11,295	-	-	-	9,447,706	-	-	-	-	-	-
Loans to other customers													
	10,084,080	1,136,882	1,414,424	1,064,248	-	-	13,699,634	4,065,803	164,484	194,117	597,289	-	5,021,693
Financial assets at fair value through profit or loss													
	-	-	-	-	2,234	2,234	-	-	-	-	-	2,234	2,234
Financial assets at fair value through other comprehensive income													
	1,509,299	875	2,222	-	-	-	1,512,396	1,509,299	875	2,222	-	-	1,512,396
Other assets													
	4,592	55	1,656	38	-	-	6,341	1	50	1,345	-	-	1,396
Total	22,396,258	1,210,888	1,429,597	1,064,286	2,234	26,103,263	5,575,103	165,409	197,684	597,289	2,234	6,537,719	
Guarantees and commitments													
Guarantees issued in HRK													
	49,769	-	11,712	-	-	-	61,481	9,003	-	6,844	-	-	15,847
Issued guarantees in foreign currency													
	11,072	32,095	151,570	-	-	-	194,737	1,764	-	59,816	-	-	61,580
Open letters of credit in foreign currency													
	-	-	-	-	11,693	11,693	-	-	-	-	-	-	-
Undrawn loans													
	3,481,864	346,839	-	125,596	-	-	3,954,299	615,977	38,021	-	-	-	653,998
Other irrevocable contingent liabilities													
	93	-	-	-	-	-	93	93	-	-	-	-	93
Total	3,542,798	378,934	163,282	125,596	11,693	4,222,303	626,837	38,021	66,660	-	-	731,518	
Total credit risk exposure	25,939,056	1,589,822	1,592,879	1,189,882	13,927	30,325,566	6,201,940	203,430	264,344	597,289	2,234	7,269,237	

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

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

Credit risk analysis, net exposure, before and after the effect of mitigation through collateral received, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Bank													
31 December 2018		Net exposure of portfolio - risk Stage 1	Net exposure of portfolio - risk Stage 2	Net exposure of portfolio - risk Stage 3	Net exposure of portfolio of risk POCI	Not subject to IFRS 9	Net exposure of total portfolio	Net exposure of portfolio after the effect of mitigation through collateral received Stage 1	Net exposure of portfolio after the effect of mitigation through collateral received Stage 2	Net exposure of portfolio after the effect of mitigation through collateral received Stage 3	Net exposure of portfolio after the effect of mitigation through collateral received POCI	Not subject to IFRS 9 after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
		HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets													
Cash on hand and current accounts with banks													
		941,069	-	-	-	-	941,069	-	-	-	-	-	-
Deposits with other banks													
		261,925	-	-	-	-	261,925	-	-	-	-	-	-
Loans to financial institutions													
		10,064,840	137,737	32,411	-	-	10,234,988	-	-	-	-	-	-
Loans to other customers													
		9,408,775	1,141,971	1,728,419	231,521	-	12,510,686	2,930,911	127,418	278,948	1,372	-	3,338,649
Financial assets at fair value through profit or loss													
		-	-	-	-	2,045	2,045	-	-	-	-	2,045	2,045
Financial assets at fair value through other comprehensive income													
		2,765,595	-	768	-	-	2,766,363	2,765,595	-	768	-	-	2,766,363
Other assets													
		2,775	12	1,395	-	-	4,182	1,809	1	1,281	-	-	3,091
Total		23,444,979	1,279,720	1,762,993	231,521	2,045	26,721,258	5,698,315	127,419	280,997	1,372	2,045	6,110,148
Guarantees and commitments													
Guarantees issued in HRK													
		13,236	-	20,340	-	-	33,576	12,371	-	-	-	-	12,371
Issued guarantees in foreign currency													
		31,756	-	1,790,640	-	-	1,822,396	1,469	-	293,997	-	-	295,466
Undrawn loans													
		2,654,591	604,066	22,193	10,182	-	3,291,032	318,481	110,058	21,945	-	-	450,484
Other irrevocable contingent liabilities													
		93	-	-	-	-	93	93	-	-	-	-	93
Total		2,699,676	604,066	1,833,173	10,182	-	5,147,097	332,414	110,058	315,942	-	-	758,414
Total credit risk exposure		26,144,655	1,883,786	3,596,166	241,703	2,045	31,868,355	6,030,729	237,477	596,939	1,372	2,045	6,868,562

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

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

As at 31 December 2019 in the total net highest exposure of the Group and the Bank after the effect of mitigation through collateral received, the amount of loans to other customers of HRK 2,979,445 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 2,066,817 thousand, local and regional authorities of HRK 708,453 thousand and public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 204,175 thousand.

As at 31 December 2019 the amount of financial assets at fair value through other comprehensive income and debt instruments at amortised cost is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 1,548,924 thousand for the Group and HRK 1,509,299 thousand for the Bank.

As at 31 December 2019 other assets of HRK 1,288 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

As at 31 December 2018 in the total net highest exposure of the Group and the Bank after the effect of mitigation through collateral received, the amount of loans to other customers of HRK 2,520,298 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 1,571,622 thousand, local and regional authorities of HRK 647,039 thousand and public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 228,404 thousand. An additional amount of HRK 73,233 thousand relates to receivables from majority state-owned companies (controlling influence).

As at 31 December 2018 the amount of financial assets at fair value through other comprehensive income and debt instruments at amortised cost is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 2,803,585 thousand for the Group and HRK 2,765,595 thousand for the Bank.

As at 31 December 2018 other assets of HRK 1,174 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument by risk category:

Cash on hand and current accounts with banks

Group					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	1,668	-	-	-	1,668
Transfer to Stage 1	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net release of loss allowance	(1,190)	-	-	-	(1,190)
Net foreign exchange loss on loss allowances	5	-	-	-	5
Balance at 31 December 2019	483	-	-	-	483

Group					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	41	-	-	-	41
Transfer by risk stages	-	-	-	-	-
Net increase of loss allowance	1,625	-	-	-	1,625
Net foreign exchange loss on loss allowances	2	-	-	-	2
Balance at 31 December 2018	1,668	-	-	-	1,668

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Cash on hand and current accounts with banks (continued)

Bank					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	1,651	-	-	-	1,651
Transfer to Stage 1	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net release of loss allowance	(1,177)	-	-	-	(1,177)
Net foreign exchange loss on loss allowances	5	-	-	-	5
Balance at 31 December 2019	479	-	-	-	479

Bank					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	41	-	-	-	41
Transfer by risk stages	-	-	-	-	-
Net increase of loss allowance	1,608	-	-	-	1,608
Net foreign exchange loss on loss allowances	2	-	-	-	2
Balance at 31 December 2018	1,651	-	-	-	1,651

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Deposits with other banks

Group and Bank

31 December 2019	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000
Balance at 1 January 2019	1,361	-	-	-	1,361
Transfer to Stage 1	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net release of loss allowance	(112)	-	-	-	(112)
Net foreign exchange loss on loss allowances	7	-	-	-	7
Balance at 31 December 2019	1,256	-	-	-	1,256

Group and Bank

31 December 2018	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000
Balance at 1 January 2018	152	-	-	-	152
Transfer by risk stages	-	-	-	-	-
Net increase of loss allowance	1,216	-	-	-	1,216
Net foreign exchange gains on loss allowances	(7)	-	-	-	(7)
Balance at 31 December 2018	1,361	-	-	-	1,361

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Loans to financial institutions

Group and Bank

31 December 2019

	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	78,126	20,941	18,087	-	117,154
Transfer to Stage 1	251	(251)	-	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net release of loss allowance	(41,274)	(10,177)	(7,035)	-	(58,486)
Unwind – changes due to the lapse of time	-	-	4	-	4
Loss allowances transferred from/to loans to other customers	(3)	-	-	-	(3)
Net foreign exchange loss on loss allowances	(2)	30	1	-	29
Balance at 31 December 2019	37,098	10,543	11,057	-	58,698

Group and Bank

31 December 2018

	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	76,581	33,937	20,502	-	131,020
Transfer by risk stages	4,272	(4,484)	212	-	-
Net release of loss allowance	(2,170)	(8,216)	(2,763)	-	(13,149)
Unwind – changes due to the lapse of time	-	-	275	-	275
Loss allowances transferred from/to loans to other customers	(4)	(24)	-	-	(28)
Net foreign exchange gains on loss allowances	(553)	(272)	(139)	-	(964)
Balance at 31 December 2018	78,126	20,941	18,087	-	117,154

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Loans to other customers

Group and Bank					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	351,878	494,557	2,469,639	64,222	3,380,296
Transfer to Stage 1	322,355	(246,453)	(75,902)	-	-
Transfer to Stage 2	(55,309)	60,546	(5,237)	-	-
Transfer to Stage 3	(1,695)	(127,555)	42,943	86,307	-
Net increase/(release) of loss allowance	(312,295)	445,262	(116,126)	(49,977)	(33,136)
Write-offs	(197)	(10)	(26,544)	-	(26,751)
Unwind – changes due to the lapse of time	(2,913)	(64)	27,565	9,030	33,618
Loss allowances transferred to/from loans to financial institutions	3	-	-	-	3
Acquisition of immovable property	-	-	(6,475)	-	(6,475)
Collection of interest transferred from the off-balance sheet records	-	-	-	-	-
Pretvaranje potraživanja u udjele	-	-	(1,812)	-	(1,812)
Isknjiženje zbog prodaje potraživanja	-	-	(52)	-	(52)
Other	-	-	36	10,221	10,257
Net foreign exchange losses on loss allowances	1,118	1,668	5,479	861	9,126
Balance at 31 December 2019	302,945	627,951	2,313,514	120,664	3,365,074

Group and Bank					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	381,600	452,780	2,758,825	-	3,593,205
Transfer by risk stages	208,556	(268,421)	9,302	50,563	-
Net increase/(release) of loss allowance	(233,530)	312,157	(298,863)	9,075	(211,161)
Write-offs	(2)	-	(42,028)	(1,228)	(43,258)
Unwind – changes due to the lapse of time	337	213	51,357	5,182	57,089
Loss allowances transferred to/from loans to financial institutions	4	24	-	-	28
Acquisition of immovable property	(5)	-	(984)	-	(989)
Interest transferred from the off-balance sheet records	-	-	496	-	496
Net foreign exchange gains on loss allowances	(5,082)	(2,196)	(8,466)	630	(15,114)
Balance at 31 December 2018	351,878	494,557	2,469,639	64,222	3,380,296

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Financial assets at fair value through other comprehensive income

Group					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	5,007	-	1,739	-	6,746
Transfer to Stage 1	47	-	(47)	-	-
Transfer to Stage 2	(416)	416	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net increase/(release) of loss allowance	(3,217)	1	(185)	-	(3,401)
Net foreign exchange gain on loss allowances	1	9	-	-	10
Balance at 31 December 2019	1,422	426	1,507	-	3,355

Group					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	3,837	451	-	-	4,288
Transfer by risk stages	-	(451)	451	-	-
Net increase of loss allowance	1,184	-	1,293	-	2,477
Net foreign exchange gain on loss allowances	(14)	-	(5)	-	(19)
Balance at 31 December 2018	5,007	-	1,739	-	6,746

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Financial assets at fair value through other comprehensive income (continued)

Bank					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	4,720	-	1,739	-	6,459
Transfer to Stage 1	47	-	(47)	-	-
Transfer to Stage 2	(416)	416	-	-	-
Transfer to Stage 3	-	-	-	-	-
Net release of loss allowance	(3,002)	1	(185)	-	(3,186)
Net foreign exchange gain on loss allowances	1	9	-	-	10
Balance at 31 December 2019	1,350	426	1,507	-	3,283

Bank					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	3,546	451	-	-	3,997
Transfer by risk stages	-	(451)	451	-	-
Net increase of loss allowance	1,188	-	1,293	-	2,481
Net foreign exchange gain on loss allowances	(14)	-	(5)	-	(19)
Balance at 31 December 2018	4,720	-	1,739	-	6,459

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Other assets

Group					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	281	-	33,837	-	34,118
Transfer to Stage 1	2	-	(2)	-	-
Transfer to Stage 2	(1)	1	-	-	-
Transfer to Stage 3	-	(6)	(36)	42	-
Net increase/(release) of loss allowance	(40)	23	1,614	(36)	1,561
Other adjustments	(2)	-	-	-	(2)
Write-offs	(76)	-	(38)	-	(114)
Net foreign exchange gain on loss allowances	-	-	7	-	7
Balance at 31 December 2019	164	18	35,382	6	35,570

Group					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	140	4	13,079	-	13,223
Transfer by risk stages	20	(1)	(19)	-	-
Net increase of loss allowance	123	(3)	20,795	-	20,915
Write-offs	-	-	(10)	-	(10)
Acquisition of immovable property	-	-	(14)	-	(14)
Other	(2)	-	-	-	(2)
Net foreign exchange loss on loss allowances	-	-	6	-	6
Balance at 31 December 2018	281	-	33,837	-	34,118

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Other assets (continued)

Bank					
31 December 2019	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2019	46	-	33,837	-	33,883
Transfer to Stage 1	2	-	(2)	-	-
Transfer to Stage 2	(1)	1	-	-	-
Transfer to Stage 3	-	(6)	(36)	42	-
Net increase/(release) of loss allowance	(17)	23	1,614	(36)	1,584
Write-offs	-	-	(38)	-	(38)
Net foreign exchange loss on loss allowances	-	-	7	-	7
Balance at 31 December 2019	30	18	35,382	6	35,436

Bank					
31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2018	4	4	13,079	-	13,087
Transfer by risk stages	20	(1)	(19)	-	-
Net increase/(release) of loss allowance	22	(3)	20,795	-	20,814
Write-offs	-	-	(10)	-	(10)
Acquisition of immovable property	-	-	(14)	-	(14)
Net foreign exchange loss on loss allowances	-	-	6	-	6
Balance at 31 December 2018	46	-	33,837	-	33,883

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.3. Credit risk (continued)

i. Allowances (continued)

Guarantees and commitments

Group and Bank 31 December 2019	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000
Balance at 1 January 2019	9,170	65,094	175,996	11,023	261,283
Transfer to Stage 1	14,916	(14,916)	-	-	-
Transfer to Stage 2	2	(2)	-	-	-
Transfer to Stage 3	-	-	(2,904)	2,904	-
Net increase/(release) of loss allowance	904	(36,026)	(157,600)	(11,368)	(204,090)
Net foreign exchange (gain)/loss on loss allowances	(46)	139	426	4	523
Balance at 31 December 2019	24,946	14,289	15,918	2,563	57,716

Group and Bank 31 December 2018	Stage 1 HRK '000	Stage 2 HRK '000	Stage 3 HRK '000	POCI HRK '000	Total HRK '000
Balance at 1 January 2018	20,203	749	28,395	-	49,347
Transfer by risk stages	(473)	476	(2)	(1)	-
Net increase of loss allowance	(10,367)	63,487	145,958	11,033	210,111
Net foreign exchange (gain)/loss on loss allowances	(193)	382	1,645	(9)	1,825
Balance at 31 December 2018	9,170	65,094	175,996	11,023	261,283

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk

The table below provides an analysis of total assets, total liabilities and total guarantees and commitments as of 31 December 2019 and 31 December 2018 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 31 December 2019	Up to 1 month HRK '000	1 to 3 months HRK '000	3 months to 1 year HRK '000	1 to 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and current accounts with banks	884,407	-	-	-	-	884,407
Deposits with other banks	33,184	519,914	-	-	372	553,470
Loans to financial institutions*	152,358	336,007	1,259,613	2,638,834	5,060,894	9,447,706
Loans to other customers	1,656,921	149,889	2,059,355	2,227,319	7,606,150	13,699,634
Financial assets at fair value through profit or loss	201,599	-	-	-	2,234	203,833
Financial assets at fair value through other comprehensive income	1,567,566	11,209	35	-	-	1,578,810
Debt instruments at amortised cost	-	457	-	-	-	457
Property, plant and equipment and intangible assets	-	-	-	-	48,281	48,281
Foreclosed assets	-	5,930	2,044	13,574	2,650	24,198
Other assets	8,609	5,957	10,389	4,182	678	29,815
Total assets	4,504,644	1,029,363	3,331,436	4,883,909	12,721,259	26,470,611
Liabilities						
Deposits from customers	89,551	24,257	12,248	15,152	35,561	176,769
Borrowings	353,615	315,555**	1,604,542	4,136,517	7,990,224	14,400,453
Debt securities issued	-	43,375	1,114,916	-	-	1,158,291
Provisions for guarantees, commitments and other liabilities	58,582	3,294	11,436	22,146	25,322	120,780
Other liabilities	157,671	12,079	35,580	67,540	66,867	339,737
Total liabilities	659,419	398,560	2,778,722	4,241,355	8,117,974	16,196,030
Liquidity gap	3,845,225	630,803	552,714	642,554	4,603,285	10,274,581
Guarantees and commitments						
Guarantees issued in HRK	61,481	-	-	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	-	-	11,693
Undrawn loans	3,954,299	-	-	-	-	3,954,299
EIF – subscribed, not called up capital	47,632	-	-	-	-	47,632
EIF CROGIP Contracted Liability	-	800	34,000	113,000	112,058	259,858
EIF FRC2 Contracted Liability	300	300	2,000	7,400	2,362	12,362
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	4,270,235	1,100	36,000	120,400	114,420	4,542,155

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

* Receivables of HRK 41,075 thousand relate to reverse REPO agreements.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk (continued)

Group 31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	944,417	-	-	-	-	944,417
Deposits with other banks	261,925	-	-	-	-	261,925
Loans to financial institutions*	389,640	693,932	1,231,553	2,718,573	5,201,290	10,234,988
Loans to other customers	2,096,151	141,949	792,913	2,769,366	6,710,307	12,510,686
Financial assets at fair value through profit or loss	334,221	-	-	-	2,045	336,266
Financial assets at fair value through other comprehensive income	2,818,280	11,167	23	-	-	2,829,470
Debt instruments at amortised cost	-	9	4	-	1,350	1,363
Property, plant and equipment and intangible assets	-	-	-	-	50,832	50,832
Foreclosed assets	-	-	9,690	2,666	12,974	25,330
Other assets	6,050	8,294	7,607	1,753	-	23,704
Total assets	6,850,684	855,351	2,041,790	5,492,358	11,978,798	27,218,981
Liabilities						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	313,492	461,196**	1,454,492	3,966,550	8,682,257	14,877,987
Debt securities issued	-	43,347	-	1,107,210	-	1,150,557
Provisions for guarantees, commitments and other liabilities	125,437	10,305	35,597	71,166	78,986	321,491
Other liabilities	143,475	14,261	44,789	88,740	87,478	378,743
Total liabilities	812,108	535,688	1,712,614	5,234,423	8,863,041	17,157,874
Liquidity gap	6,038,576	319,663	329,176	257,935	3,115,757	10,061,107
Guarantees and commitments						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	5,194,569	-	-	-	-	5,194,569

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

* Receivables of HRK 691,269 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 222,527 thousand was placed in the 3 months up to 1 year maturity category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk (continued)

The table below provides an analysis of total assets, total liabilities and total guarantees and commitments as of 31 December 2019 and 31 December 2018 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	Up to 1	1 to 3	3 months to	1 to 3	Over 3	Total
31 December 2019	month	months	1 year	years	years	
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	881,487	-	-	-	-	881,487
Deposits with other banks	33,184	519,914	-	-	372	553,470
Loans to financial institutions*	152,358	336,007	1,259,613	2,638,834	5,060,894	9,447,706
Loans to other customers	1,656,921	149,889	2,059,355	2,227,319	7,606,150	13,699,634
Financial assets at fair value through profit	191,760	-	-	-	2,234	193,994
Financial assets at fair value through other	1,527,510	11,131	-	-	-	1,538,641
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	47,309	47,309
Foreclosed assets	-	-	5,930	2,044	13,574	2,650
Other assets	7,127	1,630	10,306	4,181	678	23,922
Total assets	4,450,347	1,024,501	3,331,318	4,883,908	12,756,411	26,446,485
Liabilities						
Deposits from customers	89,551	24,257	12,248	15,152	35,561	176,769
Borrowings	353,615	315,555**	1,604,542	4,136,517	7,990,224	14,400,453
Debt securities issued	-	43,375	1,114,916	-	-	1,158,291
Provisions for guarantees, commitments and other liabilities	58,582	3,294	11,287	22,146	25,322	120,631
Other liabilities	156,976	8,827	30,247	59,344	67,853	323,247
Total liabilities	658,724	395,308	2,773,240	4,233,159	8,118,960	16,179,391
Liquidity gap	3,791,623	629,193	558,078	650,749	4,637,451	10,267,094
Guarantees and commitments						
Guarantees issued in HRK	61,481	-	-	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	-	-	11,693
Undrawn loans	3,954,299	-	-	-	-	3,954,299
EIF – subscribed, not called up capital	47,632	-	-	-	-	47,632
EIF CROGIP Contracted Liability	-	800	34,000	113,000	112,058	259,858
EIF FRC2 Contracted Liability	300	300	2,000	7,400	2,362	12,362
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	4,270,235	1,100	36,000	120,400	114,420	4,542,155

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

* Receivables of HRK 41,075 thousand relate to reverse REPO agreements.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk (continued)

Bank 31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	941,071	-	-	-	-	941,071
Deposits with other banks	261,925	-	-	-	-	261,925
Loans to financial institutions*	389,640	693,932	1,231,553	2,718,573	5,201,290	10,234,988
Loans to other customers	2,096,151	141,949	792,913	2,769,366	6,710,307	12,510,686
Financial assets at fair value through profit	328,758	-	-	-	2,045	330,803
Financial assets at fair value through other	2,781,000	11,072	-	-	-	2,792,072
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	50,764	50,764
Foreclosed assets	-	-	9,690	2,666	12,974	25,330
Other assets	4,856	970	7,585	1,753	-	15,164
Total assets	6,803,401	847,923	2,041,741	5,492,358	12,013,504	27,198,927
Liabilities						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	313,492	461,196**	1,454,492	3,966,550	8,682,257	14,877,987
Debt securities issued	-	43,347	-	1,107,210	-	1,150,557
Provisions for guarantees, commitments and other liabilities	125,417	10,305	35,487	71,166	78,986	321,361
Other liabilities	142,805	11,734	40,406	81,033	89,936	365,914
Total liabilities	811,418	533,161	1,708,121	5,226,716	8,865,499	17,144,915
Liquidity gap	5,991,983	314,762	333,620	265,642	3,148,005	10,054,012
Guarantees and commitments						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	5,194,569	-	-	-	-	5,194,569

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

* Receivables of HRK 691,269 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 222,527 thousand was placed in the 3 months up to 1 year maturity category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk (continued)

The table below indicates the remaining contractual maturity of financial liabilities, whereas the guarantees and commitments of the Group are classified in the category “up to 1 month”, owing to the possibility of a premature call to meet a liability (undiscounted amounts):

Group	Up to 1	1 - 3	3 - 12	1 - 3	Over 3	Total
31 December 2019	month	months	months	years	years	
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	89,551	24,257	12,248	15,152	35,561	176,769
Borrowings	375,094	342,026	1,757,887	4,536,871	8,983,313	15,995,191
Debt securities issued	-	43,374	1,181,900	-	-	1,225,274
Provisions for guarantees, commitments and other liabilities	58,582	3,294	11,436	22,146	25,322	120,780
Other liabilities	157,671	12,080	35,580	67,539	66,867	339,737
Total	680,898	425,031	2,999,051	4,641,708	9,111,063	17,857,751
Guarantees and commitments						
Guarantees issued in HRK	61,481	-	-	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	-	-	11,693
Undrawn loans	3,954,299	-	-	-	-	3,954,299
EIF – subscribed, not called up capital	47,632	-	-	-	-	47,632
EIF CROGIP Contracted Liability	-	800	34,000	113,000	112,058	259,858
EIF FRC2 Contracted Liability	300	300	2,000	7,400	2,362	12,362
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	4,270,235	1,100	36,000	120,400	114,420	4,542,155
Group						
31 December 2018	Up to 1	1 - 3	3 - 12	1 - 3	Over 3	Total
	month	months	months	years	years	
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	338,464	438,773	1,647,005	4,387,915	9,457,974	16,270,131
Debt securities issued	-	-	66,758	1,173,968	-	1,240,726
Provisions for guarantees, commitments and other liabilities	125,437	10,305	35,597	71,166	78,986	321,491
Other liabilities	143,475	14,261	44,789	88,740	87,478	378,743
Total	837,080	469,918	1,971,885	5,722,546	9,638,758	18,640,187
Guarantees and commitments						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	5,194,569	-	-	-	-	5,194,569

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.4. Liquidity risk (continued)

The table below indicates the remaining contractual maturity of financial liabilities, whereas the guarantees and commitments of the Group are classified in the category “up to 1 month”, owing to the possibility of a premature call to meet a liability (undiscounted amounts):

Bank 31 December 2019	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	89,551	24,257	12,248	15,152	35,561	176,769
Borrowings	375,094	342,026	1,757,887	4,536,871	8,983,313	15,995,191
Debt securities issued	-	43,374	1,181,900	-	-	1,225,274
Provisions for guarantees, commitments and other liabilities	58,582	3,294	11,287	22,146	25,322	120,631
Other liabilities	156,976	8,828	30,246	59,344	67,853	323,247
Total	680,203	421,779	2,993,568	4,633,513	9,112,049	17,841,112
Guarantees and commitments						
Guarantees issued in HRK	61,481	-	-	-	-	61,481
Issued guarantees in foreign currency	194,737	-	-	-	-	194,737
Open letters of credit in foreign currency	11,693	-	-	-	-	11,693
Undrawn loans	3,954,299	-	-	-	-	3,954,299
EIF – subscribed, not called up capital	47,632	-	-	-	-	47,632
EIF CROGIP Contracted Liability	-	800	34,000	113,000	112,058	259,858
EIF FRC2 Contracted Liability	300	300	2,000	7,400	2,362	12,362
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	4,270,235	1,100	36,000	120,400	114,420	4,542,155
Bank 31 December 2018						
	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	229,704	6,579	177,736	757	14,320	429,096
Borrowings	338,464	438,773	1,647,005	4,387,915	9,457,974	16,270,131
Debt securities issued	-	-	66,758	1,173,968	-	1,240,726
Provisions for guarantees, commitments and other liabilities	125,417	10,305	35,487	71,166	78,986	321,361
Other liabilities	142,805	11,734	40,406	81,033	89,936	365,914
Total	836,390	467,391	1,967,392	5,714,839	9,641,216	18,627,228
Guarantees and commitments						
Guarantees issued in HRK	33,576	-	-	-	-	33,576
Issued guarantees in foreign currency	1,822,396	-	-	-	-	1,822,396
Undrawn loans	3,291,032	-	-	-	-	3,291,032
EIF – subscribed, not called up capital	47,472	-	-	-	-	47,472
Other irrevocable contingent liabilities	93	-	-	-	-	93
Total guarantees and commitments	5,194,569	-	-	-	-	5,194,569

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management

34.5. Market risk

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

34.5.1. Interest rate risk

The following tables demonstrate the sensitivity of the Group to the interest rate risk as of 31 December 2019 and 2018 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 2019 and 2018 which may not be indicative for the positions in other periods.

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total	Fixed interest rate
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and current accounts with banks	650,921	-	-	-	-	233,486	884,407	650,921
Deposits with other banks	33,184	520,032	-	-	-	254	553,470	553,216
Loans to financial institutions	146,639	536,191	1,224,864	2,563,039	4,971,304	5,669	9,447,706	9,221,266
Loans to other customers	1,769,376	322,630	2,158,440	2,012,521	7,323,188	113,479	13,699,634	12,908,055
Financial assets at fair value through profit or loss	-	-	-	-	2,234	201,599	203,833	2,234
Financial assets at fair value through other comprehensive income	1,540,964	-	-	-	-	37,846	1,578,810	1,540,964
Debt instruments at amortised cost	-	448	-	-	-	9	457	448
Other assets	-	-	-	-	-	29,815	29,815	-
Total assets	4,141,084	1,379,301	3,383,304	4,575,560	12,296,726	622,157	26,398,132	24,877,104
Liabilities								
Deposits from customers	-	-	-	-	-	176,769	176,769	-
Borrowings	353,615	269,056	1,730,226	4,100,607	7,900,450	46,499	14,400,453	14,210,316
Debt securities issued	-	-	1,114,916	-	-	43,375	1,158,291	1,114,916
Provisions for guarantees, commitments and other liabilities	-	-	-	-	-	120,780	120,780	-
Other liabilities	-	-	-	-	-	339,737	339,737	-
Total liabilities	353,615	269,056	2,845,142	4,100,607	7,900,450	727,160	16,196,030	15,325,232
Interest rate gap	3,787,469	1,110,245	538,162	474,953	4,396,276	(105,003)	10,202,102	9,551,872

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.1. Interest rate risk (continued)

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total	Fixed interest rate
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and current accounts with banks	24,290	-	-	-	-	920,127	944,417	24,290
Deposits with other banks	261,922	-	-	-	-	3	261,925	261,922
Loans to financial institutions	383,417	956,301	1,193,348	2,624,259	5,070,629	7,034	10,234,988	9,922,017
Loans to other customers	2,273,725	465,131	712,572	2,476,258	6,491,188	91,812	12,510,686	11,699,344
Financial assets at fair value through profit or loss	-	-	-	-	2,045	334,221	336,266	2,045
Financial assets at fair value through other comprehensive income	2,792,223	-	-	-	-	37,247	2,829,470	2,792,223
Debt instruments at amortised cost	-	-	-	-	1,350	13	1,363	1,350
Other assets	-	-	-	-	-	23,704	23,704	-
Total assets	5,735,577	1,421,432	1,905,920	5,100,517	11,565,212	1,414,161	27,142,819	24,703,191
Liabilities								
Deposits from customers	148,351	-	-	-	-	280,745	429,096	-
Borrowings	313,492	559,016	1,441,392	3,931,617	8,577,456	55,014	14,877,987	14,665,772
Debt securities issued	-	-	-	1,107,210	-	43,347	1,150,557	1,107,210
Provisions for guarantees, commitments and other liabilities	-	-	-	-	-	321,491	321,491	-
Other liabilities	-	-	-	-	-	378,743	378,743	-
Total liabilities	461,843	559,016	1,441,392	5,038,827	8,577,456	1,079,340	17,157,874	15,772,982
Interest rate gap	5,273,734	862,416	464,528	61,690	2,987,756	334,821	9,984,945	8,930,209

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.1. Interest rate risk (continued)

The following tables demonstrate the sensitivity of HBOR to the interest rate risk as of 31 December 2019 and 2018 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 2019 and 2018 which may not be indicative for the positions in other periods.

Bank	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total	Fixed interest rate
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and current accounts with banks	648,001	-	-	-	-	233,486	881,487	648,001
Deposits with other banks	33,184	520,032	-	-	-	254	553,470	553,216
Loans to financial institutions	146,639	536,191	1,224,864	2,563,039	4,971,304	5,669	9,447,706	9,221,266
Loans to other customers	1,769,376	322,630	2,158,440	2,012,521	7,323,188	113,479	13,699,634	12,908,055
Financial assets at fair value through profit or loss	-	-	-	-	2,234	191,760	193,994	2,234
Financial assets at fair value through other comprehensive income	1,501,265	-	-	-	-	37,376	1,538,641	1,501,265
Other assets	-	-	-	-	-	23,922	23,922	-
Total assets	4,098,465	1,378,853	3,383,304	4,575,560	12,296,726	605,946	26,338,854	24,834,037
Liabilities								
Deposits from customers	-	-	-	-	-	176,769	176,769	-
Borrowings	353,615	269,056	1,730,226	4,100,607	7,900,450	46,499	14,400,453	14,210,316
Debt securities issued	-	-	1,114,916	-	-	43,375	1,158,291	1,114,916
Provisions for guarantees, commitments and other liabilities	-	-	-	-	-	120,631	120,631	-
Other liabilities	-	-	-	-	-	323,247	323,247	-
Total liabilities	353,615	269,056	2,845,142	4,100,607	7,900,450	710,521	16,179,391	15,325,232
Interest rate gap	3,744,850	1,109,797	538,162	474,953	4,396,276	(104,575)	10,159,463	9,508,805

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.1. Interest rate risk (continued)

Bank	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total	Fixed interest rate
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and current accounts with banks	20,944	-	-	-	-	920,127	941,071	20,944
Deposits with other banks	261,922	-	-	-	-	3	261,925	261,922
Loans to financial institutions	383,417	956,301	1,193,348	2,624,259	5,070,629	7,034	10,234,988	9,922,017
Loans to other customers	2,273,725	465,131	712,572	2,476,258	6,491,188	91,812	12,510,686	11,699,344
Financial assets at fair value through profit or loss	-	-	-	-	2,045	328,758	330,803	2,045
Financial assets at fair value through other comprehensive income	2,755,291	-	-	-	-	36,781	2,792,072	2,755,291
Other assets	-	-	-	-	-	15,164	15,164	-
Total assets	5,695,299	1,421,432	1,905,920	5,100,517	11,563,862	1,399,679	27,086,709	24,661,563
Liabilities								
Deposits from customers	148,351	-	-	-	-	280,745	429,096	-
Borrowings	313,492	559,016	1,441,392	3,931,617	8,577,456	55,014	14,877,987	14,665,772
Debt securities issued	-	-	-	1,107,210	-	43,347	1,150,557	1,107,210
Provisions for guarantees, commitments and other liabilities	-	-	-	-	-	321,361	321,361	-
Other liabilities	-	-	-	-	-	365,914	365,914	-
Total liabilities	461,843	559,016	1,441,392	5,038,827	8,577,456	1,066,381	17,144,915	15,772,982
Interest rate gap	5,233,456	862,416	464,528	61,690	2,986,406	333,298	9,941,794	8,888,581

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.1. Interest rate risk (continued)

Total assets and total liabilities on the basis of a possibility of changes in interest rates (fixed or variable):

	Group		Bank	
	31 December	31 December	31 December	31 December
	2019	2018	2019	2018
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Fixed interest rate assets	24,877,104	24,703,191	24,834,037	24,661,563
Variable interest rate assets	898,871	1,025,467	898,871	1,025,467
Non-interest bearing	622,157	1,414,161	605,946	1,399,679
Total	26,398,132	27,142,819	26,338,854	27,086,709
Liabilities				
Fixed interest rate liabilities	15,325,232	15,772,982	15,325,232	15,772,982
Variable interest rate liabilities	143,638	305,552	143,638	305,552
Non-interest bearing	727,160	1,079,340	710,521	1,066,381
Total liabilities	16,196,030	17,157,874	16,179,391	17,144,915

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.1. Interest rate risk (continued)

Sensitivity analysis

Assumptions used in preparing the interest risk sensitivity analysis relate to possible changes in reference interest rates in order to assess the hypothetical effect on HBOR's profit.

Volatility of reference interest rates for 2019 has been determined using the standard deviation method on the daily changes of the reference interest rates linked to EUR and USD. On the basis of the above volatility, possible changes in reference interest rates linked to EUR and USD have been established and used in the sensitivity analysis.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points of variable interest rates. All other variables remain constant.

The sensitivity of profit is influenced by hypothetical changes in interest rates during a period of one year based on interest bearing assets and liabilities with a variable interest rate.

Currency	Increase in b.p. in 2019	Effect on profit	Increase in b.p. in 2018	Effect on profit
		in 2019		in 2018
		HRK '000		HRK '000
EUR	+6	295	+1	40
USD	+17	468	+17	599
Currency	Decrease in b.p. in 2019	Effect on profit	Decrease in b.p. in 2018	Effect on profit
		in 2019		in 2018
		HRK '000		HRK '000
EUR	-6	(295)	-1	(40)
USD	-17	(468)	-17	(599)

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.2. Currency risk

Total assets and total liabilities as of 31 December 2019 and 31 December 2018 in HRK and foreign currencies can be shown as follows:

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	14,472	635,803	8	650,283	234,124	884,407
Deposits with other banks	-	553,470	-	553,470	-	553,470
Loans to financial institutions	-	4,596,801	-	4,596,801	4,850,905	9,447,706
Loans to other customers	500,047	8,346,335	-	8,846,382	4,853,252	13,699,634
Financial assets at fair value through profit or loss	-	62,169	-	62,169	141,664	203,833
Financial assets at fair value through other comprehensive income	-	324,388	-	324,388	1,254,422	1,578,810
Debt instruments at amortised cost	-	457	-	457	-	457
Property, plant and equipment and intangible assets	-	-	-	-	48,281	48,281
Foreclosed assets	-	-	-	-	24,198	24,198
Other assets	-	4,484	-	4,484	25,331	29,815
Total assets	514,519	14,523,907	8	15,038,434	11,432,177*	26,470,611
Liabilities						
Deposits from customers	13,158	28,939	536	42,633	134,136	176,769
Borrowings	489,042	13,896,411	-	14,385,453	15,000	14,400,453
Debt securities issued	-	1,158,291	-	1,158,291	-	1,158,291
Provisions for guarantees, commitments and other liabilities	10,069	5,143	1,023	16,235	104,545	120,780
Other liabilities	925	10,294	33	11,252	328,485	339,737
Total liabilities	513,194	15,099,078	1,592	15,613,864	582,166	16,196,030
Currency gap	1,325	(575,171)	(1,584)	(575,430)	10,850,011	10,274,581

*Amounts linked to a one-way currency clause represent HRK 40,105 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.2. Currency risk (continued)

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
31 December 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	4,824	15,188	1,391	21,403	923,014	944,417
Deposits with other banks	40,545	221,380	-	261,925	-	261,925
Loans to financial institutions	-	5,784,740	-	5,784,740	4,450,248	10,234,988
Loans to other customers	635,501	7,866,575	-	8,502,076	4,008,610	12,510,686
Financial assets at fair value through profit or loss	-	50,119	-	50,119	286,147	336,266
Financial assets at fair value through other comprehensive income	-	619,962	-	619,962	2,209,508	2,829,470
Debt instruments at amortised cost	-	1,363	-	1,363	-	1,363
Property, plant and equipment and intangible assets	-	-	-	-	50,832	50,832
Foreclosed assets	-	-	-	-	25,330	25,330
Other assets	-	7,395	-	7,395	16,309	23,704
Total assets	680,870	14,566,722	1,391	15,248,983	11,969,998*	27,218,981
Liabilities						
Deposits from customers	20,526	161,858	80	182,464	246,632	429,096
Borrowings	688,500	14,189,487	-	14,877,987	-	14,877,987
Debt securities issued	-	1,150,557	-	1,150,557	-	1,150,557
Provisions for guarantees, commitments and other liabilities	55,291	116,896	268	172,455	149,036	321,491
Other liabilities	3,284	9,392	34	12,710	366,033	378,743
Total liabilities	767,601	15,628,190	382	16,396,173	761,701	17,157,874
Currency gap	(86,731)	(1,061,468)	1,009	(1,147,190)	11,208,297	10,061,107

*Amounts linked to a one-way currency clause represent HRK 90,776 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.2. Currency risk (continued)

Total assets and total liabilities as of 31 December 2019 and 31 December 2018 in HRK and foreign currencies can be shown as follows:

Bank	USD	EUR	Other	Total	HRK	Total
	HRK '000	HRK '000	foreign currencies HRK '000	foreign currencies HRK '000	HRK '000	HRK '000
31 December 2019						
Assets						
Cash on hand and current accounts with banks	14,472	633,983	8	648,463	233,024	881,487
Deposits with other banks	-	553,470	-	553,470	-	553,470
Loans to financial institutions	-	4,596,801	-	4,596,801	4,850,905	9,447,706
Loans to other customers	500,047	8,346,335	-	8,846,382	4,853,252	13,699,634
Financial assets at fair value through profit or loss	-	52,330	-	52,330	141,664	193,994
Financial assets at fair value through other comprehensive income	-	316,150	-	316,150	1,222,491	1,538,641
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	47,309	47,309
Foreclosed assets	-	-	-	-	24,198	24,198
Other assets	-	161	-	161	23,761	23,922
Total assets	514,519	14,499,230	8	15,013,757	11,432,728*	26,446,485
Liabilities						
Deposits from customers	13,158	28,939	536	42,633	134,136	176,769
Borrowings	489,042	13,896,411	-	14,385,453	15,000	14,400,453
Debt securities issued	-	1,158,291	-	1,158,291	-	1,158,291
Provisions for guarantees, commitments and other liabilities	10,069	5,143	1,023	16,235	104,396	120,631
Other liabilities	774	2,056	-	2,830	320,417	323,247
Total liabilities	513,043	15,090,840	1,559	15,605,442	573,949	16,179,391
Currency gap	1,476	(591,610)	(1,551)	(591,685)	10,858,779	10,267,094

* Amounts linked to a one-way currency clause represent HRK 40,105 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.2. Currency risk (continued)

Bank	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
31 December 2018						
Assets						
Cash on hand and current accounts with banks	4,824	15,188	1,391	21,403	919,668	941,071
Deposits with other banks	40,545	221,380	-	261,925	-	261,925
Loans to financial institutions	-	5,784,740	-	5,784,740	4,450,248	10,234,988
Loans to other customers	635,501	7,866,575	-	8,502,076	4,008,610	12,510,686
Financial assets at fair value through profit or loss	-	46,807	-	46,807	283,996	330,803
Financial assets at fair value through other comprehensive income	-	611,072	-	611,072	2,181,000	2,792,072
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	50,764	50,764
Foreclosed assets	-	-	-	-	25,330	25,330
Other assets	-	110	-	110	15,054	15,164
Total assets	680,870	14,545,872	1,391	15,228,133	11,970,794*	27,198,927
Liabilities						
Deposits from customers	20,526	161,858	80	182,464	246,632	429,096
Borrowings	688,500	14,189,487	-	14,877,987	-	14,877,987
Debt securities issued	-	1,150,557	-	1,150,557	-	1,150,557
Provisions for guarantees, commitments and other liabilities	55,291	116,896	268	172,455	148,906	321,361
Other liabilities	3,088	1,317	-	4,405	361,509	365,914
Total liabilities	767,405	15,620,115	348	16,387,868	757,047	17,144,915
Currency gap	(86,535)	(1,074,243)	1,043	(1,159,735)	11,213,747	10,054,012

* Amounts linked to a one-way currency clause represent HRK 90,776 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

34. Risk management (continued)

34.5. Market risk (continued)

34.5.2. Currency risk (continued)

Sensitivity analysis

Sensitivity analysis of the Bank's total assets and total liabilities to fluctuations in foreign exchange rates is carried out for those foreign currencies that represent Bank's significant currencies as at the reporting date.

An assumption of reasonably possible fluctuations in EUR exchange rates against HRK was used in the foreign currency risk sensitivity analysis, with the other variables remaining stable, in order to assess the hypothetical effect on HBOR's profit as of 31 December 2019.

Volatility of the exchange rate EUR/HRK, determined using the standard deviation method on the changes of the foreign exchange rate EUR/HRK, equalled 1.22% in the last 12 months (2018:1.97%).

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

	Change in currency rate in 2019 %	Effect on profit in 2019 HRK' 000	Change in currency rate in 2018 %	Effect on profit in 2018 HRK' 000
EUR	+1.22	(5,333)	+1.97	(14,207)
EUR	-1.22	5,428	-1.97	15,217

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities

The accounting policy on fair value measurements is discussed in Note 4.2.

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value

Below is a breakdown of the financial assets at fair value based on IFRS 9 classification on 31 December 2019 and 31 December 2018..

Group	31 December 2019		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Financial assets at fair value through profit or loss:			
Loans at FVPL:			
Mezzanine loans	-	-	2,234
Investments in investment funds:			
Investments in investment funds at fair value through profit or loss	200,868	-	-
Equity instruments:			
Listed equity instruments:			
Investments in corporate shares	-	-	-
Unlisted equity instruments:			
Investments in corporate shares	-	-	31
Depository receipt - DR	-	-	539
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	200,868	161	2,804
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
Listed debt instruments:			
Bonds of the Republic of Croatia	1,122,448	-	-
Corporate bonds	1,000	-	-
Treasury bills of the Ministry of Finance	414,788	-	-
Accrued interest	11,232	-	-
Unlisted debt instruments:			
Corporate bonds	-	-	573
Convertible bonds - CB	-	-	2,155
Accrued interest	-	-	369
Total debt instruments	1,549,468	-	3,097
Unlisted equity instruments:			
Investment in shares of foreign legal entities	-	40	-
Shares of foreign financial institutions – EIF	-	26,205	-
Total equity instruments	-	26,245	-
Total financial assets at fair value through other comprehensive income	1,549,468	26,245	3,097

Treasury Bills of the Ministry of Finance of the Republic of Croatia were classified within Level 1 of the fair value hierarchy because credit institutions in the country started to list prices at Bloomberg, and quoted market price is used as the valuation technique.

Debt Instruments: Corporate Bonds were classified within Level 3 of the fair value hierarchy. The valuation technique used was the method of the discounted cash flows based on market interest rates, spread linked to internal credit-rating and internally determined spread linked to financial instrument liquidity.

There were no transfers between the levels in the reporting period.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

Group	31 December 2018		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Financial assets at fair value through profit or loss:			
<i>Loans at FVPL:</i>			
Mezzanine loans	-	-	2,045
<i>Investments in investment funds:</i>			
Investments in investment funds at fair value through profit or loss	334,060	-	-
Equity instruments:			
<i>Listed equity instruments:</i>			
Investments in corporate shares	-	-	-
<i>Unlisted equity instruments:</i>			
Investments in corporate shares	-	-	-
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	334,060	161	2,045
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
<i>Listed debt instruments:</i>			
Bonds of the Republic of Croatia	1,124,611	-	-
Corporate bonds	770	-	-
Treasury bills of the Ministry of Finance	1,666,299	-	-
Accrued interest	11,313	-	-
<i>Unlisted debt instruments:</i>			
Corporate bonds	-	-	535
Accrued interest	-	-	233
Total debt instruments	2,802,993	-	768
<i>Unlisted equity instruments:</i>			
Investment in shares of foreign legal entities	-	38	-
Shares of foreign financial institutions – EIF	-	25,671	-
Total equity instruments	-	25,709	-
Total financial assets at fair value through other comprehensive income	2,802,993	25,709	768

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

Bank	31 December 2019		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Financial assets at fair value through profit or loss:			
Loans at FVPL:			
Mezzanine loans	-	-	2,234
Investments in investment funds:			
Investments in investment funds at fair value through profit or loss	191,029	-	-
Equity instruments:			
Listed equity instruments:			
Investments in companies' shares			
Unlisted equity instruments:			
Investments in companies' shares	-	-	31
Depository receipt - DR	-	-	539
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	191,029	161	2,804
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
Listed debt instruments:			
Bonds of the Republic of Croatia	1,083,749	-	-
Treasury bills of the Ministry of Finance	414,788	-	-
Accrued interest	10,762	-	-
Unlisted debt instruments:			
Corporate bonds	-	-	573
Convertible bonds - CB	-	-	2,155
Accrued interest	-	-	369
Total debt instruments	1,509,299	-	3,097
Unlisted equity instruments:			
Investment in shares of foreign legal entities – SWIFT	-	40	-
Shares of foreign financial institutions – EIF	-	26,205	-
Total equity instruments	-	26,245	-
Total financial assets at fair value through other comprehensive income	1,509,299	26,245	3,097

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

Bank	31 December 2018		
	Level 1	Level 2	Level 3
	HRK '000	HRK '000	HRK '000
Financial assets at fair value through profit or loss:			
Loans at FVPL:			
Mezzanine loans	-	-	2,045
Investments in investment funds:			
Investments in investment funds at fair value through profit or loss	328,597	-	-
Equity instruments:			
Listed equity instruments:			
Investments in companies' shares	-	-	-
Unlisted equity instruments:			
Investments in companies' shares	-	-	-
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	328,597	161	2,045
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
Listed debt instruments:			
Bonds of the Republic of Croatia	1,088,457	-	-
Treasury bills of the Ministry of Finance	1,666,299	-	-
Accrued interest	10,839	-	-
Unlisted debt instruments:			
Corporate bonds	-	-	535
Accrued interest	-	-	233
Total debt instruments	2,765,595	-	768
Unlisted equity instruments:			
Investment in shares of foreign legal entities – SWIFT	-	38	-
Shares of foreign financial institutions – EIF	-	25,671	-
Total equity instruments	-	25,709	-
Total financial assets at fair value through other comprehensive income	2,765,595	25,709	768

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

35.1.1. Level 3 - fair value

a) Mezzanine loans

For the assessment of fair value of mezzanine loans, the method of discounting expected future cash flows is used.

Due to their contractual characteristics, mezzanine loans do not pass the SPPI test. Characteristics due to which mezzanine loans do not pass the SPPI test are as follows:

- in the case of realisation of contractually defined performance indicators (net debt to EBITDA ratio) over the predetermined period, creditors have the option, but not the obligation, to convert a mezzanine loan to a „senior debt“,
- upon the final maturity of the mezzanine loan, creditors have the option, but not the obligation, to convert the loan into the debtor's equity and
- the debtor has the option, but not the obligation, to prematurely repay the loan at discount.

Due to the above-mentioned characteristics of the mezzanine loan, the assessment of fair value of these loans was carried out in accordance with the precautionary principle, according to which income is recognised only when it is actually incurred, and expenses also when they are possible, under the assumption that the regular operations of debtor are continued in the future. This is a situation in which the Group would, upon the final maturity of the mezzanine loan, convert its receivables into the debtor's equity.

On 31 December 2019, the market price of ordinary shares of the debtor that the Bank could subscribe amounted to HRK 6,006 thousand, assuming that the market price of the shares included all market expectations related to future operations of the issuer. Given that HBOR can subscribe ordinary shares not earlier than on 30 April 2030, the amount of market value is reduced to the current value by applying the appropriate discount rate. The present value of these shares in HBOR's expected ownership amounts to HRK 2,234 thousand, which represents the fair value of the mezzanine loan on 31 December 2019.

b) Corporate bonds that are allocated to Stage 3

(i) Techniques of valuation and significant input data that are not visible

For the assessment of fair value of illiquid corporate bonds in the HBOR portfolio, the method of discounted cash flow of bonds is used. The fair value of bonds is the present value of all future cash flows of bonds calculated by applying the discount rate defined as yield on risk-free investments increased by the premium of specific credit risk for the respective bond and the premium for bond liquidity risk.

The discount rate on risk-free investments is calculated as linearly interpolated/extrapolated yield of Croatian bonds of the same duration and of the same foreign currency as the bonds valued. The source of information on the yields on bonds of the Republic of Croatia is the Bloomberg information system.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

35.1.1. Level 3 - fair value (continued)

b) Corporate bonds that are allocated to Stage 3 (continued)

(i) Techniques of valuation and significant input data that are not visible (continued)

The premium of the specific risk amount for the respective bond depends on HBOR's internal credit rating of the bond issuer, i.e. if the issuer is a member of a business group, the risk premium depends on internal credit rating of the parent company.

ii) Sensitivity analysis of corporate bond with the stated potential effect on profit/loss as at 31 December 2018, under the assumption of a change in discount rate (yield) of 2% and 10%

Under the assumption that the market interest rates change by 2% compared with those in effect as at 31 December 2019, the impacts would be as follows:

- a) In the case of a decrease in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the respective bond) by 2%, the discount rate would equal 9.79%, the bond price would be 38.97%, which would result in an increase in HBOR's generated profits of HRK 15.80 thousand.
- b) In the case of an increase in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the corporate bond) by 2%, the discount rate would equal 13.79%, the bond price would be 36.93%, which would result in a decrease in HBOR's generated profits of HRK 14.99 thousand.

The change in interest rates defined in the "Decision on the Management of Interest Rate Risk in the Bank Book", which is applied when calculating standard interest rate shock, is used as the basis for the change in the market interest rate of 2% compared with the market terms and conditions in effect as at 31 December 2019. "Standard interest rate shock is a parallel positive or negative change in interest rates on a reference yield curve of 200 basis points by applying the lower limit rate of 0%, except for the cases in which negative interest rate can be achieved."

In the case of a decrease in expected cash flows on corporate bonds of 10%, the generated profit of HBOR would decrease by HRK 57.35 thousand.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

35.1.1. Level 3 - fair value (continued)

c) Adjustment of fair value of Level 3:

i) The fair value of Level 3 financial assets measured at fair value upon initial recognition – mezzanine loans:

Group and Bank	2019 HRK '000	2018 HRK '000
Balance as at 1 January	2,045	4,016
Decrease in fair value through profit or loss	189	(1,971)
Balance as of 31 December	2,234	2,045

ii) The fair value of Level 3 financial assets measured at fair value upon initial recognition – unlisted debt securities:

Group and Bank	2019 HRK '000	2018 HRK '000
Balance as at 1 January	768	689
Increase in fair value through other comprehensive income	2,255	33
Net foreign exchange	5	(20)
Accrued interest	69	66
Balance as of 31 December	3,097	768

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

35.1.2 Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by level in the fair value hierarchy into which each fair value measurement is categorised.

Group 31 December 2019	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000	Total fair values HRK '000	Total carrying amount HRK '000
Assets					
Cash on hand and current accounts with banks	884,407	-	-	884,407	884,407
Deposits with other banks	-	553,470	-	553,470	553,470
Loans to financial institutions	-	-	10,733,369	10,733,369	9,447,706
Loans to other customers	-	-	16,041,117	16,041,117	13,699,634
	884,407	553,470	26,774,486	28,212,363	24,585,217
Liabilities					
Deposits from customers	-	176,769	-	176,769	176,769
Borrowings	-	-	16,315,172	16,315,172	14,400,453
Debt securities issued	-	1,141,506	-	1,141,506	1,158,291
	-	1,318,275	16,315,172	17,633,447	15,735,513
Group 31 December 2018					
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000	Total fair values HRK '000	Total carrying amount HRK '000
Assets					
Cash on hand and current accounts with banks	944,417	-	-	944,417	944,417
Deposits with other banks	-	261,925	-	261,925	261,925
Loans to financial institutions	-	-	9,487,169	9,487,169	10,234,988
Loans to other customers	-	-	15,768,096	15,768,096	12,510,686
	944,417	261,925	25,255,265	26,461,607	23,952,016
Liabilities					
Deposits from customers	-	429,096	-	429,096	429,096
Borrowings	-	-	15,454,821	15,454,821	14,877,987
Debt securities issued	-	1,190,721	-	1,190,721	1,150,557
	-	1,619,817	15,454,821	17,074,638	16,457,640

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

35. Fair value of financial assets and financial liabilities (continued)

35.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

35.1.2 Financial instruments not measured at fair value (continued)

Bank	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
31 December 2019	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets					
Cash on hand and current accounts with banks	881,487	-	-	881,487	881,487
Deposits with other banks	-	553,470	-	553,470	553,470
Loans to financial institutions	-	-	10,733,369	10,733,369	9,447,706
Loans to other customers	-	-	16,041,117	16,041,117	13,699,634
	881,487	553,470	26,774,486	28,209,443	24,582,297
Liabilities					
Deposits from customers	-	176,769	-	176,769	176,769
Borrowings	-	-	16,315,172	16,315,172	14,400,453
Debt securities issued	-	1,141,506	-	1,141,506	1,158,291
	-	1,318,275	16,315,172	17,633,447	15,735,513
Bank					
31 December 2018	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets					
Cash on hand and current accounts with banks	941,071	-	-	941,017	941,017
Deposits with other banks	-	261,925	-	261,925	261,925
Loans to financial institutions	-	-	9,487,169	9,487,169	10,234,988
Loans to other customers	-	-	15,768,096	15,768,096	12,510,686
	941,071	261,925	25,255,265	26,458,261	23,948,670
Liabilities					
Deposits from customers	-	429,096	-	429,096	429,096
Borrowings	-	-	15,454,821	15,454,821	14,877,987
Debt securities issued	-	1,190,721	-	1,190,721	1,150,557
	-	1,619,817	15,454,821	17,074,638	16,457,640

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

36. Reporting by segments

General information on segments is given in relation to business segments of the Group. Since the Group does not allocate administrative costs and interest by segments, the profitability of segments is not presented.

Assets and liabilities by segments are presented in net terms, i.e. gross after impairment and provisioning, and before the effect of mitigation through collateral received.

Business operations of segments are divided in terms of organisation and management. Each segment as a whole provides various products and services and operates in various markets.

Business segments:

The Group has following business segments:

Segment:	Business activities of the segment include:
Banking activities	Financing reconstruction and development of the Croatian economy, financing of infrastructure, export promotion, support for the development of small and medium-sized companies, environmental protection, and export credit insurance of Croatian goods and services against non-market risks for and on behalf of the Republic of Croatia.
Insurance activities	Insurance of foreign and domestic short-term receivables of business entities relating to deliveries of goods and services.
Other	Preparation of analyses, credit risk assessment and providing information on creditworthiness.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

36. Reporting by segments (continued)

2019	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	353,028	1,273	-	-	354,301
Net fee income	22,493	1,400	1,585	-	25,478
Net income/(expenses) from financial operations	4,743	446	13	-	5,202
Net premiums earned	-	5,998	-	-	5,998
Other income	8,090	73	278	(288)	8,153
Income from operating activities	388,354	9,190	1,876	(288)	399,132
Operating costs	(159,308)	(5,834)	(1,425)	288	(166,279)
Impairment loss and provisions	(73,996)	233	1	-	(73,762)
Expenses for insured cases	-	(3,710)	-	-	(3,710)
Net change in provisions	-	(1,121)	-	-	(1,121)
Other expenses	-	(162)	-	-	(162)
Operating expenses	(233,304)	(10,594)	(1,424)	288	(245,034)
Profit before income tax	155,050	(1,404)	452	-	154,098
Income tax	-	255	(55)	-	200
Profit for the year	155,050	(1,149)	397	-	154,298
Assets of segment	26,446,485	58,967	1,811	(36,652)	26,470,611
Total assets	26,446,485	58,967	1,811	(36,652)	26,470,611
Liabilities of segment	16,179,391	16,504	161	(26)	16,196,030
Total equity	10,267,094	4,963	1,350	1,174	10,274,581
Total liabilities and total equity	26,446,485	21,467	1,511	1,148	26,470,611

Intra-group transactions are presented under "Unallocated".

The Group decided to apply a simple approach of stating operating segments by taking into consideration the main business model of each member of the Group as previously described in this Note.

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

36. Reporting by segments (continued)

2018	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	375,642	1,375	-	-	377,017
Net fee income	38,650	1,281	1,274	-	41,205
Net income/(expenses) from financial operations	9,506	(272)	-	-	9,234
Net premiums earned	-	6,417	-	-	6,417
Other income	7,596	74	282	(271)	7,681
Income from operating activities	431,394	8,875	1,556	(271)	441,554
Operating costs	(161,160)	(5,747)	(1,268)	272	(167,903)
Impairment loss and provisions	(65,906)	(69)	84	-	(65,891)
Expenses for insured cases	-	(3,396)	-	-	(3,396)
Net change in provisions	-	658	-	-	658
Other expenses	-	(259)	-	-	(259)
Operating expenses	(227,066)	(8,813)	(1,184)	272	(236,791)
Profit before income tax	204,328	62	372	1	204,763
Income tax	-	-	(26)	-	(26)
Profit for the year	204,328	62	346	1	204,737
Assets of segment	27,198,927	55,340	1,363	(36,649)	27,218,981
Total assets	27,198,927	55,340	1,363	(36,649)	27,218,981
Liabilities of segment	17,144,915	12,845	137	(23)	17,157,874
Total equity	10,054,012	4,995	926	1,174	10,061,107
Total liabilities and total equity	27,198,927	17,840	1,063	1,151	27,218,981

Intra-group transactions are presented under "Unallocated"

Notes to the Financial Statements which include significant accounting policies and other explanations
for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

37. Capital management

The primary objectives of the Group's capital management are to ensure the presumptions of going concern and to respect regulatory and contracted demands imposed by creditors regarding a certain capital adequacy level.

The Group has identified own funds as a manageable capital category.

Regulatory capital has to be, at every moment, at least at the level of share capital or at the level that ensures that the capital adequacy ratio is at least 12% and that is sufficient for covering capital requirements regarding business risks.

Regulatory capital is comprised of core capital minus debit items.

The Group has determined measures for the implementation and monitoring of the capital management policy as follows:

- At the reporting date, own funds have to be at least at the level of founder's capital for the reporting period.
- The capital adequacy ratio at the reporting date has to be at the level prescribed for the banks in the Republic of Croatia as well as at the level stated within regular financial covenants determined in loan contracts and contracts with special financial institutions that HBOR has concluded as a borrower.

The Group calculates regulatory capital and capital requirements in accordance with Basel II requirements, and below is a breakdown of capital adequacy ratio as at 31 December 2019 and 31 December 2018.

	31 December 2019 HRK '000	Group 31 December 2018 HRK '000	31 December 2019 HRK '000	Bank 31 December 2018 HRK '000
Total regulatory capital	10,023,220	9,816,139	10,024,106	9,815,749
Credit risk weighted exposure amount	14,931,756	15,519,739	14,914,038	15,504,641
Credit requirements for operating risk	848,015	897,363	827,833	877,863
Capital requirements for currency risk	429,307	725,300	429,307	706,112
Total capital requirements	16,209,078	17,142,402	16,171,178	17,088,616
Capital adequacy ratio	61.84	57.26	61.99	57.44
	HRK '000	HRK '000	HRK '000	HRK '000
Own funds needed for ensuring capital adequacy according to regulatory requirements	1,945,089	2,057,088	1,940,541	2,050,634

Minimum capital adequacy ratio as of the reporting date, i.e. 31 December 2019 was 12% (31 December 2018: 12%).

Notes to the Financial Statements which include significant accounting policies and other explanations for the year ended 31 December 2019 (continued)

(All amounts are expressed in HRK thousand)

38. 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.

39. Subsequent events

Impact of COVID-19 on HBOR's business and implementation of proposed measures to assist the economy in the coronavirus outbreak

The emergence of COVID-19 (coronavirus) and the global spread since February 2020 have created significant immediate challenges and risks and it is undoubtedly like to affect economic activity in the Republic of Croatia, including the HBOR Group. The long-term level of impact on the Group's operations is currently difficult to quantify, but since the HBOR Group has high capitalisation and liquidity as well as the appropriate level of provisions for exposure to business continuity is beyond doubt.

In order to make the crisis caused by the epidemic in the Republic of Croatia easier to overcome, the Government of the Republic of Croatia adopted a Proposal of measures to assist the economy in the wake of the coronavirus epidemic. The aim of the measures is to preserve the level of economic activity, the liquidity of economic operators and, most importantly, to preserve the jobs. HBOR, as a development bank, will have an extremely important role and will be very active in implementing the following measures in these changed conditions:

- Introduction of moratorium on clients' loan obligations under existing placements,
- Rescheduling of existing loans to HBOR's clients with introduction of a grace period in the loan principal repayment,
- Approval of new liquidity loans to economic entities for financing salaries, overhead expenses and other basic operating expenses, the so-called idle mode (excluding loan obligations to commercial banks and other financial institutions) in cooperation with commercial banks,
- Approval of guarantees (insurance policies) to commercial banks of exporters and to HBOR under the Export Insurance Guarantee Fund with the aim of granting new loans for working capital – liquidity,
- Expanding the scope of the Export Insurance Guarantee Fund by including the tourism sector with the aim of enabling the issuance of guarantees (insurance policies) for loans to banks and to HBOR, for additional liquidity funds to exporters and tourism sector,
- Expanding the scope of the Export Insurance Guarantee Fund by further extending the circle of eligible beneficiaries of insurance policies from exports and tourism to economic entities that are indirect exporters or are suppliers of direct exporters.

Appendix - financial performance of the HKO Group
Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31 December

(All amounts are expressed in HRK thousand)

	2019 HRK '000	2018 HRK '000
Premium earned		
Gross premium written	12,009	10,461
Premium impairment allowance originated and reserved on collection	1	(23)
Gross outward reinsurance premium	(5,333)	(4,430)
Net premium written	6,677	6,008
Changes in the gross unearned premium reserve	(1,187)	(99)
Changes in the gross unearned premium reserve, reinsurer's share	509	485
Net premium earned	5,999	6,394
Fee and commission income	2,985	2,555
Net investment income	1,729	1,257
Other operating income	63	85
Net income	10,776	10,291
Gross expense for returned premiums	(326)	(480)
Reinsurer's share	164	222
Gross reserve for returned premiums	(378)	(267)
Reinsurer's share	178	121
Net expense and reserve for returned premiums	(362)	(404)
Claims incurred	(7,068)	(9,777)
Claims incurred, reinsurer's share	3,358	6,381
Change in the claims provision	323	5,379
Change in the claims provision, reinsurer's share	(1,244)	(4,575)
Net claims incurred	(4,631)	(2,592)
Marketing and provision expenses	(840)	(908)
Administrative expenses	(5,940)	(5,597)
Other operating expenses	42	(183)
Net exchange differences other than those on financial instruments	3	(85)
Profit before income tax	(952)	522
Income tax	200	(41)
Profit for the year	(752)	481
Other comprehensive income		
Items that are not transferred subsequently to profit or loss:		
Deferred tax – adjustment for previous period	-	(17)
Total items that are not transferred subsequently to profit or loss	-	(17)
Items that may be reclassified subsequently to profit or loss:		
Gains on revaluation of financial assets available for sale	2,829	969
Decrease in the fair value of financial assets available for sale	(1,000)	(908)
Transfer of realized gains on asset available for sale to profit or loss	(389)	-
Deferred tax	(298)	(11)
Total items that may be reclassified subsequently to profit or loss:	1,142	50
Other comprehensive income after income tax	1,142	50
Total comprehensive income after income tax	390	514
Attributable to:		
Equity holder of the parent	390	514

Profit before and after taxation in the separate financial statements of the HKO Group differs from the result in the Consolidated Income Statement of HBOR Group, as IFRS 9 has not been applied in separate financial statements.

Appendix - financial performance of the HKO Group
Statement of Financial Position
as of 31 December

(All amounts are expressed in HRK thousand)

	2019 HRK '000	2018 HRK '000
Assets		
Non-current assets		
Property and equipment	839	50
Intangible assets	134	18
Held to maturity investments	457	1,366
Deferred tax	-	-
Total non-current assets	1,430	1,434
Current assets		
Investments available for sale	40,169	42,569
Investments at fair value through profit or loss	9,839	291
Deposits with banks	-	-
Receivables from insurance operations	5,331	8,123
Other receivables	563	446
Cash and cash equivalents	2,919	3,363
Total current assets	58,821	54,792
Total assets	60,251	56,226
Equity and liabilities		
Equity		
Share capital	37,500	37,500
Retained earnings and reserves	2,501	2,237
Other reserves	4,363	3,049
Profit for the year	(752)	481
Total equity	43,612	43,267
Technical provisions		
Gross technical provisions	18,211	16,969
Technical provisions, reinsurer's share	(8,163)	(8,721)
	10,048	8,248
Current liabilities		
Liabilities from insurance operations	3,291	2,549
Other liabilities	3,300	2,162
Total liabilities	6,591	4,711
Total equity and liabilities	60,251	56,226

Appendix - financial performance of the HKO Group
Statement of Cash Flows
for the year ended 31 December
(All amounts are expressed in HRK thousand)

	2019 HRK '000	2018 HRK '000
Operating activities		
Profit before income tax	(952)	522
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>		
Depreciation	353	45
Impairment loss and provisions	(236)	(32)
Income tax	(71)	41
Accrued interest	8	94
	1	
<i>Operating profit before working capital changes</i>	<i>(897)</i>	<i>670</i>
Changes in operating assets and liabilities:		
Net decrease in deposits with other banks	-	-
Net realized (gain)/loss on assets available for sale	(389)	(15)
Decrease of discount in assets available for sale and assets held to maturity	205	223
Net gain on financial assets at fair value through profit or loss	(19)	(3)
Premium receivables	2,794	(1,369)
Net decrease/(increase) in other assets	(118)	5
Net decrease of assets and liabilities from insurance operations	742	1,366
Net increase in technical provisions	1,799	(1,044)
Net increase in other liabilities	1,099	(527)
Net cash provided/(used in) operating activities	5,216	(694)
Investment activities		
Net purchase of financial assets at fair value through profit or loss	(11,335)	-
Net sale of financial assets at fair value through profit or loss	7,345	-
Net purchase of assets available for sale	(1,252)	(4,526)
Net sale of assets available for sale	-	5,978
Purchase of assets held to maturity	-	-
Collection of assets held to maturity when due	892	-
Net purchase of property, plant and equipment and intangible assets	(1,261)	(70)
Net cash (used in)/provided investment activities	(5,611)	1,382
Effect of foreign currency to cash and cash equivalents		
Net foreign exchange	(44)	141
Net effect	(44)	141
Net (decrease)/increase in cash and cash equivalents	(439)	829
Balance as of 1 January	3,363	2,534
Net (decrease)/increase in cash	(439)	829
Balance as of 31 December	2,924	3,363

Appendix - financial performance of the HKO Group
Statement of Changes in Equity
for the year ended 31 December
(All amounts are expressed in HRK thousand)

	Share capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit/(loss) for the year HRK '000	Total equity attributable to the equity holders of the Company HRK '000	Total equity HRK '000
Balance as of 1 January 2018	37,500	1,167	2,999	1,070	42,736	42,736
Profit for the year	-	-	-	481	481	481
Other comprehensive income	-	-	50	-	50	50
Total comprehensive income	-	-	50	481	531	531
Transfer of profit 2017 to retained earnings	-	1,070	-	(1,070)	-	-
Balance as of 31 December 2018	37,500	2,237	3,049	481	43,267	43,267
Profit for the year	-	-	-	(752)	(752)	(752)
Other comprehensive income	-	-	1,142	-	1,142	1,142
Total comprehensive income	-	-	1,142	(752)	390	390
Balance adjustment of 1 January 2018	-	481	-	(481)	-	-
Transfer of profit 2018 to retained earnings	-	(217)	172	-	(45)	(45)
Balance as of 31 December 2019	37,500	2,501	4,363	(752)	43,612	43,612